

# **Rental systems in Australia and overseas**

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## **ABBREVIATIONS**

ATSIC	Aboriginal and Torres Strait Islander Commission
CHO	Community Housing Organisation
CRA	Commonwealth Rent Assistance
CSHA	Commonwealth-State Housing Agreement
FaCS	Australian Government Department of Family and Community Services
HNZC	Housing New Zealand Corporation
HUD	Department of Housing and Urban Development (United States)
IHO	Indigenous Housing Organisation
ILU	Independent Living Unit (aged persons' housing)
NCHF	National Community Housing Forum
PHA	Public Housing Authority (United States)
RGI	Rent-geared-to-income (Canada)
SHA	State (or Territory) Housing Authority
SHO	Social Housing Organisation

## A NOTE ON TERMINOLOGY

Throughout this paper there are references to various terms such as rent, household rent, property rent, current-cost rent, historic-cost rent, rental policy, rental policy and practices, rent-setting, rental structure and rental system.

'Rent' refers to the payment made by a tenant to a landlord for housing services.

'Household rent', 'property rent', 'current-cost rent', 'historic-cost rent', 'market rent', 'market-related' rent and 'market-derived rent' are different forms of 'rent' where the adjective preceding this word indicates something about the type of rent paid and how it is determined. The particular terms are defined more clearly in the text.

'Rent-setting' refers to practices through which rents are determined. These vary according to the type of rent paid and how it is determined. For example, within public housing, household rents are determined through a complex process which involves (i) tenants applying for rental rebates, (ii) tenants providing the SHA with information about their household, (iii) the SHA confirming this information, (iv) the SHA calculating the rent based on a complex formula which distinguishes different types of incomes and applies different formulas to them (as incorporated into a rental rebates manual) and (v) the SHA informing the tenant of the household rent and making the necessary adjustments to their systems etc.

A 'rental policy' is the basis upon which rents are determined. For example, rents are determined on the basis of the tenant's income or the current costs of providing social housing or the rent on an equivalent dwelling in the private rental market.

The phrase 'rental policy and practices' refers to both the basis upon which rents are determined and the rent-setting practices through which they are determined.

The 'rental structure' refers to relationship between rent on one dwelling and rent on other dwellings.

A rental system refers to (i) the rental arrangements as a whole within the social housing organisation, (ii) the relationship between the different parts – the goals to be achieved, one or more rental policies, one or more rent-setting processes and the rental structure, and (iii) the rental arrangements within the context of other arrangements such capital financing, the short-term and long-term costs of providing housing, and the forms of housing assistance (housing allowances, rental rebates, rent assistance and supplementary payments).

# EXECUTIVE SUMMARY

## Introduction

Along with eligibility/allocations policy and the supply of housing stock, rental policy is one of the constitutive elements of social housing and critical to the achievement of its objectives.

These objectives are multifaceted. The immediate objective is to provide good quality, secure and appropriate housing that is affordable for tenants. But a rental system not only has to achieve affordability for tenants without creating poverty traps and deterring employment opportunities, but also has to ensure the financial viability of social housing organisations (SHOs), alleviate housing-related poverty without creating inequities, provide housing stability and security for tenants and thereby contribute to community sustainability, and ensure that stock is well utilised.

Within Australia, rental policies and practices have been the centre of much debate over the years. While market rents and changes to household rents have provided additional rental revenue, once again State Housing Authorities (SHAs) are confronting issues of insufficient revenue to maintain and manage their current stock. Meanwhile tenants are confronted with a complex rental system with new issues emerging, including work disincentives and the administrative burdens of the system. Other questions have also arisen. Are current systems appropriate for affordable housing initiatives? Given the diversity of the social housing sector, is 'a one size fits all' approach appropriate? In this policy context, it is time for a more considered review of rental systems and of more appropriate rental system(s) for social housing in Australia.

This Positioning Paper is the first of two reports on rental systems in Australia and it:

- Highlights the importance of rental systems;
- Reviews and assesses the key literature both in Australia and overseas;
- Briefly outlines the history and debates in Australia ;
- Outlines current rent arrangements in Australia for different social housing sectors and in seven overseas countries;
- Identifies key issues for further research;
- Proposes a larger context within which possible reforms must be assessed;
- Discusses a methodology to achieve the aims of the Project.

## Project aims and scope

The broad objective of this Project is to evaluate the need and potential for reform of the rental system among the diverse social housing sectors in Australia. Specific aims are:

- To document the complex and changing nature of social housing management as it may affect rental systems, both nationally and internationally;
- To audit current rental policies and rent-setting practices in Australia;
- To document changes in rental systems internationally and to evaluate their relevance (if any) for Australia;
- To model the effects of modified forms of rent-setting practice for SHOs and tenants.

The research is to be national and international in scope, although international literature on rental policies, rent-setting practices and rental systems is relatively thin. It will be one of the first international comparative studies of rental systems within social housing. The Project locates rental systems and rental policies within a broad context and highlights the complexity of interrelated issues.

## Context

Three core questions underpin rental policies and are key themes of this Paper:

- Should rents be related to the economic attributes of the property (a property rent) or to the household's income (a household rent)?
- Given it is likely that some subsidy is required to meet the difference between what a household can afford and the property rent (or the ongoing costs of providing the housing), who pays the subsidy and how?
- Should rents be residual to other claims on a household's expenditure or should they have first claim on the household budget?

## Rental systems in Australia

Rent has been an issue of concern since SHAs were first formed in the late 1930s and early 1940s. But, despite keen and ongoing interest within SHAs and among housing activists, the Australian literature on rental systems is very limited. This Positioning Paper explores rental policies, practices and issues within each of the social housing sectors. Public housing is, by far, the largest sector. Other small sectors are community housing, indigenous housing, affordable housing, aged housing (independent living units) and disability housing. These illustrate a divergence of rental policies in response to different financial, social and political imperatives.

The Paper traces the history of rental policy in *public housing*, exploring the assumptions and debates over this time. While the rental system has changed somewhat, it is still a dual system with both a property rent (setting the maximum rent) and a household rent based on a proportion of the tenant's income.

Indigenous housing organisations (IHOs) managing *indigenous community housing* funded through ATSIC have adopted a variety of rental policies and practices, with most rents quite low, such that some have been unable to meet their ongoing costs. Recently, ATSIC recommended the adoption of rental guidelines issued by State Indigenous Housing Authorities.

The *community housing* sector has diverse rental systems reflecting different approaches as it has emerged over the past two decades. This diversity revolves around:

- Their overall rental systems: some community housing organisations (CHOs) determine both property rents and household rents, others only maintain a household rent;
- Their approach to property rents: some charge a market-derived rent, some a cost rent, some a discounted market rent;
- Their approach to household rents: some base these on the public housing rent formula, some adopt a proportion of income approach, some adopt a flat amount;
- Their approach to Commonwealth Rent Assistance (CRA): some ignore it altogether, some include it within household income, some adopt a rental formula which includes all the tenant's entitlement or the maximum CRA.

Rent policies and practices within the newly emerging *affordable housing* sector vary considerably as they seek to cover the costs of private sector finance. Current policies include a discounted market rent set just below 75% market rent, and rent based on 30% income for a higher income group.

*Aged housing* (independent living units) within the aged care sector operates under either the *Retirement Villages Act* or the *Residential Tenancies Act* in each State. These organisations determine their own rental policies. Typically, tenants/residents pay about 20% of the age pension.

Some government departments and community organisations provide shared housing or accommodation specifically for *people with disabilities*. However, little is known about their rental policies except that many of these organisations are separating rents from charges for other services.

## **Rental systems overseas**

Generally, in Europe, rent does not appear to be a contentious major issue. Discussion has focused mainly on the related issues of subsidies for social housing, the supply of social housing, residualisation, changing management policies and the role of government. The one exception is the United Kingdom where, as in Australia, rental policy has been a contentious issue since the early 1970s.

The Positioning Paper describes the rental systems in seven countries: New Zealand, the United States, Canada, the United Kingdom, Germany, Sweden and the Netherlands. This selective review highlights some unique characteristics of the Australian system:

- Australia and New Zealand are the only countries operating a dual system of property rents and household rents;
- Australia and New Zealand are the only countries that use private market rents to derive property rents and measure subsidies to tenants on the basis of the difference between these market-derived rents and the household rent actually charged;
- Australia, New Zealand and the United States are the only countries operating a household rent which is adjusted on the basis of the circumstances of each individual household. Affordability is a function of their particular circumstances. In other countries, housing allowances are adjusted according to different types and sizes of households and different regional rents using implicit benchmarks. Affordability is related to households with common characteristics rather than the circumstances of each individual household;
- Australia is the only country where the SHO carries the rental subsidy internally. In all other countries it is paid by a central agency, whether Treasury, Social Security or a Housing Ministry or Department;
- Where the rental subsidy is funded externally, systems vary as to whether it is paid directly to the tenant (Sweden, Netherlands, United Kingdom, Denmark) or to the housing agency (United States, New Zealand);
- In countries that have a property rental system, rental revenue is the major source of income and all the short-term and long-term costs of providing housing have to be met through this revenue. However, the level of these costs is partly determined by various other capital and operating subsidies such as grants for capital purposes, concessional loans, zoning of land for social housing purposes, taxation concessions, interest rate subsidies and, in some cases (particularly in the past), provider subsidies. Many of the operating subsidies are implicit;
- In all countries studied (other than Australia), there is a clear separation of subsidies for acquiring new stock and those subsidies which assist tenants to afford their rent and allow SHOs to meet the cost of their operations;
- In countries with a property rental system, SHOs' financial viability is not as sensitive to the mix of income groups, as the level of housing allowance compensates for housing groups with lower household incomes.
- The twin goals of affordability for tenants and financial viability for SHOs are the main drivers underlying rental systems in all countries. However, those with property rental systems clearly separate government decisions on these two competing goals. In Australia they are not separated and the rental system is the critical pressure point and focus of debate about two competing goals.



The implications of these differences will be explored more fully in the Final Report.

## **Key research issues**

Changes in rental policies and practices have quite diverse impacts. The key research issues for this Project, then, revolve around four interrelated areas.

### *Emerging issues within Australia*

An initial review of rents in Australia indicates some emerging issues. While market-derived rents have now become more accepted, some basic questions remain:

- What do market-derived rents assume about how markets work, about transparency, about how subsidies are measured and about tenant behaviour?
- How do market-derived rents relate to the achievement of social housing objectives? Do they give priority to some objectives rather than others?
- How does a market-derived rental system compare with other rental systems such as historic-cost and current-cost? How does it differ? Are these differences significant and why?
- What is the long-term impact on tenants, organisations and housing of a rental system subject to the vagaries of private sector supply and demand?
- What is the difference between market-derived rents and market-clearing rents? What are the implications for SHOs?
- What are we to make of contradictory views on whether market-derived rents should be discounted (to market clearing levels) or subject to a premium (Industry Commission)?
- How do SHAs determine market-derived rents, particularly where there is no equivalent private sector housing stock?

Over 90% of public tenants pay household rents but:

- To what extent are they affordable for tenants? Are they affordable for all household types? If not, is this an argument for changes to rents or changes to income support?
- To what extent should they take account of household type (such as number of children) or dwelling characteristics (such as location, quality and type)?
- To what extent can their administration be simplified?
- To what extent are they understood by both tenants and housing workers, impact on their relationship and intrude on tenants' privacy?

The community, affordable and indigenous housing sectors have additional issues:

- How does CRA fit within their rental system?
- Depending on their particular objectives, should there be greater flexibility for them to adopt a different rental system from public housing or from each other?
- How do SHOs maintain their financial viability as well as provide housing which is affordable for tenants?

### *The objectives of social housing and the rental system*

The rental system contributes to the achievement of social housing objectives. Changes in objectives impact on the system and vice-versa. We therefore need to clarify how the rental system contributes to social housing objectives, and how changes in the system impact on their achievement.

### *The social housing financial framework and the rental system*

Financial viability is a function of the whole social housing financing system, not just one component such as the rental system. Any change in one element will require a corresponding change in one or more other elements. We therefore need to clarify the relationship between these elements so we can throw light on some key financial issues:

- Why is the rental system the pressure point for SHOs' financial viability, and are there better ways to ensure this?
- How and why do SHOs take direct responsibility for housing affordability, while governments have taken a secondary 'last resort' role?
- What are the advantages and disadvantages of the current dual rental system, compared with the single property rental system in Europe?
- What are the implications of including CRA in a rental system?

### *Social housing management and the rental system*

In the past two decades, the management of social housing has changed significantly, with increasing complexity and demands on housing officers. Any reforms to the current rental systems must be consistent with and take account of this complexity.

## **Proposed methodology and timelines**

Through four stages, the Project seeks to identify some practical and worthwhile directions for reform and to evaluate these directions within this larger context.

Stage 1 is this Positioning Paper.

Stage 2 will identify the strengths and weaknesses of current Australian rental policies and practices. This will involve phone interviews and structured questionnaires with housing providers, forums for housing practitioners, and discussions with peak public housing tenant organisations. It will achieve the second aim of the Project, an audit of current rental policies and practices in Australia.

Stage 3 will work through a complex array of issues related to the principles for rent-setting, and to the relationship of rents to the objectives of social housing, to the larger social housing finance system and to social housing management. It will involve focus groups to identify options for further analysis, development of an evaluation framework, evaluation of identified options, and a seminar on the results. This stage will achieve the broad objective of the Project (evaluate the need and potential for reform of rental policies and practices) as well as the fourth aim (to model the effects of modified forms of rent-setting).

Stage 4 will draw together material from this Positioning Paper, the interviews with SHOs, housing practitioners and social housing tenants, the development of the analytic framework and financial modelling, the evaluation of the policy options and the reflections from the seminar into a Final Report.

# 1 INTRODUCTION

The objectives of social housing are multifaceted. The immediate objective is to provide good quality, secure and appropriate housing that is affordable for tenants. But there are also a range of secondary objectives that may have to be met including financial and community sustainability, social mix, locational diversity, and facilitation of employment, educational and health outcomes, that is, non-shelter outcomes.

Along with eligibility/allocations policy and the supply of housing stock, rental policy is one of the constitutive elements of social housing and critical to the achievement of its objectives.

A rental system in social housing not only has to achieve the goal of affordability for tenants, but also may have to contribute to other goals. Rent revenue is the primary source of income for social housing organisations (SHOs). Thus, a rental system can affect their financial viability. A rental system can make housing affordable for tenants but it can create poverty traps and deter employment opportunities. It can alleviate housing-related poverty but also create inequities between tenants when some pay more for their housing than others or when tenants pay the same for their housing regardless of its quality, location and appropriateness to their circumstances. A rental system can provide housing stability and security for tenants and thereby contribute to community sustainability, but can impact on how stock is utilised: whether it is wanted by tenants, whether it is under-occupied or over-occupied, and whether it is hard-to-let and vacant. The form of the rental system can create an administrative burden for housing workers and confusion for tenants.

Within Australia, rental policies and practices have been the centre of much debate over the years. But the intense and highly politicised debates about market-related rents of the late 1970s and 1980s, and the highly charged comparisons with private rental in the 1990s, are now behind us. While market rents may have provided additional rental revenue during these times, once again State Housing Authorities (SHAs) are confronting issues of insufficient revenue to maintain and manage their current stock. Meanwhile tenants are confronted with a complex rental system with new issues emerging, including the relationship between rents and work disincentives, the administrative burdens of the system, the appropriateness of current systems for affordable housing initiatives and the appropriateness of a 'one size fits all' model. In this policy context, it is time for a more considered review of rental systems and of more appropriate rental system(s) for social housing in Australia.

## 1.1 Project aims

The broad objective of this Project is to evaluate the need and potential for reform of the rental system among the various social housing sectors in Australia. Specific aims are:

- To document the complex and changing nature of social housing management as it may affect rental systems, both nationally and internationally;
- To audit current rental policies and rent-setting practices in Australia;
- To document changes in rental systems internationally and to evaluate their relevance (if any) for Australia;
- To model the effects of modified forms of rent-setting practice for SHOs and tenants.

## 1.2 Project scope

The research is to be national and international in scope, although international literature on rental practices and systems is relatively thin. Most of the material is from the United Kingdom and focuses on implementation issues rather than on underlying principles, goals and relationships. Most research which reviews different types of systems and the implications for social housing has a one-country focus with no

systematic comparative analysis. This Project will be one of the first international comparative studies of rental systems within social housing.

The Project locates rental policy and practice within a broad context in order to highlight the complexity of interrelated issues. This includes analysis of the funding regimes that underpin rental systems, e.g. who pays any subsidy and how, and the role of a social housing sector in the overall housing system and society as a whole. The Project has not confined itself to a discussion of rents within SHAs but elaborates on rental systems in such a way that the discussion is applicable to all social housing sectors: public housing, community housing, indigenous housing, affordable housing, aged housing (independent living units) and disability housing.

### **1.3 This Positioning Paper**

This Positioning Paper is the first of two reports on rental systems in Australia. This paper:

- Highlights the importance of rental systems to the achievement of social housing objectives (Section 1);
- Reviews and assesses the key literature on rental systems both in Australia (Section i)) and overseas (Section 0);
- Briefly outlines the history and debates about rental systems in Australia (Section ii));
- Outlines current rent arrangements in Australia for different social housing sectors (Section 0);
- Outlines current rent arrangements overseas (Section 2.3);
- Identifies key current issues with rental systems which will provide a basis for further research:
  - Market-derived rents (Section 0);
  - Household rents (Section 0);
- Outlines the larger context within which possible reforms must be assessed including:
  - The objectives of social housing (Section 3.1);
  - The viability of a social housing finance system (Section 3.3);
  - The changing nature of social housing management (Section 3.4).

The paper concludes by discussing a methodology to achieve the aims of the Project (Section 4).

## 2 RENTAL SYSTEMS IN AUSTRALIA AND OVERSEAS

This section is divided into two major sub-sections: the first relates to rental systems in Australia, the second relates to rental systems overseas. Each sub-section discusses:

- The literature in relation to rental policy and practice;
- The rental policies and practices for different social housing sectors (Australia) and different countries (overseas).

The sub-section on Australia also includes a brief history of rental policies.

The sections reviewing the literature identify the extent to which rental policies have become an issue within the major literature. At the outset, it should be noted that the literature on rental policies, rent-setting practices and rental systems within social housing is relatively thin. In Europe, rent does not appear as a major issue. The focus here has been mainly on the related issues of subsidies for social housing, the supply of social housing, residualisation, changing management policies and the role of government.

In both Australia and the United Kingdom, rent has been an ongoing issue of concern. It has been an issue on and off in Australia since SHAs were first formed in the late 1930s and early 1940s. In the United Kingdom, rent as part of the social housing finance system has been a hot issue since at least the early 1970s.

The section discussing the rental policies and practices identifies the key elements of the rental systems in Australia and overseas. These descriptions only serve to highlight the uniqueness of the Australian system. Apart from Australia, they do not trace the development of these systems nor do they attempt to identify the particular issues that brought about this development or the emerging issues with current systems.

### 2.1 Context

Like private landlords, all SHOs have to strike a rent of some form. However, because of a greater multiplicity of objectives, a different funding regime and more stakeholders, the task is much more complex. While this complexity has many themes, three core questions underpin much of the debate about rental policies and practices:

- Should rents be related to the economic attributes of the property (a property rent) or to the household's income (a household rent)?
- Given it is likely that some subsidy is required to meet the difference between what a household can afford and the property rent or the ongoing costs of providing the housing, who pays the subsidy and how?
- Should rents be residual to other claims on a household's expenditure or should they have first claim on the household budget?

How we answer these questions has implications for the level at which rents are set and what is an appropriate benchmark for rents.

Discussion around these three questions underpins much of the structure of this Positioning Paper.

### 2.2 Rental systems in Australia

#### *i) Literature on rental policies and practices in Australia*

Despite keen and continuing interest in rental systems within SHAs and among housing activists, the Australian literature is very limited. Other than internal reviews by SHAs (such as Ali 1985; Henry 1984; Milligan and Livesey 1988),<sup>1</sup> the major pieces of work are:

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<sup>1</sup> Many internal reports are not publicly available or are difficult to access.

- The initial work undertaken by Oswald Barnett prior to the formation of the Victorian Housing Commission and the signing of the first Commonwealth-State Housing Agreement (CSHA);
- A chapter by Jones (1972) which provides a brief history until the early 1970s;
- The discussion of market-related rents in Australia in the Report of the Commission of Inquiry into Poverty (the Henderson Report) (1975), the Report on Housing of the Priorities Review Staff (1975), various articles and publications by Paris (Paris 1979; Paris, Stimson and Williams 1984), Kemeny (1980, 1981) and others (such as Bethune 1982; Stretton 1978) in the 1970s and early 1980s;
- A proposal by the Industry Commission (1993b) and a response for a CSHA working group prepared by Yates (ca. 1994);
- A Masters thesis by McNelis (2000) on rental systems in Victoria;
- Rent proposals for the emerging affordable housing sector (NCHF 2002, 2003);
- Two modules on rent-setting written for the Graduate Certificate in Housing Management and Policy at Swinburne University of Technology (Burke and Hulse 2003a, 2003b).

A discussion of this literature has been woven into the following section on the history of rental policy in Australia.

*ii) A brief history of rental policy in Australia*

The Australian social housing system started with public housing and added a small community sector from the 1970s onwards. Whether public or community sector, however, the rental systems in place today trace their history from the first CSHA of 1945.

**Rental policy at the inception of public housing (1930s and 1940s)**

When the States first established public housing, the rent that tenants should pay was a key policy issue. The method that was finally adopted was based on a combination of rule of thumb and budget standard, tracing back to the principles of Justice Higgins' determination in his Harvester Judgement of 1907. This set a living wage based on what an unskilled labourer required to meet the normal needs of himself, his non-working wife and three children. Higgins found that rent constituted 7 shillings<sup>2</sup> (one-sixth of a weekly wage of 42 shillings) (McNelis 2000: 38). The Harvester Judgement set a general benchmark for a discussion of rents just prior to the inception of public housing.

In the discussions leading up to the first CSHA in 1945, Oswald Barnett, a social reformer and founding member of the Victorian Housing Commission, was a key figure, particularly in relation to rental policy. As chairman of the Victorian Housing Investigation and Slum Abolition Board, he investigated over 40 rental adjustment schemes in England. In a radical departure from past practice, the board recommended the adoption of a differential rental system whereby rents would be adjusted according to the tenant's capacity to pay. This rental system would apply to any family whose income was less than the basic wage. It also recommended that dwellings be constructed in such a way that the economic rent would not exceed a benchmark of 22% of income for family on the basic wage (McNelis 2000: 39ff).

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<sup>2</sup> Until February 1966, Australian currency was pounds (£), shillings (s) and pence (d), expressed as £/s/d. There were 12 pence in a shilling and 20 shillings in a pound. An amount of 5 pounds, 4 shillings and 3 pence is expressed as £5/4/3. With the change to decimal currency, one penny was deemed equivalent to 1¢, a shilling 10¢ and a pound \$2.

These principles, if not the details, of rental policy were largely adopted by the Victorian government in its legislation to establish the Housing Commission, but only after extensive lobbying by Barnett and long debates in cabinet. They also formed the basis for the Commonwealth Housing Commission's recommendations of 1944 and subsequent provisions regarding rents in the first CSHA a year later (McNelis 2000: 45).

Clause 10 and the First Schedule of the 1945 CSHA outline how the 'economic rent' (the property rent) would be determined. The rent for each dwelling was based on the costs of that dwelling or housing project. A cost formula included an allowance for the annual amortised repayment of principal and interest, maintenance, rates and taxes, insurance, vacancies and defaults, and administration. The aim was to ensure that the costs of each dwelling were met. While the CSHA outlined a method for determining rents, the Agreement allowed the States to determine the specifics. In addition, Clause 6 of the First Schedule allowed the States to adopt their own method for determining rents provided that the rent on all dwellings did not exceed the total rent as determined by the above method. This economic rent was a particular form of historic-cost rent.

Clause 11(1) set the benchmark for rebate of rents at one-fifth of family income equal to the basic wage, with families whose income was less than this receiving a further rebate by one quarter for any amount below the basic wage. Rebates decreased by one-third for any amount above the basic wage. Unlike the Victorian Housing Investigation and Slum Abolition Board proposal, the 1945 CSHA rent rebate formula made no allowance for the number of children in the household. This was taken into account by excluding from family income any income received under the *Child Endowment Act 1941-1945* and the *Maternity Allowance Act 1912-1943*. In addition, no allowance was to be made for taxation or superannuation payments. This was effectively a residual rent method whereby other expenditures had first claim on the household budget, with the income-related rent varying between 11% and 20% depending on household type.

With a focus on working families and rents set to cover costs (except for rental rebates), both the States and the Commonwealth expected the SHAs to sustain minimal losses. They thus agreed to share SHA cash losses, with the States meeting two-fifths and the Commonwealth meeting three-fifths of these losses.

This brief discussion highlights the way in which the detailed rent provisions of the 1945 CSHA have effectively structured Australia's rental system even up to the present day: a dual system consisting of a property rent and an income-related household rent for those on low income, the exclusion of family payments from assessable income, and assessable income based on gross income rather than net income.

### **Property rents: from historic-cost rents to market rents (1950s to 1990s)**

The 1945 CSHA specified rental arrangements in detail: a property rent based on a form of historic-cost rent along with an income-related rebated rent. With its expiry, the States were free to establish their own rents for properties purchased after 1955. However, it appears that most States, for political reasons, kept rents low. Rents were only infrequently increased, usually when dwellings became vacant. Thus, tenants in the one area could be on various rents, depending upon when the dwelling was constructed and when they first became tenants.

In the 1956 CSHA, the Commonwealth had withdrawn from sharing rental losses and thus the States had to meet the full cost of rental rebates. This initiated a crisis within the SHAs, particularly where the State government refused to support their cash losses. To meet this crisis, Victoria, for example, introduced 'rent averaging' in the early 1960s. This was another form of historic-cost rent based on their whole portfolio with different rents for different property sizes and types. All property rents were adjusted upwards so that the Housing Commission could meet the costs of rental rebates (McNelis 2000: 54ff).

A further crisis in the SHAs' rental systems emerged in the 1970s. The history of public housing during this time and the early 1980s is one of conflict, of claim and counter-claim and of rhetoric masking intentions. The major source of conflict revolved around

the replacement of historic-cost rents with market-related rents. The objection was not to rent increases per se, which continued regularly regardless of the rental system in place. Rather, it was to the principle of linking public housing rents with private sector rents.

The 1970s were a period of rapid change in Australian society. The certainties of the 1950s and 1960s were challenged by the new social and economic environment within which public housing had to operate. As interest rates increased, so too did the implicit level of subsidies provided by the Commonwealth through their concessional loans. As private rents increased, so too did the gap between public and private rents. The prevailing view was that public housing tenants received large subsidies while most of the poor were in private rental (Poverty Commission 1975; Jones 1972). With high unemployment and growing numbers of single parents, the proportion of public tenants on low incomes and receiving rental rebates increased. The pressures on SHAs grew accordingly. Not only were they expected to house more of the poor, they were expected to meet ongoing costs (including the costs of rental rebates) through rental revenue.

Four different threads ran through proposals in support of a market-related rental policy. Market rents would generate additional income for SHAs, provide a justification for the States to increase their rents and further minimise their rental losses (SHAs and Jones). Market rents were a way of achieving equity between public tenants in older stock and in new stock (Jones). Market rents were a way of redistributing subsidies from dwellings to people and from the better-off public tenants to those who were poor (Poverty Commission 1975; Henderson 1978). Market rents were a way of promoting competition between public housing and the private rental sector, and of providing tenants with a choice of location and dwelling (Priorities Review Staff 1975).

Jones, the Poverty Commission and the Priorities Review Staff all had strong reservations about moving the non-poor out of public housing, yet this became a key motivation of the 1978 CSHA. On the other hand, the Priorities Review Staff's concern for a more efficient public housing sector was a secondary motivation but returned with full force in the 1990s.

The Commonwealth was under fiscal pressure and looking for ways in which to reduce its expenditure. Market rents offered the hope of SHAs making surpluses and, thus, a reason to reduce Commonwealth capital expenditure. In the public arena, the only reference to the Commonwealth's view of market-related rents is a speech by the First Assistant Secretary of the Department of Housing and Construction, Bill Harris (1982). This put forward reasons why the Commonwealth supported the policy. It also acknowledged the major criticisms of the national market-related rental policy but, in typical bureaucratic style, disengaged from any debate about the policy and makes no attempt to address these criticisms.

The 1978 CSHA was a pivotal moment in Australian housing policy. It forced SHAs to separate public housing from owner-purchase programs. It initiated major changes in public housing, relating it to the private rental sector. By introducing market rents it ensured that public housing did not compete with the private sector. Indeed, it ensured that the public sector supported private sector rents. The 1978 CSHA also placed restrictions on the SHA owner-purchase programs, requiring them to sell stock at market values. No longer could owner-occupied housing programs cross-subsidise the losses on rental operations.

The introduction of the market-related rental policy involved minimal changes in directions already established by SHAs in the 1960s and early 1970s. While changes in rental directions were minimal, the assumptions upon which the policy was introduced and the symbolism of relating public housing to the private rental market provoked a major furore, with strong opposition from academics such as Paris (Paris 1979; Paris, Stimson and Williams 1984), Kemeny (1980), Bethune (1982) and Stretton (1978), community organisations such as National Shelter, housing activists and the Australian Labor Party.



For Kemeny, the introduction of market-related rents was of major significance to the future of public housing. It 'negates the economic advantage of public (cost) renting over private (profit-oriented) renting'. It realigned public housing with the private rental market and means that equity between public and private tenants would become the paramount consideration. The inequity, according to Kemeny, went further. Those paying market rents were from a relatively low income group. It was this group who were being asked to pay extra to support those on very low incomes in public housing, rather than the Australian public through the taxation system.

Some argued that market-related rents would impact on owner-occupied housing. For many Australians, particularly since 1956, public housing was a stepping stone to owner-occupied housing. The introduction of market rents would make it more difficult to save the deposit required to purchase a dwelling. Others argued that market-related rents supported the owner-occupied sector by making public housing less attractive.

The 1978 CSHA marked the re-entry of the Commonwealth into debates about rental policy and introduced, in principle, a market-related rental policy. The practice was more complicated as each State interpreted the policy differently and made a range of provisions to gradually increase rents. The 1984 CSHA reflected the Labor government's opposition to market rents and, at least in principle, introduced a new form of cost rent, one based on current costs rather than historic costs. Victoria, in particular, adopted this new policy whereby total rental revenue was related to the short-term and long-term costs of providing public housing. At the same time, however, the rent on each property was determined in relation to a particular market indicator (its capital improved value). The extent to which other States adopted the cost rent policy is variable and the Commonwealth had no effective power of enforcement. Whatever the particular arrangements in each State, one thing is clear: public housing rents continued to increase at the rate of CPI or above. By the early 1990s, CSHA practices had 'overcome' the principle of cost rents, with rents being generally set according to the market rent.

Since 1945, Australia has had three types of property rental systems: historic-cost rents (based on the historic cash costs of providing housing), current-cost rents (based on the short-term and long-term costs of providing housing), and market-related or market-derived rents (based on equivalent rents in the private rental market). While each has a different underlying philosophy, the long-term trend has seen property rents increasing in real terms. They have reached their limit with market-derived rents. As we will see in the next section, attention is now turning to household rents, and this also reveals an upward shift in the benchmark for the household rent.

### **Household rents: what benchmark for household rents?**

Property rents – whether historic-cost, current-cost or market-derived – provide no guarantee that a household will be able to afford that rent or have enough income left to live on after paying rent. Income-related household rents ensure affordability.

As we have seen, the 1945 CSHA introduced a benchmark whereby those tenants on a basic wage paid 20% of their income on rent. This proportion reduces as income earned is less than the basic wage. It increases as income earned is greater than the basic wage. The 1945 CSHA also distinguished between total family income and assessable income by excluding family payments. Since that time, household rent formulas have evolved in response to an ever changing environment:

- The basic wage has been phased out of awards;
- The nature, type, structure and coverage of family payments has changed;
- The Commonwealth has introduced a range of benefits for particular purposes, e.g. education, orphan, mobility and telephone allowances, and carers and disability allowances;

- The structure of households in public housing has changed, with more households with non-dependent children and residents, more single person households and more group households;
- A broader range of income sources such as maintenance, workers' compensation and car accident payments.

In response to each of these changes, SHAs have had to assess their relationship with rents and adapt their rental formulas. Thus, the formulas have become increasingly complex and vary from State to State, reflecting continuing local policy decisions.

In general, however, household rents have increased from a benchmark of less than 20% income (for those on low incomes) up until the 1970s, to a benchmark of 20% income in the 1980s and 25% income in the 1990s.<sup>3</sup>

The driving force behind real increases in rents and the drift to a 'rent first' system has been twofold: first, the reluctance of Australian and State governments to provide either rent subsidies directly to tenants or operating subsidies to SHAs, that is, to reduce or to subsidise the level of rental rebates provided to tenants, and second, the requirement that SHAs maintain their financial viability through rental revenue.

### **Industry Commission proposal (1990s)**

In 1992 and 1993, the Industry Commission conducted a major inquiry into public housing. Amongst its conclusions, it noted that 'rent-setting practices in public housing are not efficient'. This was based on their concern that 'most tenants pay a rent related to their income' and that 'rent does not reflect the value of the service they receive' (Industry Commission 1993a: xxiv).

The Industry Commission rejected the current rent-setting practices on two grounds. First, they were inequitable because tenants in similar financial circumstances paid the same rent but could receive very different levels of service. Second, they encouraged tenants to remain in their current housing even when the size of the household decreased, resulting in under-utilisation of housing stock. In short, the Industry Commission concluded that rent-setting practices in public housing were not efficient on the grounds of horizontal equity and allocative efficiency (Yates ca. 1994).

The Industry Commission proposed that the rental rebate for each household be determined first, and the residual is the rent to be paid by the tenant. Thus, the rent paid by the tenant is the difference between the market rent for the property and the rental rebate (or rental subsidy). As the residual, rent would vary according to the market rent of the dwelling. The Industry Commission proposed that the level of the rental rebate (or rental subsidy) vary according to three factors: income, household type or family composition, and market rent of an appropriate dwelling.

Calculation of the rebate involved three steps:

- Determination of an affordable benchmark rent according to the tenant's income and household type (the affordable benchmark rent would be set on a sliding scale between 20% for those on low incomes and 25% for those on higher incomes);
- Determination of a standard market rent for each size household or family composition within a particular area (the Industry Commission proposed that the standard market rent would be the average of market rents of public housing of appropriate quality);
- The rental rebate (rental subsidy) to which each household is entitled is the difference between the standard market rent and the affordable benchmark rent.

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<sup>3</sup> There are some exceptions to this trend. For example, in some States, the higher benchmark is being phased in and applies only to new tenants; in South Australia and the Northern Territory, lower benchmark rates are applied to older persons (FaCS 2003: Table G6, pp. 169ff).

This process determines the level of the rental rebate for a particular household. Once determined, this is constant regardless of the property occupied. The actual rent paid by this household will depend upon the market rent of the dwelling they occupy. If they occupy a dwelling which has a market rent above the standard market rent, the household will pay more than the affordable benchmark rent. On the other hand, if they occupy a dwelling which has a market rent below the standard market rent, the household will pay less than the affordable benchmark rent. In this income-related rental system, rents paid by tenants are related to the market rent.

For the Industry Commission, the strength of this system is tenants' capacity to choose their dwelling and to make trade-offs between its rent and its amenity. This trade-off sends signals to the SHA about the price and quality of dwellings demanded by their tenants.

The Industry Commission proposal as formulated raises a number of implementation issues. These include: the determination of regions; large difference in rents within a region; the variable quality and amenity in public housing stock; the impact of the proposed rental model on tenant choices (to what extent will tenants modify their housing demand due to price considerations?); and restrictions on choice by tenants, in particular, in transferring from one dwelling to another (Yates ca. 1994).

The proposed model may have resulted in some low income tenants paying more than 25% or 30% of their income on rent. In view of this possibility, the Industry Commission suggested a modification that the tenant and the SHA share any additional rent above the standard market rent. It did not suggest what proportion should be borne by the tenant.

Most of the elements of the Industry Commission model were never implemented. They were swamped by the more general debates of social housing reform in the 1990s. By 2003 market rents had largely become practice across the social housing system.

### **Emerging contemporary debates**

Over the past two years, with the emergence of the affordable housing sector, a new debate has ensued about rental policies. The National Community Housing Forum (NCHF) has released two discussion papers regarding rents for this sector. Some level of private sector finance and a wider target group are two factors which distinguish this sector from community housing. Both these factors impact on rental policy, beginning with an alternative definition of affordable, that is, that the property rent is affordable to a broader range of households. The affordable rent is a flat rent linked to the revenue required to meet the operating and financing costs of the property. Among the issues raised by the NCHF are:

- The method by which rents can be determined;
- How to maintain affordability;
- Whether 'one model fits all' is appropriate;
- The relationship between rent structures, workforce incentives and poverty traps (NCHF 2002).

### ***Contemporary Australian rental systems***

Social housing in Australia comprises at least six different sectors: public housing, community housing, indigenous housing, affordable housing, aged housing (ILUs) and disability housing. The largest sector, by far, is public housing, and the rental system within this sector has largely become the norm for the others. However, each sector differs in some way from this norm and together they illustrate a range of possible variations to rental systems within social housing in response to different financial, social and political imperatives.

## Public housing rents

All SHAs operate a dual rental system whereby they determine both a rent for each property (the property rent) and a rent for each household (the household rent). The property rent is a ceiling or maximum rent payable on each property. Most SHAs derive the property rent from the rent paid for an equivalent dwelling in the private rental market, that is, a market rent or, more accurately, a market-derived rent.<sup>4</sup>

The household rent, usually referred to as a 'rebated rent'<sup>5</sup> or an 'income-related rent', is based on the income of each tenant. While the rent formula used to calculate household rents varies between SHAs, most apply an upper benchmark of 25% of tenant income. The treatment of both Centrelink family payments and the income of other residents can vary, with most SHAs charging a lower proportion for these incomes.<sup>6</sup>

Nationally, at 30 June 2003, 89% of public housing tenants paid a rebated rent, ranging from a high of 91% in Western Australia to a low of 83% in the ACT (Steering Committee for the Review of Government Service Provision 2004). Thus, in most jurisdictions, property rents, are becoming less relevant as a source of funds for public housing operations. They are mainly used for reporting purposes only.

In 2001 rental revenue of \$1.24 billion met only 88% of the \$1.41 billion operating costs (non-capital costs) of providing public housing (not including the costs of major upgrade and redevelopment of stock and debt repayments). The deficit of about \$168 million over the portfolio represented \$468 per property per annum (FaCS 2003: Table C8).

Viewed another way, overall rents charged are about 50% of the market rental value of the public housing property portfolio (FaCS 2003: Table C8). The cost of rebates is the difference between market rents on the properties (about \$2.51 billion) and rent chargeable (\$1.24 billion), that is, approximately \$1.27 billion or \$3,531 per property per annum. These different measures of the value of rents raise questions as to what is the actual subsidy inherent in the system and what is the best method for measuring this subsidy. Is the subsidy the difference between market rent and rebated rents, or the difference between rent revenue and the short-term and long-term costs of providing public housing?

The cost of rebates (the difference between market-derived rents and household rents) is largely the direct responsibility of SHAs, with neither the Commonwealth nor State governments reimbursing them for the difference between property rents and household rents. There is, however, some limited provision for reimbursement within the CSHA as SHAs can use CSHA funds for recurrent rather than capital purposes. For the most part, SHAs use these for debt repayments and to meet the costs of major upgrades and redevelopment of stock.

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<sup>4</sup> Market rents are more accurately described as market-derived rents because the properties are not let on the open market and subject to demand/supply forces. Rather, their rent is determined through an administrative process of which a central component is an assessment of the market rent, based upon that of similar properties in the area.

<sup>5</sup> A rent is 'rebated' where the SHO does not charge the full amount but reduces it or provides a discount. SHAs use an income-related formula to determine the household rent and then rebate the difference between the property rent and the household rent, that is, rebate = property rent minus household rent.

<sup>6</sup> For a brief overview of the differences between SHAs, see FaCS (2003: Table G6, pp. 169ff).

## **Indigenous housing rents**

Indigenous Australians have access to a range of social housing options, including public and community housing. Two specific options are public housing provided by statutory authorities or other bodies operating at arm's length of the SHA in each State (such as the Aboriginal Housing Office in New South Wales and the Aboriginal Housing Board in Victoria) and community housing provided by Indigenous Housing Organisations (IHOs).

Most statutory authorities have adopted their respective public housing rental system. One exception is the New South Wales Aboriginal Housing Office (2004) who have adopted a single property rent based on a form of cost rents. The rent for each dwelling is based on the sum of the costs of land rates, water rates, building insurance, day-to-day repairs and maintenance, cyclical maintenance and management fee.

Community housing managed by IHOs is funded through a variety of sources including ATSIC, tied CSHA funds (Aboriginal Rental Housing Program), untied CSHA funds and supplementary State funds (Steering Committee for the Review of Government Service Provision 2004). In the past, IHOs have adopted a variety of rental policies and practices. Rents on many dwellings have been very low, such that the continued viability of some IHOs has been threatened because they 'cannot generate enough income to cover the recurrent costs of housing: maintenance, insurance, rates and charges, and administration costs' (ATSIC 2002).

ATSIC is moving towards more satisfactory rental policies as a basis for further funding. IHOs will be required to establish clear rental policies that take account of:

- The rent charged by the SHA for a house of a similar standard in the location (a market-derived rent);
- The income of the tenant;
- Access to CRA;
- The high cost of living in remote areas.

In some States and Territories, it has recommended that IHOs adopt the rental guidelines issued by the Indigenous Housing Authorities (ATSIC 2002).

## **Community housing rents**

The community housing sector has emerged over the past two decades at different times and in different forms across Australia.<sup>7</sup> The diverse rental systems reflect the different approaches to community housing over this time. This diversity revolves around different approaches to four elements of community housing rental systems.

First, their overall rental systems: some CHOs have a dual rental system with both property rents and household rents, others only maintain a household rent.

Second, their approach to property rents: some CHOs charge a market-derived rent (rental housing cooperatives in Victoria), some charge some sort of cost rent (common equity rental cooperatives in Victoria), some charge a discounted market rent (South Australia).

Third, their approach to household rents: some CHOs base their rent on the public housing rent formula, some adopt a proportion of income approach (say, 20% or 25%), some adopt a flat amount (sometimes with a view to level of the current age pension).

Finally, their approach to CRA. A key difference between public and community housing is that tenants in community housing are eligible for CRA. Some CHOs ignore it all together, some include it within household income, some adopt a rental formula which

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<sup>7</sup> See McNelis (1997b: Appendix I) for a description of ownership/financial models in community housing throughout Australia.

includes all the tenant's entitlement to CRA or includes the maximum CRA for that household type (McNelis 2001; Queensland Department of Housing 2003).

Where CHOs head-lease SHA properties (such as the Rental Housing Cooperatives Program and the Rooming House Program in Victoria), tenants are charged rents on the same basis as public housing tenants: a property rent based on market-derived rents and a household rent based on the public housing rent formula. Under these arrangements, the responsibility for the cost of rental rebates lies with the SHA.

Other CHOs, particularly where ownership is vested in the CHO or church organisation and not vested in the SHA, will charge a household rent based on 25% household income or 25% household income plus entitlement to CRA, e.g. community housing in Queensland. Under these arrangements, rental revenue is the CHO's sole source of revenue. In 1999, it was estimated that 80% of tenants in community housing paid between 21% and 25% of household income on rent (NCHF 2000).

Rental policy in community housing in Australia is variable. It has provoked considerable discussion as the sector tries to grapple with the complex issues of financing social housing: How does CRA fit within the rental system?

- Should there be greater flexibility for these organisations (depending on their particular objectives) to adopt a different rental system from public housing or from each other?
- If so, what sort of rental system: a cost rent or possibly discounted market rent?
- How do CHOs maintain their financial viability as well as provide housing which is affordable for tenants?

It is partly around this discussion that a new social housing sector has emerged – the affordable housing sector.

### **Affordable housing**

Affordable housing is a relatively new sector within Australian social housing. In the 1990s public housing, in particular, but also community housing was progressively targeted at households not only on low incomes but also those requiring additional support. The affordable housing sector is seeking to house those households who are eligible for social housing but have relatively higher incomes.

Rent policies and practices in this sector vary considerably and are characterised by innovation as they seek to cover the costs of private sector finance. For example, Brisbane Housing Company has introduced a discounted market rent set just below 75% market rent (in order to meet the criteria for GST-free supply); City West Housing in Sydney has introduced different benchmarks for different income groups, with rent based on 30% income for the higher income group.

### **Aged housing (Independent Living Units)**

Between 1954 and 1986 many not-for-profit organisations within the aged care sector (such as the RSL, Lions, Southern Cross Homes, Masonic Homes, Brotherhood of St Laurence and the Country Women's Association) received subsidies from the Australian government under the *Aged Persons' Homes Act* to construct independent housing for older persons. During this time over 30,000 independent living units (ILUs) were constructed.

Some of these are operated on a rental basis and tenants are charged relatively low rentals, typically about 20% of the age pension. Others are operated under the *Retirement Villages Act* with many requiring a relatively small ingoing contribution on the part of the resident. Again, the ongoing charge is typically about 20% of the age pension.

Within the parameters set by the *Retirement Villages Act* and the *Residential Tenancies Act* in each State, ILU organisations determine their own rental policies. Many are currently reviewing their rents with a view to an increase. This will ensure their continued viability as well as provide for current and future upgrading requirements (McNelis 2003).

### **Disability housing**

Over many years, government departments with specific responsibilities for people with disabilities and community organisations have acquired housing specifically for people with disability. These organisations manage a variety of accommodation arrangements, in particular, shared housing which incorporate various levels and types of support services.

Little has been documented about these arrangements. In the past, many of these organisations provided a 'whole of life' service to people with disabilities. One recent trend is to separate out housing from other services, and thus to separate rent from other charges.

## **2.3 Rental systems overseas**

### *Contemporary issues about rental systems overseas*

Overseas, most discussion about social housing has focused on the social, economic and political forces which allowed, constrained or promoted the 'quantity, quality and terms of provision of social rented housing' (Harloe 1995: 13), rather than on rental policy as a constitutive element of social housing.

Comparative housing research is one area in which rental systems have become an important topic. Kemeny (1995) proposes that policy decisions about rents can explain the divergence in social housing systems and the structure of housing between different countries. As the differential between social housing and private rents increases, governments can respond by increasing social housing rents or by allowing social housing and private housing to compete. Countries such as Australia have increased rents, thereby protecting and promoting owner-occupied housing and private rental from competition. In this dualist model, the tenures develop separately without competition. This explains why Australia has a welfare rather than social housing sector. Countries such as Germany have allowed social housing and private rental to compete, thus reducing rent levels. In this unitary model, the tenures develop in competition with one another.

Where there is material on rental policy, most of it is from the United Kingdom and very narrowly focused on implementation issues or on specific issues arising within an already established rental system (Kleinman and Whitehead 1991; Garnet, Reid and Riley 1991; Gibbs 1992). But rental policy in the United Kingdom has also been the centre of a vigorous debate. For Malpass (1990), 'questions of rents and subsidies lie at the heart of the politics of housing', and he shows how higher rents have been a central strategy in reshaping housing policy. In particular, he links rent policies with the process of residualisation within council housing from the 1950s onwards.

Both Malpass and Hills (1988a, 1988b, 1991) note that, with the shift away from historic-cost rents (with capital subsidies), the many policy changes have been a search for 'a politically acceptable and durable pricing system based on some measure of current value, supported by means-tested assistance for the least well off' (Malpass 1990: 3). It is in this context that Hills (1988b: 1) proposes 'target rents' to 'ensure that on average rents for social housing bore a defined relationship to income and hence "affordability" while individual rents bore a consistent relationship to the value of the resources employed in the provision of that housing'.

The work of Malpass (see also Malpass 1997a, 1997b) and Hills highlights the complex relationship between the objectives of social housing, rental systems and housing subsidy arrangements. Bramley (1991) explores this relationship more explicitly in one of the few attempts to relate rental systems to the objectives of social housing. He

begins his examination of public sector rents with a discussion of the objectives of social housing – affordability, equity, efficiency and operational autonomy – and assesses four rental systems (historic-cost, current-cost, market value and affordability) against them.

In April 2000, the United Kingdom government undertook a major review of social housing and released a Green Paper entitled *Quality and Choice: A Decent Home for All* (UK. DETR 2000a). A key issue for discussion was a ‘fairer system of affordable rents’. The focus of the Green Paper is twofold:

- To provide greater coherence to the rent structure so that it is fairer and easier to understand;
- To ensure convergence of rents between local authorities and registered social landlords (RSLs).

It canvassed a number of current and alternative proposals which sparked extensive discussion. In particular, the debates revolved around the objectives of social housing, the differential impact any change in the rent structure would have on different groups of tenants in different locations, and the financial viability of RSLs under any new rent structure.

Ditch, Lewis and Wilcox (2001) sought to ‘review social housing provision and housing allowances in ten countries: Australia, Canada, France, Germany, Great Britain, the Republic of Ireland, the Netherlands, New Zealand, Sweden and the United States of America’. The rental system was but one among a number of elements in the study. While it provided broad information about rental systems, it has been necessary to supplement their research with data from a range of other sources, including web searches of housing agencies, interviews with housing providers in some of the countries (New Zealand and Sweden), and Hulse’s (2002a, 2002b) work on housing allowances.

The study did not take the next step of developing a framework which highlighted the interrelationship between the key elements of a social housing finance system (of which rent is one element) and the interrelationship between the social housing finance system and the social assistance system in each country. It is only when such a task is undertaken that we can develop a better understanding of the dynamic role of a particular rental system in achieving particular outcomes for tenants and for SHOs.<sup>8</sup> The Final Report of this study will attempt to provide such a framework.

### *Overseas rental systems*

This section focuses on the rental systems in seven overseas countries. These comprise four English-speaking countries (New Zealand, the United States, Canada and the United Kingdom) and three European countries with large social housing sectors (Germany, Sweden and the Netherlands). In all cases, sufficient material in English was available to provide an overview of their rental systems.<sup>9</sup>

#### **New Zealand**

In New Zealand, social housing, like that of Australia, is a very small tenure making up approximately 7% of all dwellings. Most is owned and managed by Housing New Zealand Corporation (HNZC), a Crown entity established under the *Housing Corporation Act 1974*. Most local government authorities own and manage social housing, predominantly for older persons, totalling approximately 15,000 units. In addition, there is a small community housing sector (mainly leasing stock from HNZC)

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<sup>8</sup> The importance of this understanding is discussed further in Section 3.3.

<sup>9</sup> Ditch, Lewis and Cox (2001) also included France and Ireland in their study. These countries were not included here because this study did not provide sufficient information about these rental systems and corroborating studies were not available to complement this information.



as well as a very small cooperative housing sector. HNZC manages around 65,000 properties, with another 1,300 leased to community organisations (HNZC 2002).

New Zealand operates a dual rental system with both a property rent and a household rent. The property rent is a market-derived rent and is the maximum rent paid by tenants. For most tenants, the household rent is 25% of household income (HNZC 2003b). For those with household income above a threshold level, the New Zealand Superannuation,<sup>10</sup> this rate is increased to 50% for that household income above this level. Currently, less than 10% of tenants pay property rents (HNZC 2003a). With rents related to incomes, they increase as wages and social assistance increase.

New Zealand did not always have a dual rental system for public housing. From the late 1930s, all tenants paid a property rent which was based on the current costs of providing housing. Where 'needy families' were judged unable to meet this rent, a separate process provided them with an income supplement. By the 1960s, New Zealand had adopted a limited dual rental system, with some households receiving rebated rents. In the early 1970s, household rents were based on 17% household income. By the late 1980s, this had risen to 25% of net income (Ferguson 1994). In 1991, a single rental system was introduced whereby all tenants paid a market-derived property rent. In addition, where a tenant paid more than 25% of their income on rent, they were eligible for an 'accommodation supplement'. This supplement paid only part of the difference between the property rent and 25% income. The current dual rental system was introduced for public housing in December 2000, making social housing tenants ineligible for the accommodation supplement (Waldegrave 2002).

In the local government sector and embryonic community sector in New Zealand, different arrangements apply. These agencies operate a single cost rental system, relying on the accommodation supplement to achieve affordability.

HNZC operates in a very different financial regime to Australia. While sharing the dual rental system and a similar benchmark of 25%, the subsidy to make up the difference between the market rent and household rent is paid by the Treasury, not HNZC. In the year ending 30 June 2003, HNZC received \$577 million in rental revenue (\$280 million from tenants and \$297 million from the government). Rental revenue from tenants comprised just under half market-derived rents, while the Treasury subsidy comprised just over half market-derived rents. Operating costs are approximately 65% to 70% of total revenue (HNZC 2003a).

It is notable that the \$297 million Treasury subsidy on a per capita basis is equivalent to A\$1,485 million, which is greater than gross CSHA grants (Commonwealth and State) of around \$1,400 million. Net of repayments from the States to the Commonwealth (which are probably of the order of \$200 million), the New Zealand system has the equivalent of another A\$300 million per annum for program expenditure.

HNZC surplus after operating costs and interest is in the order of 10% to 15% of total revenue. This surplus is payable to the government. However, the actual dividend is determined with regard to three factors: maintaining a debt to equity ratio of around 23:77, HNZC capital program, and working capital requirements (HNZC 2002). Thus the surplus either directly or indirectly (through government and domestic and overseas private sector borrowings) funds the acquisition of new dwellings, stock modernisation and community renewal, and very little is returned to Treasury.

### **United States of America**

In the United States, social housing is predominantly owned and managed by Public Housing Authorities (PHAs) in each State, with extensive financial support from the federal government through the Department of Housing and Urban Development (HUD). PHAs are municipal, county or State housing agencies and in total account for

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<sup>10</sup> The New Zealand Superannuation is the age pension. As at April 2003, the threshold levels were \$NZ245 for single persons and \$NZ377 for couples and families.

approximately 2% of all housing stock. Most (87%) are quite small with less than 500 units (Millennial Housing Commission 2002; Carson et al. 1993). PHAs operate a single rental system by charging only household rents based on the tenant's anticipated gross annual income less deductions, if any, from all sources – tenant, spouse and family members 18 years or more. In accord with federal legislation,<sup>11</sup> public housing tenants pay a monthly rental based on the highest of the following formulas:

- 30% monthly adjusted income (adjustments include: deductions for each dependent; for an elderly person or a person with disability; some medical expenses of an elderly person or person with a disability; and child care expenses). PHAs have discretion in relation to deductions for excessive travel expenses and earned income, that is, income from work; or
- 10% monthly gross income (before deductions); or
- Welfare rent, if applicable, that is, the portion of welfare assistance which is specifically designated to meet the tenant's housing costs; or
- A minimum rent of at least an amount determined by the federal government (currently \$25) up to twice this amount (that is, \$50) as determined by the PHA (USA. HUD 2003; USA. US Code).

PHAs also have to offer tenants the option of a flat rent rather than income-based rent. This flat rent is based on the actual monthly costs to the PHA of providing the dwelling. It also seems to act as a ceiling rent for each property. However, given the eligibility levels for access to public housing, it is not clear from the literature the extent to which it is relevant and used by PHAs.

Tenants are subject to at least annual reviews of income, and rents are adjusted on that basis. However, increases in rent are phased in over a number of years so as not to act as a disincentive to increase income through work.

In 1998, Congress passed legislation designed to promote work among residents of public housing. The requires that an 'earned income disregard' be applied in calculating the rent charged that some public housing tenants must pay, so that rents do not jump substantially when they go to work or increase their work hours. Thus, families who are receiving or have recently received benefits through the Temporary Assistance to Needy Families (TANF) programs pay no additional rent for 12 months after their earnings increase. In the second 12 month period, only half of the household's increased earnings are considered in calculating rent. The disregard is a 'once in a lifetime' benefit for each individual in a household (Sard and Sanders 2001).

The cost of this workforce incentive is met by the federal government rather than PHAs or the States. The earned income disregard forms part of the rent formula, and the federal government meets the difference between rent revenue and reasonable PHA operating costs.

PHAs receive two annual grants from HUD: operational subsidies and capital funds. Operational subsidies under a Performance Funding System are 'allocated to PHAs on the basis of a formula that relates legitimate or acceptable operation expenditures...to each PHA's characteristics' (Carson et al. 1993), including its units, regional costs and local inflation. Operational subsidies are the difference between the allowable expense levels and rental revenue from tenants.

Capital funds are allocated for modernisation of public housing, including rehabilitation, demolition and replacement. Little public housing has been built since the early 1980s, with the last federal funds specifically for the acquisition of new dwellings appropriated in 1994.

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<sup>11</sup> Public housing rental payments are outlined in some detail in legislation (Title 42, Chapter 8, Section 1437a of the US Code).

## **Canada**

Around 6% of Canadian households live in social housing. Approximately two-thirds of this is provided by not-for-profit organisations, while provincial housing agencies and local government in Ontario provide the remaining one-third.

Social housing tenants in the not-for-profit sector pay either a property rent or a rent-geared-to-income (RGI). The property rent is a discounted market rent or a 'low end of market' rent. It is determined through a market appraisal of the unit, and set at roughly 90% to 95% of market rent. These rents are adjusted annually in line with market trends. Not-for-profit organisations house tenants on a range of incomes but allocate a proportion of their units to tenants eligible for RGI (Ditch, Lewis and Wilcox 2001).

RGI is a household rent based solely on income. Prior to 1986, rents ranged from 16% to 25% of adjusted gross income. Since that time, rents based on 30% of adjusted gross income have been phased in. Gross income is adjusted by deducting travel allowances, family allowance and earnings of dependents. When tenants become eligible for an RGI rent, they may not automatically pay an RGI rent (as happens in Australia with rebated rents) but may have to wait until the organisation is approved for subsidies and can charge an RGI rent.

Not-for-profit organisations charging RGI rents are subsidised the difference between the property rent and the RGI rent by the provincial government and, depending upon the project agreement, by the Canadian government.

Most public housing tenants (in housing provided by provincial housing agencies and local government in Ontario) pay an RGI rent similar to that charged by not-for-profit organisations. This varies from province to province, with some basing the RGI on a lower rate and some providing reductions according to the age and number of children. Again, in some provinces, the maximum rent charged is the comparable market rent in order to encourage tenants on higher incomes to remain (Sewell 1994).

## **United Kingdom**

Around 22% of United Kingdom households live in social housing. Local authorities (council housing) provide around 75% of this, while registered social landlords (RSLs) (housing associations) provide the remaining 25%.

All tenants, whether in council housing or a housing association, pay a property rent. There is no household rent. Local councils and housing associations have used a variety of rental systems to determine rents. These include:

- A points system where dwellings are allocated points according to their qualities or characteristics. These points are aggregated and then rents distributed in such a way that all rents will cover the total costs of providing housing;
- Market rents;
- Discounted market rents (30% to 40% discount, with the level of the discount such that the total costs of providing housing are covered);
- Property values (annual rents based on a proportion of the value of each dwelling);
- A complex system combining average regional earnings and property values (used by local councils) (UK. DETR 2000a; More et al. 2003; Goodchild and Syms 2003; Gibbs 1992).

Over the past two decades, social housing rents have been the centre of an ongoing debate with numerous changes. In 2000, the government undertook a major review of social housing (UK. DETR 2000a, 2000b) which has resulted in the progressive implementation of a new uniform rental system. The review sought to address the large differences in rents between council housing and housing associations, between similar dwellings in the same area, and between different but similar locations. The new rental system seeks to relate property rents to earnings in each region, property values and

size of dwellings. Rather than a once-off change, rents will incrementally move to new levels over the next ten years.

Social housing tenants may be entitled to a housing benefit payment. Those with a net income below an applicable amount (usually the same as the income support and jobseeker's allowance benefit rates which vary by household size and type) receive a payment equal to their property rent, that is, the housing benefit meets the full cost of their housing. For those with a net income above the applicable amount, their housing benefit is reduced at the rate of 65p for each £1 of additional income. Housing benefit also continues to be paid for four weeks after the tenant begins work (Kemp 1998).

## **Germany**

In Germany, social housing is defined as those dwellings in receipt of a public subsidy. Social housing renters constitute around 2.5 million households or 15% of all households, with owner-occupiers at 38% and private renters at 43%. Social housing landlords include private investors, not-for-profit housing companies and local authorities. By accepting public subsidies, landlords agree to certain conditions: cost rents which allows for a modest profit, and to house eligible households as tenants. These agreements have traditionally had a term of 20 to 25 years. While landlords initially housed eligible households, over time the proportion of households in social housing above the income limits has increased to 42% of social housing dwellings. A rental surcharge can be imposed on those above the income limits, but this is rarely done (Dorn 1997).

Rents in Germany, as in many other European countries, are in a process of change as subsidy arrangements change – property subsidies are reduced and housing allowances increased – and states or local authorities can enter into more flexible arrangements with landlords. This has been occurring over the last decade but most tenants are still on the older arrangements with lower cost rents.

Broadly, social housing renters pay a cost rent. Those in receipt of social assistance receive a payment which covers the whole of their rent. Other tenants are also eligible for a means-tested housing allowance. This allowance depends upon a number of factors: tenant's income, allowable deductions from income, the age of the dwelling and the level of rent. Allowable deductions from income are based on the number of children, older people and earners in the household and whether income tax, health insurance or pension contributions are paid (Ditch, Lewis and Wilcox 2001).

The cost rent covers the cost of (i) interest on borrowed capital, (ii) interest on equity, (iii) depreciation, and (iv) running expenses such as maintenance and administration costs. Under older arrangements, the cost rent on new dwellings could amount to double the market rent. Subsidies reduced this cost rent to about half market rent. Under new subsidy arrangements, cost rent levels are generally closer to market rents.

## **Sweden**

The social housing sector in Sweden is very large by Australian standards (40% of stock) and is provided by local government and community housing associations. Rent-setting practices highlight the point made at the start of this Positioning Paper that rental policy has to fit with the broad objectives of the system, and in Sweden rents have to achieve some different objectives to that of Australia. The two that are particularly different are tenant participation and private rental stabilisation.

Swedish housing associations have a single rental system, which is a form of a current-cost rent. Rent increases are regulated with the objective of shaping rent levels in the entire rental sector, including private rents. All tenants, in both the social and private sectors, are bound by a collective agreement between landlords (the housing association) and a tenants association (equivalent in Australia to a tenants union).

A housing association in a given area (for example, a municipality of 100,000 people) sets rents in a negotiating process with the tenants association with the whole process overseen by representatives of the national government. The housing association will estimate the total cost of running their housing agency for the coming year including new capital works and loan costs. This is taken to the tenants association where the negotiation process (effectively a housing arbitration system) will result in an outcome where the general level of rent increase is agreed on. In this process the housing association has to document in detail its costs and where the cost increases justify a rent increase. In this way, the established social housing rent then becomes the benchmark for all rents including those of the private sector where a landlord would have to justify why they are increasing rents at a faster rate than social housing.

This basic level of rents also serves as a guide for more detailed negotiations with tenant representatives and housing associations (overseen by an ombudsman) to set rents and rent increases for specific properties. The objective here is to set rents reflective of the quality of houses in the system with very different rents struck for location, fitting and fixtures, and the general level of amenity. Even within an individual block (for example, the equivalent of a high rise or walk-up flats) there can be very different rents with some households having a higher level of fitting and fixtures or design and therefore having to pay for it. The objective is both equity and an element of client choice. If tenants want a premium property with a premium rent they can have it (Boelhouwer and van der Heijden 1992).

Such a system is administratively complex but this is recognised and the cost of negotiations and rent-setting are allowed as part of the rent structure of housing associations with the cost equivalent to 1% of the rental revenue. The advantages that are seen to attach to it are greater engagement between tenants and landlords, control over the entire rent structure of a town or region, the transparency of the system (all costs are made public) and the greater variation in rents in relation to quality reconciling both choice and equity.

Low-income social housing tenants are eligible for a housing allowance. In Sweden, there are two housing allowance schemes: one for families and young couples without children, and a second for pensioners. The housing allowance for households with children seeks to be a special support for families and enable them to secure good quality and spacious housing. The housing allowance for pensioners enables these households to afford reasonable housing and 'to be able to stay for as long as possible in the housing and environment they are used to, rather than them being forced to move into institutional accommodation' (Ditch, Lewis and Wilcox 2001).

The level of the housing allowance for families with children depends upon the household type and size, rents and household income, and includes additional allowances for the number of children. The allowance is only payable where the accommodation is below a specified size (for example, 100 m<sup>2</sup> for a family with two children). If households exceed specified income limits, the allowance is reduced for families by 20% of the income above the income limit and for households without children by one-third (Ditch, Lewis and Wilcox 2001).

### **The Netherlands**

As in Sweden, the social housing sector is very large at around 40% of stock. All social housing tenants in the Netherlands pay a property rent. Again there is no household rent. For most dwellings, this property rent is determined through a Housing Appraisal System which establishes the rent by reference to quality indicators. In a country where social housing is owned and managed by housing associations and municipal authorities, rent increases (for both social housing and the low rent private sector) are regulated by the central government (Milligan 2003). They are reviewed annually on 1 July.

Social housing tenants are also eligible for a housing allowance which is payable to those with income less than a specified maximum and paying rent within a specified band. It is a standard amount based on household size, household type and rent band.

All households pay that part of the rent below a 'standard rent' level and no subsidy is paid above a specified maximum rent limit. The proportion of housing allowance or subsidy paid above the standard rent level depends upon a series of thresholds as outlined below (Ditch, Lewis and Wilcox 2001).

<i>Rent thresholds</i>	<i>Housing subsidy</i>
Rent up to the 'standard rent' threshold	No subsidy
Rent above standard rent, up to the second threshold	100% subsidy
Rent between second and third thresholds	75% subsidy
Rent between third threshold and the maximum rent limit	50% subsidy
Above maximum rent limit	No subsidy

The level of housing allowances is determined with reference to affordability (Priemus 1998) and allows low and moderate-income earners a wide choice of social and private rental housing. It is administered by the national ministry responsible for housing policy (rather than social assistance). This enables close links with other aspects of housing policy such as rent increases and operating subsidies for new dwellings.

## 2.4 Summary and review

This section has provided an overview of the literature on rental systems both in Australia and overseas, a brief overview of the history of public housing rental systems in Australia and a brief description of how rental systems currently operate in Australia and seven overseas countries. These descriptions highlight a number of important differences in the design of rental systems within social housing:

- Australia and New Zealand are the only countries operating a dual system of property rents and household rents;<sup>12</sup>
- Australia and New Zealand are the only countries that use private market rents to derive property rents and measure subsidies to tenants on the basis of the difference between these market-derived rents and the household rent actually charged;
- Australia, New Zealand and the United States are the only countries operating a household rent which keeps rents for individual households to some defined benchmark. In these rental systems, rents are calibrated (and regularly adjusted) on the basis of the circumstances of each individual household. In other countries which charge only the property rent (and eligible tenants receive a housing allowance), rents are not individually calibrated. Rather, housing allowances are calibrated according to different types and sizes of households and different regional rents using implicit benchmarks. This approach aims to achieve the intended level of affordability for groups of households with common characteristics rather than as a function of the particular circumstances of individual households. As discussed in the next section, a rental system may have to fulfil a number of often competing objectives. However, the ability to do this is greater where there is capacity (unlike in Australian public housing) to move away from a 'one size fits all' rental system;

<sup>12</sup> Ireland also operates a dual rental system similar to Australia and New Zealand, with a property rent below private market rents and predominantly based on the costs of providing housing, along with a household rent related to income (Ditch, Lewis and Wilcox 2001).

- Australia is the only country where the SHO carries the rental subsidy internally. In all other countries it is paid by a central agency, whether Treasury, Social Security or a Housing Ministry or Department. As will be discussed in Section 3 below, this appears to financially constrain public housing agencies in Australia to a greater degree than their overseas equivalents;
- Where the rental subsidy is funded externally, systems vary as to whether it is paid directly to the tenant (Sweden, Netherlands, United Kingdom, Denmark) or to the housing agency (United States, New Zealand);
- In countries that have a property rental system, rental revenue is the major source of income and all the short-term and long-term costs of providing housing have to be met through this revenue. However, the level of these costs is partly determined by various other capital and operating subsidies such as grants for capital purposes, concessional loans, zoning of land for social housing purposes, taxation concessions, interest rate subsidies and in some cases (particularly in the past) provider subsidies. Many of the operating subsidies are implicit;
- In all countries studied (other than Australia), there is a clear separation of subsidies for acquiring new stock and those subsidies which assist tenants to afford their rent and allow SHOs to meet the cost of their operations.
- The continued viability of SHOs in countries with a property rental system (along with a housing allowance paid directly to tenants) is not as sensitive to the mix of income groups because the level of allowances is calculated to achieve affordability thresholds for typical household types and sizes and, thus is adjusted according to household income (with lower income households receiving higher levels of allowances). As a result, SHOs are compensated for housing groups with lower household incomes in a way public housing in Australia is not;
- The twin goals of affordability for tenants and financial viability for SHOs are the main drivers underlying rental systems in all countries. However, those with property rental systems (along with a housing allowance directly to tenants) clearly separate these competing goals, thus enhancing the transparency and accountability of government decisions in relation to each. This is further highlighted by the type of policy debates in each country. In those with property rental systems, debates are separated into one about the structure and level of housing allowances which will provide affordable housing for tenants, and another about the type and level of capital and (implicit) operating subsidies which ensure SHOs' financial viability and growth. In Australia, these two debates (as we shall see in the next section) are conflated into a debate about the rental system as the critical pressure point within the social housing framework.

The implications of these differences will be examined more fully in the Final Report for this Project although most of them relate directly or indirectly to the themes which will be explored in the next section: the objectives of social housing, the social housing financial framework and the changing context for social housing provision in Australia.

### **3 KEY RESEARCH ISSUES**

As outlined in Section 1, rental policy is one of the constitutive elements of social housing. It embodies and balances a range of social housing objectives, and thus a change in the rental system is no simple matter. It has quite diverse impacts.

Section 2 outlined the history of rental policy in Australia, and described and contrasted current rental systems both in Australia and overseas. This section takes a different tack, with a discussion of the issues for current rental systems in Australia.

The overall aim is to evaluate the need and potential for reform. Four interrelated issues emerge from this overall aim and these form the basis for this Project:

- The relationship between the objectives of social housing and the rental system;
- The particular issues emerging from the current rental systems within Australia;
- The current social housing financial framework and how it ensures SHOs' financial viability;
- The relationship between the complexities of contemporary social housing management and the rental system.

A more thorough consideration of these issues forms the basis for possible directions for the future of rental policies and practices in Australia.

This section briefly outlines these interrelated issues and their implications for rental reform. It also indicates where the research from this Project will head.

#### **3.1 Rental systems and the objectives of social housing**

Social housing has a range of social and economic objectives. A rental system contributes to the achievement of these objectives. As governments and SHOs change or redefine social housing objectives or give greater or lesser priority to one rather than another, so too does the rental system need to change. On the other hand, a change in the rental system signals a change in the objectives, a better way of achieving the current objectives or the introduction of a new objective. In making any change to the rental system, we need to be clear about what we want to achieve, how this relates to other social housing objectives and what priority this objective has in relation to others.

The following brief discussion highlights the complexities of the relationship between rental systems and the objectives of social housing.

##### **Affordability**

Social housing operates under two different notions of affordability: the first relates to whether household rents are affordable for tenants on lower incomes, the second relates to whether property rents are generally affordable.

As outlined above in Section ii), the general benchmark for household rents has increased from less than 20% of assessable household income to 25%. This trend raises an important question as to what is the acceptable benchmark, and how much households should pay for their housing. The goal is to ensure that housing is affordable. But affordability depends not only upon the relationship between household income and rent, but also upon the level of Centrelink payments and the costs of living incurred by a household. Both of these can vary by household type and household size. For example, the Youth Allowance provides a very meagre level of income yet young people are expected to pay the same proportion of income on rent. Centrelink makes some adjustments in payments for households with teenage children rather than young children because they incur different costs, yet they are also expected to pay the same proportion of income on rent.

In short, after paying a percentage of income on rent, do households have enough money left for other necessities? Such questions begin to raise the questions of how we measure affordability. Is a rent based on a 'percentage of income' approach sufficient or



should we be measuring its effect on income left after paying rent? Is this an argument for changes to rents or changes to income support? Various attempts have been made to measure the affordability of housing and to review these measures (NHS 1991; King 1994; Victoria. Department of Planning and Housing 1992; Saunders et al. 1998).

One rationale for the 25% benchmark is based on a rule of thumb that housing costs are normally around a quarter of a household's income. This is not a sophisticated evidence-based policy, but appears to have emerged from historical observation of people's housing practices and financial institutions' lending practices. It underpinned the National Housing Strategy even though this only gave cursory attention to the rationale for this benchmark, providing a brief overview of what some other countries set in terms of benchmarks (many are much lower) and then apparently choosing an upper end benchmark of 30%, the Canadian core housing needs model. This was also seen to fit contemporary practices in terms of home ownership lending conditions by financial institutions (NHS 1991: 6-7).

A major assumption of 25% and 30% benchmarks is that rent payments have first claim on a household's budget, that is, a public housing tenant is expected to pay at least 25% of their income on rent; if this does not leave enough for other essential expenditures, then that is an income problem, not a housing problem. Alternatively it is assumed that 25% does ensure affordability. However, Burke and Ralston (2003) have shown that, after paying the household rent, substantial proportions of public tenants were left with inadequate income for other necessary living expenses.

As we have seen in Section ii), property rents based on historic-cost rents were arranged in such a way that they were affordable for a family on the basic wage. In the overseas rental systems we examined in Section 0, this objective in relation to property rents continues, despite increases in property rents. It was a central consideration in the recent reforms of the rental system in the United Kingdom, with property rents related to earnings in each region. In Australia, however, property rents have increased considerably since the mid-1950s. Under pressure to maintain their financial viability, SHAs have accorded equity as a priority over the affordability of property rents. Affordability is now the preserve of household rents.

## **Equity**

As we have already noted, as SHAs are subject to pressure in relation to their financial viability, the notion of equity, particularly in relation to property rents, has shifted from equity between public housing tenants and owner-occupiers (1940s and 1950s) to equity between public tenants (1950s and 1960s) to equity between public tenants and private tenants (1970s and 1980s). As notions of equity have changed, equity has gained precedence over affordability. The rental system changes to reflect these changing priorities.

The focus has now shifted to household rents, again with changing notions of equity underpinning changes or proposed changes in household rents. The traditional goal of household rents has been affordability. With pressure on their financial viability, SHAs have increased the real level of household rents without reference to a demonstrable benchmark for affordability. Despite this, the focus on outcomes, that is, the rent paid by tenants, has been maintained.

But the introduction of market-derived rents and a market framework for public housing is shifting this focus. Market-derived rents highlight the differences in subsidies received by public tenants and private tenants. They highlight the differences within public housing where public tenants can pay the same rebated rent for dwellings with markedly different dwelling rents (by receiving different levels of subsidy). Rather than focusing on the rent paid by public tenants, the focus is now shifting to the subsidy they receive and whether the relative level of subsidy is equitable.<sup>13</sup>

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<sup>13</sup> Proposals such as those of the Industry Commission (1993a, 1993b) illustrate this shift in focus.

However, a closer examination of rent assistance and public housing rental rebates indicates that the subsidies paid to low income households on similar incomes in the private and social housing sectors are more complex than commonly assumed. Depending upon household type and particular housing market, some private tenants on similar incomes receive greater subsidies than those in public housing (McNelis 1997a).

### **Social cohesion**

As social cohesion and workforce incentives becomes more important, rental systems are reviewed to ensure that tenants are not forced out of public housing. Current rent policies, particularly the way in which property rents are determined, may encourage tenants to move out as their income increases. Alternatively, rental policy could be used to encourage tenants to remain in their dwelling even if their income increases and they pay a property rent. Longer tenure among tenants adds to local social cohesion. Should rental policy be used as a mechanism for enhancing this?

### **Workforce incentives**

Notions of mutual obligation and the need to encourage greater workforce participation or at least minimise work disincentives among social housing tenants are a particular issue for the structuring of housing rents. This received attention in the late 1980s and early 1990s (DSS 1993; Industry Commission 1993a, 1993b; Burke and Wulff 1993). The Reference Group on Welfare Reform (2000: 15) also reported: 'It is important that housing is not a barrier to social and economic participation and that housing policies, both public and private, support people's ability to find, access and take-up paid work'. Under Schedule 1 of the 2003 CSHA, one of the performance requirements for 5% of base funding is the introduction of 'rent policies that reduce the workforce disincentives associated with the current link between earned Income and rent'.

At least two specific issues remain:

- 'Income test stacking' whereby any additional income can impact on rents, income support payments and other payments or costs. The income support system has a 'free income area' before payments start to be withdrawn. In many jurisdictions, rents increase from the first dollar earned. In some instances, the Effective Marginal Tax Rate on additional income may exceed 100%;
- In areas with high and very high market rents, tenants face extended increases in their rents until they reach the unlikely situation of very high incomes. This compares with areas with relatively low market rents where rents stabilise after relatively small increases in additional income.

To what degree rents are a factor in workforce incentives and whether it is possible to design a household rent that does not deter social housing tenants from taking on additional employment and earning extra income will be partly answered by this study, drawing heavily on a parallel AHURI study on housing and workforce incentives (Hulse et al. 2003).

### **Financial viability**

Financial viability is a key objective of SHOs. Unless they can maintain their financial viability they cannot continue to provide social housing.

Financial viability is an outcome of the whole social housing financial system. It will depend upon the complex interactions between capital arrangements, the rental system, the supply and demand subsidy arrangements, and the short-term and long-term costs of providing social housing. The rental system is a primary contributor to financial viability and its role will vary as arrangements for other elements vary.

For example, in many of the European countries where supply subsidies (whether in the form of capital grants or support for loans) and demand subsidies (such as housing allowances for tenants) are separated, property rents are determined with reference to the ongoing costs of providing social housing, and SHOs can adjust rents accordingly.

The capacity of SHOs to make these rent adjustments ensures their financial viability. The pressure point within these countries tends to be the adequacy of housing allowances to provide affordable housing.

In Australia, however, where supply subsidies and demand subsidies (in the form of rental rebates) are not separated and where affordability is related to the level of household rents, SHOs have much more difficulty adjusting their rents to meet their ongoing costs. Rental revenue may be seen to be inadequate and threatening SHOs' financial viability, but any increase in household rents impacts on affordability. The rental system has two goals: to ensure the financial viability of SHOs (within the context of the current social housing financial system) and to ensure the affordability of housing for tenants. As a result, it becomes the pressure point for change rather than additional operational subsidies or housing allowances or the social housing financial system as a whole.<sup>14</sup>

### **Targeting**

The way in which rents are set critically affects SHOs' financial operations and financial viability. A combination of greater targeting in allocations, together with a system in which most tenants pay household rents based on income, reduces the rental income stream which SHOs receive and ultimately can jeopardise their financial viability. The current profile of tenants, together with current systems of household rents, does not generate sufficient revenue for SHOs to meet their ongoing costs.

Over the past three decades, social housing in Australia has become increasingly targeted at not only low-income households but also low-income households who have additional support needs. Putting aside the debates about the underlying principle of targeting social housing to low income households, there are three particular characteristics of social housing which work against the practicality of targeting: first, the concentration of public housing within local and neighbourhood areas; second, its impact on rental revenue without compensatory changes in subsidy arrangements; and third, its impact on the costs incurred by SHOs. It is this second factor that is of particular relevance to rental systems in Australia.

Continued targeting of social housing since the mid-1970s, along with a particular social housing finance system, has placed increasing pressure on social housing rental systems as SHAs seek to maintain their financial viability. As a result, over this time, they have made numerous changes to their rental systems in a bid to raise additional revenue. First, in the 1950s, 1960s and 1970s, the cost of rental rebates was included in cost rent calculations, resulting in higher cost rents. Second, market-related rents were introduced (1978), followed by current-cost rents (1984) and market rents (early 1990s) as ways of increasing rental revenue from those tenants on relatively higher incomes. Third, as the cost of rental rebates increased and became more apparent, rental formulas were reviewed. Thus, the rental benchmark has increased from less than 20% to 20% (in the 1980s) and then to 25% (in the 1990s). In some States, the differential treatment of non-dependant children and other residents has also been eroded.

The third factor noted above refers to the additional costs incurred by SHOs in targeting. This also impinges on their financial viability as they seek to provide additional services which private landlords do not usually undertake. These include the cost of looking after complicated waiting lists based upon the needs of applicants, the

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<sup>14</sup> Many community housing tenants pay a household rent which includes rent assistance, a form of demand subsidy. In this instance, rent assistance becomes part of the formula used to determine the household rent. This increase in revenue allows CHOs to meet some additional costs of providing housing, in particular, depreciation or the provision for long-term upgrade of dwellings. Whether the additional revenue is sufficient to meet this additional cost is a matter of some debate. However household rents are determined, whether including or excluding rent assistance, they serve two different goals: as rental revenue to maintain the financial viability of the provider, and to provide affordability for tenants.

administrative cost of providing rental rebates, the additional costs of acquiring, upgrading and modifying properties so that they meet tenants' needs, and the additional costs of supportive tenancy management, maintenance, rental arrears, bad debts etc.

This illustrates the tension between three competing social housing objectives: targeting, financial viability and affordability. At the centre of this tension is the rental system which is under immense pressure from these objectives.

### **3.2 Particular issues for the current rental system in Australia**

This section outlines some particular issues about current rental systems operating in Australia.<sup>15</sup> They are divided into two parts: the first, discussing some particular issues with market-derived rents; the second, discussing some particular issues with household rents.

#### *Market-derived rents*

Market-derived rents have been an accepted part of the public housing rental system for a decade. The intense and highly politicised debates about market-related rents of the late 1970s and 1980s, and the highly charged comparisons with private rental in the 1990s, are now behind us. It is possible to undertake a more clear-headed assessment of market-derived rents, particularly in a context where fewer than 10% of public tenants pay such rents. The following outlines some basic questions that any such assessment needs to make.

First, an assessment of a market-derived rental system needs to highlight its underlying assumptions. What are its assumptions about how markets work? What are its assumptions about transparency and how subsidies are measured? What are its assumptions about tenant behaviour such as their responsiveness to pricing signals?

Second, how does a market-derived rental system relate to the achievement of social housing objectives? The introduction of market-derived rents highlighted equity with private tenants, transparent housing subsidies and pricing signals. Does a market-derived rental system achieve these objectives and how? Why give priority to these objectives rather than others? What about objectives such as affordability, social cohesion and other notions of equity?

Third, how does it compare with other rental systems such as historic-cost rents and current-cost rents? How does it differ from these? Are the differences significant and why? For instance, market rents are typically assumed to be higher than either historic-cost rents or current-cost rents. Historically this has been so. But are they necessarily lower?

Fourth, market-derived rents are subject to the vagaries of supply and demand in the private rental market. Rents increase (and decrease) unevenly and at different rates from CPI. In some sub-markets, they are distorted because supply is based on the preferences of investors. Rents can increase significantly in some areas while other areas are stagnant. What is the long-term impact on social housing tenants of such changes?

Fifth, are market rents market-derived or market-clearing? The first means that as an administered rental system it may be insensitive to the demand for a particular property, while the latter means setting a rent at a level which clears the property. This means giving regional housing managers the rent-setting capacity of estate agents.

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<sup>15</sup> The material in this section largely draws on the experience and knowledge of the Swinburne research team, either from their direct experience within social housing as managers, consumer advocates etc. or from discussions and debates with a range of housing workers participating in Swinburne's postgraduate courses in Housing Management and Policy.

Sixth, what are we to make of contradictory views on whether market-derived rents should be discounted or subject to a premium? One argument is that, if all social housing stock was released into a competitive market place, then market rents would fall because tenants do not have sufficient incomes to clear the market. On the other hand, the Industry Commission has argued that premium market rents should be charged to reflect security of tenure within social housing as well as the financial security provided by household rents if required in the future.

Finally, on a more technical note, how do SHAs determine market-derived rents? How do they determine them where there is no equivalent private sector housing stock? How do they change the market-derived rents from year to year?

Market rents have an intuitive appeal and are consistent with the principles of transparency and targeting need. On the other hand, many people have serious reservations about their place within a social housing sector, seeing them as based on over-simplified assumptions about how housing markets work and about the characteristics and behaviour of social housing tenants. It seems that both sides have not seriously considered the many issues surrounding market rents. One side highlights the strengths and advantages without recognising the weakness and disadvantages, while the other highlights the weaknesses and disadvantages without recognising the strengths and advantages of market-derived rents in the particular context of Australian social housing.

### *Household rents*

Over 90% of public tenants and similar proportions in other sectors pay household rents. This section highlights some issues emerging from current household rents. They revolve around two areas: the achievement of social housing objectives (in particular, housing affordability and equity) and administering household rents.

### **Household rents and social housing objectives**

#### *Housing affordability*

To what extent are current household rents affordable for tenants? Do rents based on a percentage of income ensure affordability? Are they affordable for all household types or only some? Are they affordable for those who are on very low incomes and/or have special needs? Or to put it another way, after paying a percentage of income on rent, do households have enough money left for other necessities such as food and clothing?

This begins to raise the question of how we measure affordability. Is a rent based on a 'percentage of income' approach sufficient or should we be measuring its effect on income left after paying rent? Is this an argument for changes to rents or changes to income support?

#### *Equity*

Current household rents are based on household income. To what extent should they take account of different household types (such as number of children) or different dwelling characteristics (such as location, quality and type of dwelling)? For example, social housing tenants often consider it unfair that they pay the same rent for a poor quality house in an undesirable area as another tenant on a similar income who is allocated newer or better quality housing in a more desirable area. The system of household rent-setting means that there is every incentive for clients to hold out for a better property during the allocations process or to try and move to a better or more desirable dwelling once they have entered social housing.

### **Administering household rents**

Whilst household rent formulae can be complicated enough, their administration is particularly challenging. It also adds significantly to the costs of administering public housing compared to the private rental sector where property rents are used. Some of the reasons for complexity and costs are as follows.

### *Fluctuating incomes*

Household rent-setting practices are usually very complex to administer as they are based on household income (and, indirectly, household composition) that may change frequently. Such fluctuations may be due to movement into and out of the workforce, temporary, casual and part-time work, self-employment, the movement of household members into and out the dwelling, the different types and levels of Centrelink payments and, for those in receipt of overseas pensions, fluctuations in exchange rates.

### *Assessable household income*

Household rent-setting practices rely on a definition of household income which is intended to take into account households' improved capacity to pay. This is further complicated by:

- Distinctions between assessable and non-assessable income as SHAs allow tenants the full benefits of payments made for special purposes such as education, pharmacy costs, disability aids and travel;
- Different household income subject to different rates, for example:
  - Family payments (for children) are usually assessed at a lower rate than income for tenant and spouse;
  - The income of other residents, particularly children, are assessed at different rates again;
- The expectation that the tenant will charge income-earning family members rent, no matter what their level of income, and will be able to collect this rent.

### *Frequency of rent reviews*

Different States have different policies in relation to rent reviews. At a minimum, rents are subject to twice yearly adjustment as Centrelink payments are increased. In other instances, the onus is on the tenant to report changes in income and circumstances that may affect the calculation of a household rent. This may be quite onerous for tenants and housing workers alike, due to the need to supply and assess documentation. If there are frequent changes in income, this may act as a disincentive to taking on paid work.

### *Accuracy of assessment of household rents*

There are further issues around the accuracy of household rent-setting in view of some of the difficulties outlined above. Housing workers often rely on hard copy or computerised tables and may not understand in detail the way in which such systems work. Similarly, tenants may not understand how their rent is calculated, and the importance of some types of information and documentation to the process. The accuracy of individual rent assessments may be tested through appeals procedures and through internal audit reviews.

### *Relationships between tenants and SHOs*

Current rent-setting practices in Australia seem to complicate the relationships between tenants and SHOs. To what extent do tenants find the process of documenting income an intrusion on their privacy? How do they view the documentation requirements? Do they have difficulty understanding how their rents are calculated? Are rent calculations explained well enough? Do tenants become confused about what rent to pay because of regular changes in their rent? How do they view the practice of backdating rent assessments?

### **3.3 Rental systems and the social housing finance framework**

Financial viability is a function of the whole social housing financing system, not of just one component such as the rental system. The financing system consists of a number of interrelated elements: property portfolio and acquisitions, capital financing, ongoing costs, rental revenue and housing subsidies. A SHO will arrange each of these elements in such a way that it will be able to cover its ongoing costs and ensure its financial viability. Any change in one element will require a corresponding change in one or more other elements.

Australia has a particular social housing finance system with the CSHA as its centrepiece. From a social housing finance perspective, CSHA funds have two primary functions: as capital for the acquisition of social housing, and as operational subsidies to compensate SHAs for their loss in rental revenue resulting from charging household rents rather than property rents. Together, rental revenue and operational subsidies are used to meet the short-term and long-term costs of providing social housing. Politically, CSHA funds are related to the acquisition of social housing. Increasingly, however, they are subsidising SHA operations, in particular the costs of major upgrading and redevelopment of stock and debt repayments. Is there a better way of ensuring SHAs' financial viability without relying predominantly on rental revenue from household rents and CSHA funds which are subject to regular review and renegotiation? Is there a better way of ensuring the financial viability of other SHOs?

A reform to the current rental system will have an impact on SHOs' financial viability. The rental system is an integral part of a broader social housing finance framework, and the impact of any reform will depend upon the interrelationship between the various elements. We therefore need to clarify the relationship between rents, housing subsidies, the costs and sources of capital, and the ongoing costs of providing social housing.

This broader context raises some particular issues about rental systems. Three are of particular importance.

#### *Responsibility for affordability*

Who has responsibility for ensuring that rents are affordable? SHOs or governments? Traditionally, the affordability of housing has been seen as an important part of an SHO's role. They ensure that rents are affordable by maintaining household rents. In this way, SHOs have taken direct responsibility for housing affordability while governments have taken a secondary role – in the last resort providing subsidies where they are necessary to maintain SHOs' financial viability. To what extent should SHOs take responsibility for housing affordability? Should the cost of affordability for very low income households be borne by the SHO or directly by government as part of their income support role?

#### *Single or dual rental system*

Australia is one of the few countries to operate a dual rental system. Rather than calculate household rents and provide rental rebates, most European countries have a single property rent, with governments rather than SHOs taking direct and major responsibility for affordability by providing tenants with some sort of housing allowance.

What are the advantages and disadvantages of the current dual rental system compared with a single property rental system. What impact will such a fundamental change in arrangements have on tenants, SHOs and governments? Could such a change build on the current system of CRA? If so, what supplementary changes would be required to the current arrangements to ensure that rents are affordable for social housing tenants?

### *Broader relevance*

This has a broader relevance as well. Section 2.3 above described the rental systems in a range of countries. It is only when we have some understanding of the particular interrelationship between rents, housing subsidies, the costs and sources of capital and the ongoing costs of providing social housing in these countries that we can gain a better understanding of the particular role of the rental system, assess the strengths and weaknesses of the Australian rental system (and social housing finance system) and evaluate the relevance of rental systems in other countries to Australia. A more systematic approach opens up the prospect of developing our understanding of the relationship between the rental systems and the values that underpin social housing in various countries as well as their relationship with broader social forces that structure a housing system.

## **3.4 Rental systems and social housing management**

In the past two decades, the management of social housing has changed significantly:

- Housing officers require a greater range and level of skills;
- Allocation systems, asset management systems, rental systems and financial systems are becoming increasingly complex;
- SHOs are now subject to more extensive accountability and reporting requirements;
- SHOs are now planning their activities more extensively and examining the implication of these activities on their future;
- SHOs are developing activities around agreed outputs;
- The legal responsibilities of housing managers have increased with new legislation such as residential tenancies law, planning and building codes, occupational health and safety, fire safety requirements, privacy and the new taxation system;
- Many SHOs seek to become accredited and meet specific standards of services. Some have introduced customer service charters;
- Some SHOs raise funds through private sector arrangements and this requires greater skills and knowledge of financial arrangements, housing markets and their related risks;
- Tenancy management has become more complex as social housing has become increasingly residualised. Housing officers are dealing with greater numbers of people who are struggling to cope financially, socially and emotionally, whose primary language is not English and who require ongoing support to maintain their housing.

Any reforms to the current rental systems must be consistent with and take account of this complexity within contemporary social housing management.

## **3.5 Directions for reform**

This Project seeks not only to describe rental policies and practices within Australia and overseas, to identify current and emerging issues and to understand the rental system in a larger context, that is, in relation to the objectives of social housing, to the social housing finance system and the complexities of social housing management. It also seeks to identify some worthwhile directions for reform and to evaluate these within this larger context.

Already the Commonwealth and State governments through the 2003 CSHA (Schedule 1, p. 22) have indicated their intentions regarding rent reform:



The Commonwealth, States and Territories agree to develop a nationally consistent approach to the way rents are calculated, one which also allows flexibility between States and Territories, tenant circumstances and product types. In developing a national approach to the way rents are calculated, the main principles will be:

- Rents remain affordable;
- Methods used to calculate rents are applied fairly across all income support groups;
- Methods used to calculate rents are promoted and clearly explained to tenants, to ensure they are aware of how those methods operate.

The Project seeks to get beyond the simple ideological debates of the 1980s regarding market-derived rents by examining and evaluating the broad range of often conflicting issues. The goal is to propose directions which are not only soundly based within the objectives of social housing but which are practical given the current situation of public housing in Australia.

Many of these directions for reform have been canvassed above. Some involve simplifying administrative arrangements and reducing the complexity of current arrangements. Others involve a consideration of more radical changes to rental systems in Australia.

## 4 PROPOSED METHODOLOGY AND TIMELINES

This Project on rental policies and practices will develop through four stages.

Stage 1 which has reviewed current overseas and Australian literature on rental policies and practices is now complete with the production of this Positioning Paper. This stage achieves the first aim of the Project, to document rental policies, both nationally and internationally.

Stage 2 will identify the strengths and weaknesses of current Australian rental policies and practices. This will involve:

- A series of phone interviews, supported by a structured questionnaire, with housing providers (eight SHAs and eight CHOs/IHOs);
- A series of forums for housing practitioners in conjunction with the Australasian Housing Institute;
- Distribution of a discussion paper and feedback from peak public housing tenant organisations.

The objective of this stage is to get hard evidence on the current state of rental policies and practices for social housing sectors in Australia from different perspectives, that is, housing providers, housing practitioners and.

The interviews, forums and discussions will cover the following areas:

- Current rental policies and practices and their rationale;
- Principles underpinning current policies and practices;
- Strengths and weaknesses of current policies and practices, particularly in relation to the objectives of social housing, the social housing finance system, the complexities of social housing management and alternative options;
- Any initiatives or pilots of reform;
- Possible directions for the future.

This will achieve the second aim of the Project, an audit of current rental policies and practices in Australia.

Stage 3 will work through a complex array of issues related to the principles for rent-setting, the relationship of rents to the objectives of social housing, to the larger social housing finance system and to social housing management. It will involve a four-step process:

- A focus group with a small number of policy staff from SHAs, the Australian Government Department of Family and Community Services and others to identify the most viable, innovative or interesting options for more detailed analysis;
- Development of an analytic framework and financial model which can be used to evaluate the identified options;
- A policy and financial evaluation of the identified options;
- A seminar and a presentation that discusses the various options and their evaluation.

This stage will achieve the broad objective of this Project (evaluate the need and potential for reform of rental policies and practices in Australia) as well as the fourth aim (to model the effects of modified forms of rent-setting for SHOs and tenants).

Stage 4 will draw together material from this Positioning Paper, the interviews with SHOs, housing practitioners and social housing tenants, the development of the analytic framework and financial modelling, the evaluation of the policy options and the reflections from the seminar into a Final Report. It will include:

- A descriptive overview of rental policies and practices overseas;
- A description and critical review of current Australian rental systems, including an analysis of their perceived strengths and weaknesses;
- An analysis of the different types of rental systems, their underlying principles, their relationship to the objectives of social housing, their relationship within a social housing finance system and their relationship with social housing management;
- A number of policy options, along with a financial evaluation and a broader assessment of each option;
- Some proposed directions for reform of rental policies and practices in Australia.

The figure below outlines timelines for each stage of the Project.

	<i>Nov 2003</i>	<i>Dec</i>	<i>Jan 2004</i>	<i>Feb</i>	<i>Mar</i>	<i>Apr</i>	<i>May</i>	<i>Jun</i>	<i>Jul</i>	<i>Aug</i>
<b>Stage 1: Review of literature</b>										
<b>Stage 2: Identifying strengths and weaknesses</b>										
<b>Stage 3: Evaluating policy options</b>										
<b>Stage 4: Final report</b>										

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