

Expanding the supply of affordable housing in Australia

*Housing affordability in Australia is declining, especially for low-income tenants in the private sector. A number of attempts have been made to attract more private investment into boosting the supply of affordable housing in Australia. However, these attempts have been one-off and small-scale, enjoying very limited success. Large professional and institutional investors continue to avoid the private rental sector in this country. This study, by **Mike Berry**, of the AHURI RMIT Research Centre, is one of a number of AHURI projects on this subject and is based on, and extends, earlier work carried out for the Affordable Housing National Research Consortium. The study examines the factors behind the pattern of private sector investment and explores a range of ways that governments can overcome current barriers to attract significant volumes of private investment into expanding the supply of affordable housing in Australia.*

KEY POINTS

- Affordable and appropriate housing is a central support to a decent life, which entails maintaining stable households connected to the main institutions in our society – jobs, services, family and social networks.
- In current circumstances and with existing public policy settings, large investors like superannuation funds will not invest in rental housing, especially at the low-to-moderate-income end of the market.
- The key barrier to the involvement of institutional investors – and other professional investors – is that, in the current circumstances, the expected rate of return on rental housing investment in Australia is too low, relative to the myriad risks that this investment entails, and to the more attractive range of alternative investments on offer.
- Appropriate 'policy packages' that deliver an adequate stream of subsidies in efficient and effective ways, would be required in order to attract investment capital from large private investors to finance a large-scale increase in the supply of affordable housing.
- Affordable housing can deliver significant 'social dividends' to a mature capital market that is increasingly interested in engaging in 'socially responsible investment' – but only if appropriate financial products are created as part of the policy packages implemented by government.

CONTEXT

Australia has always had a relatively high rate of owner occupation. At the same time, the private rental sector has never fallen below 20% of the total housing stock. However, in recent times, there are signs that home ownership is declining, especially among the young, and permanent or long term renting is on the rise. These trends became well-entrenched during the 1990s, despite a generally buoyant economic climate and low nominal interest rates, on the one hand, and continuing direct and indirect support for (subsidies to) home owners by government, on the other.

Along with growing demand for rental housing has come increasing housing stress (defined as a household paying more than 30% of its income on housing) and declining effective housing choice for low and moderate income earners. Recent research by AHURI found that problems of housing affordability were not only concentrated among the lowest income earners and the most economically vulnerable people, but that low waged workers and their families were also at risk.

Australian governments have long established policies designed to assist tenants in meeting reasonable housing costs. The real value of government spending on capital housing subsidies provided through the Commonwealth State Housing Agreement (CSHA) has fallen considerably over the past ten years, while real spending on rent assistance paid to eligible private tenants has leveled out since 1993-94.

INTERNATIONAL EXPERIENCE

There has been interest in attracting private investment into the provision of affordable housing in a number of other OECD countries in recent times. In many European countries there has also been an attempt to move the recurrent 'supply-side' expenditures for social housing 'off balance sheet' in favour of demand side subsidies paid to tenants or landlords, encouraging greater reliance on private finance.

In the United States, Federal Government housing subsidies and institutional supports have characterised the owner occupation sector in the US since the 1930s. Subsidies to the private rental sector are more recent, starting with housing allowances or vouchers in the 1970s and, more recent still, are subsidies delivered in the form of income tax credits to developers and landlords who keep rental property in low rent usage for a minimum of 15 years after construction. The social housing sector is (proportionately speaking) miniscule, so supply-side capital subsidies have not figured in any significant way.

In the United Kingdom social housing still accounts for more than 30% of the total housing stock in the UK. However, over the past 20 years there has been a shift away from local council managed public housing towards the non-profit housing association sector. This has occurred as a direct result of government policy and has established the institutional framework for a large increase in private debt finance for affordable housing, supplied by the major banks that now fund about 50% of the value of new social housing.

On the other hand, little advance has been made in attracting debt or equity finance into the private rental sector, which accounts for less than 10% of the total stock. The reasons

for this appear to be similar to those facing Australian investors – inadequate returns given the risks, the cottage-like nature of the sector and the absence of suitable investment instruments. The most recent attempt to attract private investors – the creation of tax-favoured 'housing investment trusts' – has foundered.

Dutch housing policy has also changed through the 1990s in an attempt to place a brake on the cost of escalating housing subsidies paid to tenants, managers and builders of social housing. Over 40% of the total stock is in the social housing sector, most of that in the form of non-profit housing associations. The Dutch Government has capitalized future annual subsidies and applied this amount to canceling the outstanding debt of the housing association sector on its existing stock. This means that the sector now has ownership of a valuable resource that serves as the collateral on which individual housing associations borrow to finance additions to their stock. About 90% of new dwelling construction by the associations is financed by bank-provided loan finance.

BACKGROUND

This AHURI report is one of a number on the subject of stimulating private sector investment in affordable housing. It is based on a project initially funded by the Affordable Housing National Research Consortium. Work for the consortium, by Mike Berry (AHURI, RMIT) Jon Hall (AHURI, Sydney), and the Allen Consulting Group, examined the extent of the housing affordability problem in Australia and developed options to address it.

Further work by Mike Berry and Jon Hall, funded by AHURI, has continued the development of a preferred option and addressed the policy package from government and implementation plans that would be necessary to put it into operation.

This Bulletin provides a summary of the findings from earlier reports on the extent and nature of the affordability problems and barriers to private sector investment. Because the findings of this study are primarily directed to the nature of the policy changes required to encourage private sector investment in affordable housing, they are reported as Findings and Policy Implications.

FINDINGS AND POLICY IMPLICATIONS

HOUSING IS BECOMING LESS AFFORDABLE FOR MANY LOW AND MODERATE INCOME PRIVATE TENANTS

- Between 1986 and 1996, the proportion of private tenants in the bottom two income quintiles paying more than 30% of their household incomes in rent rose from 64% to 73% in the six State capital cities (and Darwin).
- By 1996, more than 80% of this group living in Sydney were paying more than 30% of their incomes in rent – up from 67% in 1986.
- Only in Darwin and Perth did the percentage drop over this ten-year period.

- The number of rental households in housing stress increased by 90,000 during this period, to 227,480 by 1996.
- At a sub-metropolitan level, housing affordability is declining for households in the bottom two income quintiles in both inner and outer areas of Melbourne, Sydney and Adelaide (the cities analysed in detail in this study) and for both houses and small flats. No low income household could afford to buy the average priced three-bedroom house anywhere in these three cities; all but a small minority could not afford to rent the average house throughout the metropolitan regions.

COMMONWEALTH RENT ASSISTANCE (CRA) DOES NOT SEEM TO BE MAKING A SIGNIFICANT IMPACT ON THE PROBLEM

- There were no local government areas in Sydney, Melbourne or Adelaide in which a single person household in receipt of CRA could afford to rent the average house or flat, in either of the two years analysed, 1994 or 2000.
- The same situation faced couples without children, with the exception of one-bedroom flats only, which were affordable by this group in a small minority of outer local government areas.
- The situation was little better for single parents with one or two children. By 2000, there were no local government areas in Sydney (and only 19% in Melbourne) where single parent households could afford to rent the average two bedroom flat. Larger units were also totally beyond affordable reach throughout Melbourne.
- Only in the case of couples with children did prospects improve. But even here, affordable choices were strictly limited, particularly in Sydney, where in 2000 (even after receiving CRA) they could afford to rent the average two-bedroom house or flat in only 25% of areas and three-bedroom houses in only 2% of areas.
- In general, affordability and locational and dwelling choices declined from 1994 to 2000 throughout both major cities.
- Without deliberate government intervention to offset existing barriers constraining private investment, housing affordability is likely to continue to decline for low and moderate income households locked into the private rental sector in Australia.

BRIDGING THE AFFORDABLE RENT GAP

The rate of return required by institutional investors to invest in affordable housing is high, due to risks associated with: movements in financial conditions (interest rates, inflation, etc.); dwelling management and operating costs; the market value of dwellings; and government policies that impinge on investment outcomes in the sector.

Other barriers that constrain investment here are: the relative illiquidity of housing (and all property) as an investment; poor market information on the past performance of housing investment; and absence of a track record for investments of this type.

ACTIONS REQUIRED TO REDRESS THESE CIRCUMSTANCES

To bridge the difference between what investors would require by way of a rate of return on rental housing and the current level of rents that are affordable by target groups would require action by government. An appropriate 'policy package' would include:

- an identified stream of subsidy support;
- a mechanism for delivering that support; and
- a marketable set of financial instruments for investors to acquire in order to finance the resulting housing.

Subsidies could be in the form of cash outlays or taxation concessions by government. Risks facing potential investors could also be reduced by governments providing guarantees on returns or capital values of the dwellings or prescribing rules for all investors to follow.

Feasible policy packages would need to satisfy the criteria of: equity; efficiency; the capacity to generate large volumes of private finance; and financial and political feasibility.

Three policy approaches were modeled.

- Model 1 depended on a Commonwealth outlay subsidy to support the States and Territories borrowing to finance an increase in the stock of social housing.
- Model 2 entailed launching an equity vehicle on the Australian Stock Exchange, dependent on a Commonwealth equity injection and State revenue subsidies to meet investor returns.
- Model 3 is a non-profit company financed by an initial non-refundable, dividend-free equity injection by a State government, complemented by State borrowing and voluntary developer contributions.

In each model, the government subsidies provided were significantly 'leveraged' by private investment, so that more new affordable housing could be provided than if government funding alone was committed. In the base case of Model 1, \$4.50 of private investment was committed for every \$1 of government subsidy. A \$2 billion expansion of the affordable stock could, in this model, deliver about 15,000 extra dwellings for a Commonwealth subsidy commitment of \$440 million.

The outcomes of the models are sensitive to the level of capital gain on the housing provided and to factors including changes in the incomes of tenants, the level of charges such as stamp duty on sale and purchase and the initial cost of the dwellings.

Effective policies in this area need to recognise the requirements of large investors operating in given regulatory and taxation regimes, while ensuring that the resulting private investment expands housing opportunities for targeted households currently experiencing or at risk of housing stress. For government, the criteria for policy packages implemented should be that they:

- are of sufficient scale to make a significant contribution to expanding the stock of affordable housing in the short to medium term;
- are cost effective (give maximum 'bang for the subsidy buck'); and
- minimise the risk of 'cost blow-out' for government.

The models presented in this study satisfy these imperatives. They also:

- provide a firm basis for continuing cooperation between Commonwealth and State governments;
- offer governments flexibility in matching subsidy flows to housing needs in particular jurisdictions;
- provide strong incentives for governments to monitor outcomes and effectively manage the risks they carry.

Given the market inefficiencies characterising the low-cost end of the rental market, and the current shortages of available housing in this submarket, it is unlikely that a government-induced expansion of stock of the order of 15,000 dwellings nationally would cause significant disinvestment by current rental investors.

MEETING THE NEEDS OF INSTITUTIONAL INVESTORS

The policy packages modeled in this study are likely to be attractive to institutional investors because they meet the key requirements to overcome barriers to investment. In particular, the investment instruments are liquid, backed by a long-term government commitment and available in large volumes (so allowing investors to spread transaction costs). Moreover, they fill a gap in the investment portfolios of many institutions which are looking for more low risk-low return opportunities to balance the many equities-driven high risk-high return investments included in their portfolios.

The rapid recent and continuing growth in the market for 'socially responsible investment' in Australia (and many other OECD economies) also makes the prospect of marketable affordable housing investments attractive to institutions such as superannuation funds. Housing offers positive 'social dividends' to investors increasingly interested in 'triple bottom line' performance. This interest is fueled by the high concern among superannuation fund members for investment opportunities that demonstrably avoid financing socially and environmentally damaging outcomes while generating positive outcomes on these grounds, in addition to generating acceptable financial returns.

MEETING THE REQUIREMENTS OF GOVERNMENT FUNDERS

The general approach suggested in this study complements, rather than replaces, the two current arms of government housing assistance for tenants in Australia – public housing financed through the CSHA and rent assistance provided to eligible private tenants on Centrelink benefits. CSHA funding is increasingly required to maintain and upgrade the existing public housing stock, which is rapidly becoming obsolete. Rent assistance functions as a necessary income support to (many) low income households.

The proposed 'third way' involving leveraging private investment allows the maximum expansion of the affordable housing stock for any given additional commitment of government subsidy funds.

By adding a third arm to its housing assistance arsenal, government is able to more effectively manage the risks of subsidy blow-out, since the total subsidy commitment is distributed over three (rather than two) broad programs, each with different risk profiles for government.

This reduces the likelihood that adverse movements in particular environmental factors – such as interest rates or building costs – will impact disproportionately on subsidy costs. This logic is the same that drives investors to diversify their investments over many areas, an unsurprising observation since investors and governments who engage in the property sector face essentially the same risks. Not holding all your eggs in one basket is sound advice for all concerned.

FURTHER INFORMATION

For more information about this research project see www.ahuri.edu.au/research/summary/project21.html
See also AHURI publications for the Affordable Housing Project at: www.ahuri.edu.au

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