

Is the Australian housing system sustainable?

THE CURRENT COMMONWEALTH HOUSING ASSISTANCE SYSTEM IS FISCALLY SUSTAINABLE IN NET TERMS, BUT ONLY BECAUSE FUTURE HIGHER EXPENDITURES ON RENT ASSISTANCE WILL BE PARTIALLY OFFSET BY LOWER EXPENDITURE ON FIRST HOME OWNER GRANTS.

KEY POINTS

- Over the 2006 to 2045 period, the proportion of households experiencing housing costs greater than 30 per cent of their income (that is, in housing stress) is projected to increase marginally from 12 per cent to 14 per cent.
- By 2045, almost two-thirds of lower-income private renters are projected to be in housing stress (compared to just over half in 2006).
- Expenditure on Commonwealth Rent Assistance is projected to increase in real terms from \$2 billion in 2006 to over \$5 billion in 2045 (and from 0.20 per cent of Gross Domestic Product in 2006 to 0.25 per cent in 2045), though expenditure on First Home Owner Grants is projected to decline and offset much of that increase.
- Rates of housing stress are projected to increase for a range of alternative scenarios involving different assumptions about housing costs, tenure change and wages growth.
- Under current housing policy settings, these results suggest that Australia's current housing system and its system of rent assistance is unsustainable.

CONTEXT

In 2002 and again in 2007, the Australian Government released an Intergenerational Report (IGR1 and IGR2). These reports considered whether Commonwealth Government policies and programs would be sustainable for future generations of Australians, during the period of unprecedented population ageing anticipated to occur to 2041.

*This bulletin is based on research led by **Professor Hal Kendig** and **AIProfessor Judith Yates** (AHURI Sydney Research Centre), supported by modelling by the AHURI RMIT-NATSEM Research Centre. It examines the implications of projected demographic and economic changes and housing trends for the sustainability of the current housing system and for the fiscal sustainability of the current system of housing assistance.*

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CONTEXT

IGR1 and IGR2 addressed fiscal sustainability in several major policy areas – notably health, income support and education – but did not consider housing. This research complements the Intergenerational Reports. It examines the implications of the changes in economic and demographic conditions anticipated in those reports, as well as current trends in housing costs and housing tenure, for households and for the Australian Government.

METHODOLOGY

Achieving intergenerational sustainability requires that the actions taken by current generations do not compromise the interests of future generations and that future generations of households are no worse off than the present generation. In this research, housing sustainability was measured in terms of the ability of the current system of housing provision to prevent any increase in housing stress – that is, in the proportion of households who are paying 30 per cent or more of their incomes on housing, with a focus on lower-income households. Fiscal sustainability for Australian governments was measured by the projected impact on demand for housing assistance – Commonwealth Rent Assistance (CRA) and First Home Owner Grant (FHOG) – resulting from the changed housing circumstances.

Modelling of housing stress outcomes and future levels of government expenditure on housing used NATSEM's STINMOD, a micro-simulation model of Australia's tax and transfer system. This model is benchmarked on data from the ABS Survey of Income and Housing Costs in 2000/01 and 2002/03. The data was updated to 2006 using a standard set of inflators, and by applying changes in the tax/transfer system that occurred from 2002/03 to 2006.

To produce the base case results for this project, the data in the model was 'aged' from 2006 to 2025 and 2045 using demographic assumptions consistent with those made in the Intergenerational Reports. Housing costs and household incomes in the survey data also were projected to 2025 and 2045 in line with assumptions made about key economic indicators (such as GDP and inflation) in the IGRs. It is important to highlight that this research presents projections, not predictions.

The baseline model used in this study conservatively assumes trends in housing costs in line with the long-run average rise (rather than the rapid rises experienced recently). It is also assumed that there is no future

increase in public housing, no further decline in rates of home ownership among the young, and an incremental catch-up as they grow older that is the same as has occurred in the past. Under these assumptions, the overall home ownership rate falls to 66 per cent in 2045 compared with 70 per cent in 2006, as the older cohorts who have higher rates of home ownership die.

Six alternative scenarios explored the sensitivity of the findings to different assumptions about housing costs, tenure change and wages growth.

KEY FINDINGS

Projections of housing stress

Figure 1 shows the proportion of all households and lower-income households projected to be in housing stress in 2025 and 2045 compared to estimated levels in 2006.

The increased proportion of all households in stress and the increased concentration of stress among lower-income households can be explained by demographic change (continuing household growth, smaller households and an ageing population) and tenure change (declining home ownership and no increase in public housing).

Fiscal sustainability

Figure 2 shows projected increases in real expenditure on CRA. By 2045, if current policy settings are retained, CRA is projected to increase by 2.5 times from a current value of less than \$2 billion to over \$5 billion, measured in 2006 dollars. The increase arises primarily as a result of the steady growth in the number of CRA-eligible households in the private rental sector. It means CRA would increase from 0.2 per cent of GDP in 2006 to 0.25 per cent by 2045. By the criteria set in the IGR, the current rental assistance system is fiscally 'unsustainable'.

On the other hand, under current policy settings, expenditure on the First Home Owner Grant (FHOG), the other major Commonwealth housing program examined, is projected to decline to less than half of its current real value of just over \$1 billion because of a declining proportion of first home buyers and an unchanged level of assistance.

As a result of the projected decline in expenditure on the FHOG partially offsetting the impact of a projected increase in expenditure on CRA, the current Commonwealth housing assistance system is fiscally sustainable in net terms, according to IGR criteria.

Sensitivities

The scenarios modelled for this study examined housing stress and fiscal sustainability under different assumptions about tenure and about the rate of growth of rents and housing costs in relation to wages income.

Figure 3 shows that, under these scenarios, the projected proportion of Australian households in housing stress in 2045 ranges from a low of 11.3 per cent to a high of 24.3 per cent. The estimate under the base model is 14.1 per cent. At best, these results suggest that there will be

only a marginal improvement in affordability outcomes by 2045 under the most optimistic of the scenarios modelled.

The scenario that yields the most pessimistic outcomes is that in which housing costs rise faster than household incomes. In this scenario, over 1.5 million lower-income households (and over 23 per cent of all households) would be in housing stress in 2045. More than 75 per cent of these households are projected to live in the private rental market.

FIGURE 1: PROPORTION OF HOUSEHOLDS IN HOUSING STRESS

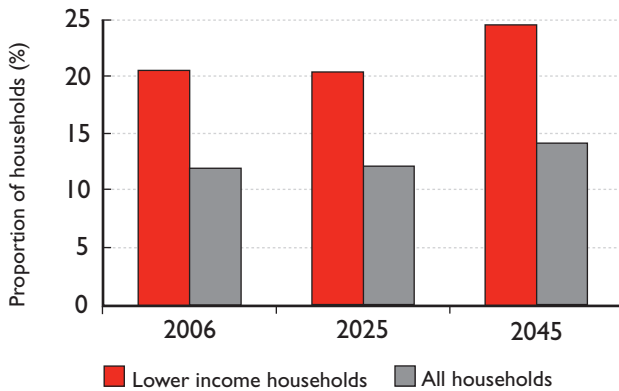


FIGURE 2: PROJECTED REAL EXPENDITURE ON CRA

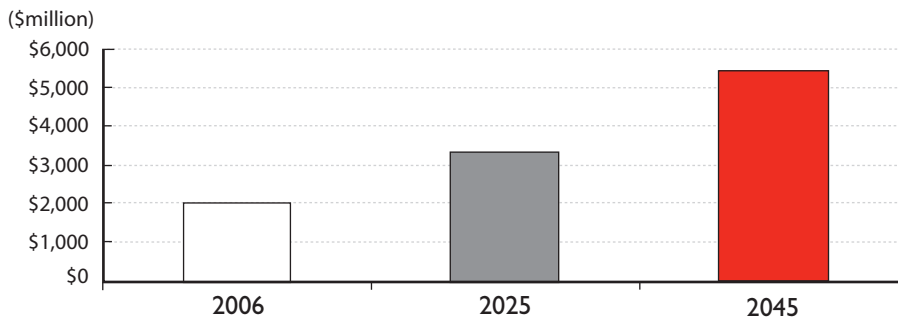
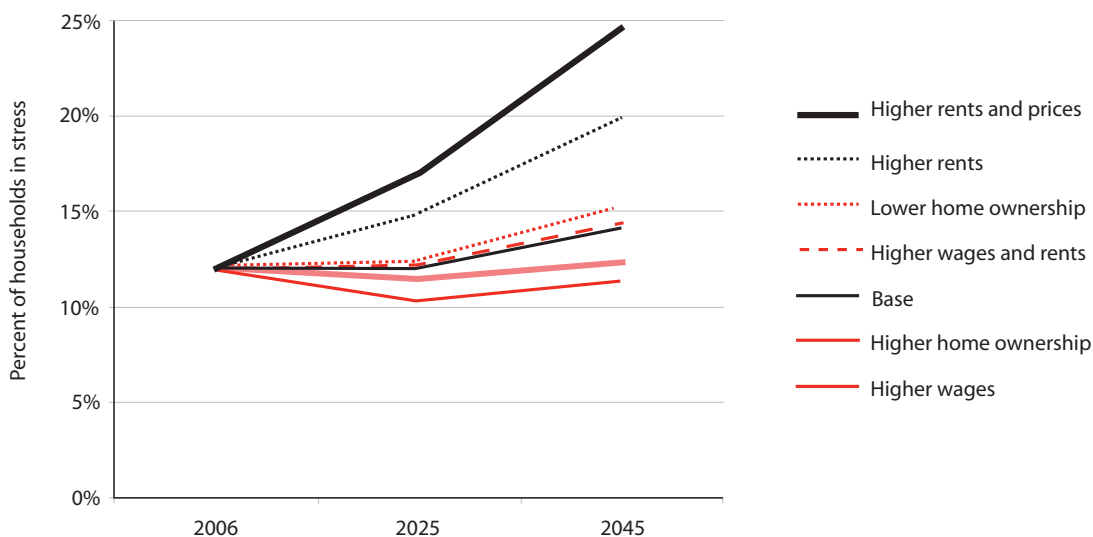


FIGURE 3: PER CENT OF HOUSEHOLDS IN HOUSING STRESS UNDER DIFFERENT SCENARIOS



Changes to the assumptions about tenure alter the rate at which increases in CRA expenditure occur and the rate at which expenditure on FHOG declines. However, under every scenario, the combined expenditure on CRA and FHOG is always higher in 2045 than it was in 2006 in real terms. The least impact (with only a 50 per cent increase in total real expenditure) would occur if the current decline in home ownership among younger households does not continue. The greatest impact (with a 120 per cent increase in total real expenditure) occurs when rents increase relative to incomes.

POLICY IMPLICATIONS

Overall, in the future as in the past, the majority of Australians will have affordable housing throughout their lives. However, over the next 40 years there will be an increasing number, and an increasing proportion, of households in housing stress. From an intergenerational sustainability perspective, the main policy question is: what can be done over the coming decades to ensure that future generations have the housing opportunities that have been available to current generations?

Policies to improve housing affordability and incentives for first home buyers will be important, to reverse the downward trend in home ownership among the present generation of young adult households. Policies will also be needed to offset the impact of the projected large numbers of ageing renters in housing stress.

Re-distributional policies directed at improving housing affordability outcomes among renters already exist – these include Commonwealth Rent Assistance and funding under the Commonwealth State Housing Agreement to sustain the existing stock of public housing. Assistance for marginal home buyers (to help them exit rental and hence free up rental stock) is also available through such policies as the First Home Owner Grant. Such policies will be essential to prevent an increase in housing stress. However, alongside these measures, stronger policy action needs to be directed at increasing the existing supply of affordable housing in order to further contain housing stress and improve intergenerational equity.

Broader policy actions that complement housing assistance measures are also essential, to achieve intergenerational sustainability of the Australian housing system in the long term. It is proposed that future Intergenerational Reports include a housing chapter, to ensure that the critical importance of housing to intergenerational sustainability continues to be monitored and understood.

FURTHER INFORMATION

The International Reports (IGR1 and IGR2) referred to in this bulletin are:

Intergenerational Report 2002-03, Commonwealth Treasury, Canberra

Intergenerational Report 2007, Commonwealth Treasury, Canberra

These reports are available online at: www.treasury.gov.au/igr

This study has been linked to a three-year AHURI-funded research program, 'Housing Affordability for Lower Income Australians'. A summary of all the major findings of that broader research can be found in:

Yates, J. and Milligan, V. (2007) *Housing affordability: a 21st century problem*, Final Report, National Research Venture 3: Housing affordability for lower income Australians, <http://www.ahuri.edu.au/nrv3>

All data in this bulletin are derived from modelling undertaken by NATSEM. Full details can be found in the Final Report of the project.

This bulletin is based on AHURI project 60314, *The Australian housing system and intergenerational sustainability*.

The Final Report from this project can be found on the AHURI website: www.ahuri.edu.au or contact the AHURI National Office on +61 3 9660 2300.



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