

EXECUTIVE SUMMARY

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Demand-side assistance in Australia's rental housing market: exploring reform options



Authored by

Rachel Ong, Curtin University

Hal Pawson, The University of New South Wales

Ranjodh Singh, Curtin University

Chris Martin, The University of New South Wales

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Authors

Rachel Ong, Curtin University
Hal Pawson, The University of New South Wales
Ranjodh Singh, Curtin University
Chris Martin, The University of New South Wales

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Acronyms and abbreviations used in this report

AFTSR	Australia's Future Tax System Report
ABS	Australian Bureau of Statistics
AHURI	Australian Housing and Urban Research Institute Limited
ACOSS	Australian Council of Social Service
AIHW	Australian Institute of Health and Welfare
AS	Accommodation Supplement (NZ)
CPI	Consumer Price Index
CRA	Commonwealth Rent Assistance
DSS	Department of Social Services
EHAP	Experimental Housing Allowance Program
FTB	Family Tax Benefit
HAP	Housing Assistance Payment (Ireland)
HILDA	Household, Income and Labour Dynamics in Australia
LHA	Local Housing Allowance (UK)
NZ	New Zealand
OECD	Organisation for Economic Co-operation and Development
PHA	Public housing authority (US)
PC	Productivity Commission
PRA	Private rental assistance
RS	Rent Supplement (Ireland)
SEIFA	Socio-economic Indexes for Areas
TAG	Target-accurate group
TEG	Target-error group
TER	Target-error rate
UC	Universal Credit (UK)
UK	United Kingdom
US	United States

Glossary

A list of definitions for terms commonly used by AHURI is available on the AHURI website www.ahuri.edu.au/research/glossary.

Executive summary

Key points

- By international comparison, Australia's Commonwealth Rent Assistance (CRA) regime is distinctive in terms of being (a) restricted to income-support recipients; (b) paid to renters, not landlords; (c) capped at modest maximum rates; (d) regionally invariant; and (e) not rationed.
- In severely disadvantaged areas, 32.4 per cent of a modelled increase in CRA is shifted into higher rents. CRA is more likely be captured in higher rents in disadvantaged rental markets because of relatively inelastic housing supply in low-value market segments.
- Out of 1.41 million low-income private renter income units, nearly two-thirds or 933,000 are assisted by CRA. Meanwhile, CRA is also paid to 419,000 private renter income units with moderate incomes, partly due to targeting error.
- Over one-third of low-income CRA recipients still carry a net housing cost burden of more than 30 per cent after CRA is deducted from rents.
- Around 246,000 or 18 per cent of low-income private renter income units pay rents that exceed 30 per cent of their income but are ineligible for CRA. Another 330,000 or 23 per cent receive CRA despite paying rents below 30 per cent of their income. CRA's overall target error rate is 41 per cent.

- **Raising the CRA maximum rate would improve affordability outcomes for 623,800 income units or 44 per cent of low-income private renters. However, it is the costliest of the three modelled reforms, requiring additional annual expenditure of \$1 billion to amount to a total cost of \$5.6 billion.**
- **Reforming the CRA eligibility rules to reflect housing need would achieve the greatest housing affordability improvements among the three modelled reforms, and at the lowest cost. The reform would reduce the CRA target error rate to zero and cut the population of low-income private renter income units in housing stress by 371,200 or 44 per cent. At the same time, it would generate an annual cost saving of \$1.2 billion.**
- **Because it would involve severing the existing link with other social security entitlements, constitutional barriers would need to be overcome to change the CRA eligibility rules to reflect housing need. However, it is possible that this issue could be addressed within existing constitutional limitations.**

Key findings

What is the likely effect of changes in demand-side rental housing assistance on market rents?

Our modelling detected that an increase in CRA is likely to be partially absorbed into higher rents in disadvantaged neighbourhoods. In moderately to severely disadvantaged areas, 6.6 per cent of any increase in CRA can be expected to be 'lost' to higher rents in this way. In severely disadvantaged areas, 32.4 per cent of CRA is absorbed by higher rents. CRA is more likely to be captured in higher rents in markets with relatively inelastic rental housing supply. This is because any CRA-induced rise in rental housing consumption cannot be adequately met by new housing supply. In the absence of an adequate supply response, rents rise. Capitalisation effects are thus more prominent in disadvantaged neighbourhoods because new housing supply is relatively inelastic in low-value housing market segments in Australia. This source of market failure contributes to the presence of capitalisation effects in disadvantaged areas.

What are the impacts of reforming CRA on low-income private renters?

We model three reforms:

- **Reform 1:** Raising the CRA maximum rate by 30 per cent
- **Reform 2:** Resetting the rent thresholds to address higher levels of housing stress among income units with no children
- **Reform 3:** Changing the CRA eligibility criteria to reflect housing need, defined as low-income private renters paying rents in excess of 30 per cent of their income.

Reforming the CRA program to reflect housing need (reform 3) would achieve the greatest affordability improvements at the lowest cost. Such a reform would reduce targeting error down to zero. The other two reforms have mild to no impact on target error rates. Reform 3 would also reduce the population of low-income private renter income units in housing stress by 371,200 or 44 per cent. This is a slightly greater reduction than the 342,200 (40%) decline achieved under reform 1 and the 303,700 (36%) decline achieved under reform 2. Raising the CRA maximum cap is the costliest reform, requiring additional annual expenditure of \$1 billion, amounting to a total cost of \$5.6 billion. Reform 3 is the least costly; changing the CRA eligibility rules to reflect housing need will generate annual cost savings of \$1.2 billion, reducing CRA expenditure to \$3.4 billion.

Raising the CRA maximum rate (reform 1) would generate the largest number of winners, amounting to 623,800 income units or 44 per cent of low-income private renters, albeit at the greatest cost. No low-income private renter would be worse off if the CRA maximum rate were raised. Changing the eligibility rules would see a shift in the composition of people who benefit from CRA; it would reduce the number of income units whose rents fall below the moderate housing stress benchmark, and increase the number of income units whose rents exceed the benchmark. This would result in 246,000 beneficiaries from the reform and 330,300 who would see their position deteriorate as a result of the reform.

Though some portion of CRA is shifted into higher rents for those living in severely disadvantaged areas, these effects make little impact on dampening the effectiveness of the reforms. Low-income private renter income units living in severely disadvantaged areas often pay such low rents that many fall below the rent thresholds required to qualify for CRA under actual or reformed arrangements, despite their low-income status.

Overall, each reform will have negligible impact on the relative price of renting to owning for low-income renters. While reforms 1 and 2 will reduce the average net cost of renting, it is unlikely that they will assist in a move out of the private rental sector into home ownership. The small amount of annual savings is unlikely to generate sufficient funds for renters to bridge the deposit gap for home purchase.

Policy development options

We evaluate the reforms using key criteria from Milligan, Phibbs et al.'s (2007) affordable housing policy evaluative framework. These criteria are effectiveness, appropriateness and efficiency. Effectiveness is defined as the extent to which low-income private renters' housing affordability outcomes are assisted under the current CRA structure. Appropriateness refers to how well (or not) the existing CRA structure correlates with the needs of the low-income clients it serves, i.e. CRA's targeting accuracy. Efficiency refers to the relative cost of achieving the outcomes of alternative CRA reforms taking into account the number of tenants assisted.

The existing CRA program

Out of 1.41 million low-income private renter units, nearly two-thirds or 933,000 are assisted by CRA. Low-income private renters eligible for CRA pay, on average, 36 per cent of their gross income in rents prior to receiving CRA. After receipt of CRA, this average housing cost burden drops to 26 per cent. CRA also plays an important role in lifting low-income private renters out of housing stress. Approximately 65 per cent of low-income CRA recipients would experience moderate to very severe stress if they did not receive CRA. This incidence plunges to 34 per cent after CRA is taken into account.

Thus, CRA plays an important part in alleviating housing stress among low-income private renters. However, there is scope to improve its performance with respect to its effectiveness and appropriateness. Approximately one in three low-income CRA recipients remain in moderate to very severe housing stress after CRA is deducted from rents. CRA also suffers from a lack of targeting accuracy. Approximately 246,000 or 18 per cent of low-income private renter income units are ineligible for CRA despite being in moderate to very severe housing stress. Another 330,000 or 23 per cent are not in housing stress, but are eligible for CRA. Overall, CRA's target error rate sits at 41 per cent.

The modelled CRA reforms

Raising the CRA maximum rate (reform 1) would result in improvements in CRA's effectiveness, reducing the number of low-income private renter income units in housing stress by 40 per cent. However, it has no impact on appropriateness; targeting accuracy remains unchanged. CRA's efficiency would also remain unchanged because the benefits of raising the CRA maximum rate for eligible CRA tenants also involves the largest increase in cost among the three reforms, amounting to \$1 billion per annum for all private renters, or \$633,000 for low-income private renters.

Resetting the CRA minimum rent thresholds (reform 2) would raise CRA's effectiveness, reducing the number of low-income private renters in housing stress by 36 per cent. While this reform would have little impact on the targeting error or appropriateness of CRA, it would generate annual cost savings of \$938 million.

Changing the CRA eligibility rules to reflect housing needs (reform 3) – as defined by paying rents in excess of 30 per cent of income – would offer the greatest improvements in the effectiveness of the CRA program, reducing the number of low-income tenants in housing stress by 44 per cent. Strong improvements in appropriateness would be achieved, with targeting accuracy reaching 100 per cent. Reform 3 would also offer stronger improvements in efficiency than the other two options. It would generate annual savings of \$1.2 billion, while simultaneously reducing the number of tenants in housing stress by the largest number. While retaining overall reform cost-neutrality it would be possible to further expand the beneficiaries of this model by raising CRA caps to some degree.

Implications for future development of CRA

Overall, it would appear that changing the CRA eligibility rules (reform 3) would offer the greatest benefits from the perspectives of effectiveness, appropriateness and efficiency. However, there would be constitutional complications in implementing reform 3. It would require a constitutional basis beyond the Australian Government's narrow social security power. Nevertheless, there could be constitutionally-compliant ways of overcoming these constraints, such as using the external affairs power to effect the internationally recognised right to housing; expanding the Australian Government's constitutional powers to make provision for housing benefits; or reforming CRA as a Commonwealth-State and Territory program, with the Australian Government making grants to state and territory governments to pay Rent Assistance to eligible persons. Care would need to be taken to ensure it retains its form as a cash payment to tenants, not landlords.

There is some scope for combining two or more of the CRA reforms to enhance affordability outcomes for a larger group of low-income renters while maintaining cost neutrality. For instance, the savings generated by changing the CRA eligibility rules (reform 3) could be retained to fund an increase in the cap on the CRA maximum rate (reform 1). There also exists a case to consider combining reform options 1 and 2 – raising the CRA maximum rate and re-setting the minimum rent thresholds – as a relatively cost neutral package. The savings from reform 2 could be diverted towards helping to fund the cost of reform 1. When combined, these two reforms would help reduce housing cost burdens while achieving some improvements in targeting. These are the likely key outcomes of reform 3, which could be achieved only by overcoming constitutional limitations.

We find increases in CRA are partially absorbed into higher rents in disadvantaged neighbourhoods. In severely disadvantaged areas, nearly one-third of CRA is shifted into higher rents. CRA is more likely to be captured in higher rents in markets with relatively inelastic rental housing supply, because any CRA-induced rise in rental housing consumption cannot be adequately met by new housing supply. In the absence of an adequate supply response, rents rise.

The findings raise concerns on various fronts. When CRA is captured in higher market rents, this affects not only CRA recipients, but also non-CRA eligible tenants living in disadvantaged areas. For instance, some low-income workers living in disadvantaged areas might not meet CRA eligibility requirements, but will suffer a rise in the rents they face as a result of the capitalisation effects of CRA into market rents. This would be more problematic in the case of reform 1, which would raise the CRA payment cap without restructuring entitlement so that this is expanded beyond social security recipients. Tenants residing in disadvantaged areas tend to have lower average incomes, so they face tighter credit constraints than higher income tenants. When tenants in disadvantaged areas face a rise in rents, they are less able to respond by exiting the rental sector into home ownership due to these credit constraints. Some government spending on CRA is likely to be 'lost' to capitalisation effects (in other words, the effect of a higher benefit income for a tenant recipient will be partially offset by needing to pay a higher rent). Our estimates show that raising the CRA maximum cap (reform 1) will lead to the largest 'loss' of \$27.9 million, while we can expect \$7.3 million and \$12.3 million to be 'lost' through reforms 2 and 3 respectively.

The study

This report's overarching aim is to shed light on possible cost-effective reforms of demand-side housing assistance that could improve housing outcomes for low-income renters. The main demand-side rental housing assistance for low-income renters in Australia is CRA, which is payable to eligible households renting outside the public housing sector. Various studies have suggested that, as CRA rules are currently structured, payments to low-income private renters are insufficient to achieve benchmark affordability because the real value of CRA has fallen well behind rent. Furthermore, there remains scope for improved targeting so that CRA entitlements more closely match the needs of different cohorts and accommodate the heterogeneity of housing markets across Australia. Concern has also been raised that increases in a demand-side rental housing assistance like CRA would be shifted into higher rents, rather than being captured within renter households' budgets to ease their affordability pressures.

Against this background, this report examines how demand-side housing assistance could be reformed in cost-effective ways to improve housing outcomes for low-income renters. Specifically, the report will address the following research questions:

1. What is the likely effect of changes in demand-side rental housing assistance on market rents?
2. What are the impacts of reforming CRA on low-income private renters? Specifically,
 - What is the cost-effectiveness of alternative CRA reform proposals in terms of targeting accuracy to achieve improved affordability housing outcomes and impacts on government budgets?
 - Who are the winners and losers from alternative reforms?
 - How might reforms to CRA affect decisions to transition from private renting to owning?

This research deployed a multi-stage approach that integrated an international literature review, policy engagement, econometric modelling and policy simulations. The quantitative arms of the research approach (econometric modelling and policy simulations) drew directly on the 2017 Household, Income and Labour Dynamics in Australia (HILDA) Survey, the latest HILDA Survey data available at the time of analysis. The HILDA Survey contains a comprehensive range of housing, income and other socio-demographic data facilitating population-wide conclusions on rental outcomes. It is a staple Australian data source for social science research and is Australia's only nationally representative panel dataset.

We conducted an international literature review of demand-side rental housing assistance programs in comparator countries to identify program frameworks potentially applicable to Australia. The completion of the literature review was followed by an AHURI Policy Engagement workshop. This was guided by AHURI's Policy Development Research Model, which seeks to integrate the separate processes of evidence building and policy development into one set of practices. Workshop attendees comprised a select group of policy makers from the Australian Government and state governments, as well as non-governmental representatives from areas of policy and practice related to the rental sector. The workshop provided a forum for considering ways of adapting overseas approaches for application in an Australian setting and highlighting priority reforms from a policy perspective.

Quantitative modelling was deployed in two strands. First, econometric modelling was used to estimate the likely impacts of demand-side rental housing assistance on market rents. Second, through policy simulation modelling, we predicted the impacts of potential reforms by comparing the impacts of CRA under its actual structure (2017) with impacts of three modifications to CRA. These reform designs were guided by outcomes of the policy engagement workshop. The reforms modelled were as follows:

- Raising the CRA maximum rate by 30 per cent
- Resetting the rent thresholds to address higher levels of housing stress among income units with no children
- Changing the CRA eligibility criteria to reflect housing need, defined as low-income private renters paying rents in excess of 30 per cent of their income.

We evaluated the impacts of these reforms against criteria of effectiveness, appropriateness and efficiency, as well as highlighting its distributional impacts.



Australian Housing and Urban Research Institute

Level 12, 460 Bourke Street

Melbourne VIC 3000

Australia


+61 3 9660 2300

information@ahuri.edu.au

ahuri.edu.au

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