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Subsidised affordable rental housing: lessons from Australia and overseas

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Executive summary

A supply of affordable rental housing is essential to allow households to transition out of scarce public and social housing and into the private rental sector. Affordable rental options are essential for those households already in the private rental sector who are struggling to pay market rents. This report explores the lessons that can be learnt from the National Rental Affordability Scheme (NRAS) (discontinued in 2014), which sought to stimulate the supply of affordable rental housing for low- and moderate-income earners. Drawing on evidence from comparable international programs for subsidising rental housing supply, the report makes recommendations on how to design and fund a new scheme to deliver the supply of affordable rental housing required in Australia.

Key findings

- By June 2015, NRAS had delivered 27,603 dwellings with a further 9,980 to be delivered, 76 per cent of which were in major cities. Dwellings were delivered across a variety of housing types including apartments (39%), separate houses (22%), studios (17%) and town houses (22%). The variety of dwellings delivered was a very positive outcome.
- Dwellings were delivered in suburbs with a range of socio-economic characteristics and with generally good-quality transport infrastructure. The allocation decisions were a combination of financially feasible project applications and state government directed housing priorities, and the approach worked well in delivering quality spatial outcomes.
- Subsidising rents to 20 per cent below market levels, the model adopted by NRAS not only increases the number of suburbs accessible to income-eligible households but, if such a discount were available to all eligible households, would lift a third of them out of housing stress.
- NRAS was discontinued in May 2014 after almost six years. Although not without problems, this research identified NRAS as an effective supply stimulus, delivering tens of thousands of units in a relatively short timeframe. Concerns about complex administration, poor targeting and administrative delays resulted in the discontinuation of the scheme just when momentum and private-sector investor confidence was building.
- Strengths of the scheme included: the ability to combine subsidies from a variety of sources; the level of engagement from the community housing sector and from private investors, particularly in the later rounds; the variety of dwelling types and sizes delivered; and the level of innovation it generated within the industry. The weaknesses were its administration and lack of longevity.
- A new program to deliver a supply of subsidised affordable rental housing should be introduced as soon as possible to build on the investment momentum generated by NRAS, which saw the final three funding rounds (i.e. calls for applications) heavily oversubscribed and a secondary market for incentives starting to develop.
- A new program needs clear and measurable targets and objectives, and must demonstrate long-term commitment of government to secure the confidence of the investment sector. It should run alongside alternative affordable housing investment options, such as a financial intermediary designed to secure low-cost funding for the community housing sector.
- A subsidised affordable rental scheme, combined with planning mechanisms to deliver land for affordable housing and measures to build the capacity of the community housing sector, could deliver a significant supply of dwellings to help tenants transition from social housing into the private rental market.

Background

The introduction of the NRAS in 2008 represented a significant shift in the provision of housing assistance in Australia, for the first time leveraging private investment in the supply of affordable rental housing at a national scale. In the context of declining rental and home-purchase affordability in Australia, and sluggish rates of new housing construction, NRAS addressed important goals for boosting the supply of total dwellings, not just affordable dwellings. In contrast to traditional approaches to social housing, NRAS represented a mixed market approach, able to integrate affordable rental accommodation within wider market developments. This report explores lessons that can be learnt from the operation of NRAS. Supplemented by lessons from comparable international schemes, including detailed case studies of the United States (US) and England, this report generates a set of guidelines for the delivery of any future subsidised private rental housing scheme within a broader affordable housing investment framework.

Research method

This project addressed the following research questions.

1. How have other countries with similar housing systems delivered subsidised affordable rental housing and what lessons can be learnt from the outcomes?
2. To what extent has NRAS been effective in delivering a supply of housing across Australia to address affordability in areas with differing dwelling price/rent and demographic characteristics?
3. To what extent has NRAS affected the supply and affordability of dwellings at the lower end of the private rental market?
4. Is there potential for an alternative model to deliver subsidised affordable rental housing supply?

The methodology focused on the outcomes, actors and institutions engaged in housing delivery. Policy documents from Australia, the US, England, France, Canada and Ireland informed an assessment of policy mechanisms employed in those jurisdictions, with international experts providing detailed case studies on the US and England.

Affordability and spatial outcomes for NRAS were analysed with reference to suburb-level data from the Australian Bureau of Statistics (ABS), rent/price data from RPData, and NRAS output data derived from the NRAS Quarterly Performance Reports published by the Department of Social Services (DSS). These data were mapped using ArcGIS. Affordability outcomes were computed with reference to data from the survey of Household, Income and Labour Dynamics in Australia (HILDA), allowing an assessment of the extent to which subsidised rental housing impacts on housing affordability and on households' rental affordability stress.

An Investigative Panel, held in September 2015, considered the potential for a new scheme to deliver subsidised affordable rental housing. The Investigative Panel included: CEOs from community housing organisations in Queensland, South Australia (SA) and Victoria; a manager from a major financial institution; an affordable housing consultant; the CEOs of two affordable housing development companies; and a number of leading academics. Additional evidence for the project was gathered through interviews with representatives from state government, community housing providers, the development industry and the valuation profession.

Findings

By June 2015, NRAS had delivered 27,603 dwellings with a further 9,980 to follow. Of these, 75.7 per cent were in major cities, with smaller proportions in inner regional (13.9%), outer regional (8.7%), remote (1.4%) and very remote areas (0.4%). A variety of dwelling types were delivered, including apartments (38.7%), separate houses (21.9%), studios (17.2%) and town houses (22%). The variety of dwellings produced was a very positive outcome, in contrast with patterns of delivery from some international schemes, such as the American Low-Income Housing Tax Credit (LIHTC) scheme, which provides volume but has delivered mainly apartments within inner city areas.

Queensland had the greatest proportion of NRAS dwellings at 27.7 per cent, followed by New South Wales (NSW) (18.2%), Victoria (16.3%) and Western Australia (WA) (13.9%). For this reason, the analysis of spatial and affordability outcomes from NRAS focused on these four states. The study developed a composite measure to identify patterns of outcomes related to socio-economic characteristics and investment potential. NRAS dwellings were delivered in suburbs with a range of socio-economic characteristics, although not at the very top and bottom of the scale. Most of the NRAS units were supplied in locations served by good-quality transport infrastructure.

The distribution of NRAS incentives across states/territories and regions was found to be a function of two drivers: firstly, the priorities of both the federal and state governments; and secondly, the financial viability of a project as determined by the Approved Participants (developers/investors). The dwellings delivered were clustered in suburbs with certain investment characteristics, which ensured the incentive delivered value to the investor, be that the community housing sector or a private investor. For example, for a weekly market rent of $300 per week, the 20 per cent reduction reduces rental income by $3,120 per year, meaning that the incentive of around $10,000 still delivers a considerable gain to the investor. With a rent of $600, the annual reduction is $6,240 and the gain is much smaller. Ignoring the after-tax position, the higher the market rent, the less beneficial the NRAS incentive. To maximise the impact of the incentive, private-sector investors sought areas with potential for capital growth combined with a rent that was low enough to benefit from the incentive itself.

Subsidising rents to 20 per cent below market levels increases the number of suburbs accessible to income-eligible households. For example, in Sydney, 62 suburbs were identified as having 15 or more total incentives (NRAS dwellings). A household of *two adults* or a *sole parent with one child* on an eligible income could afford to rent in only 10 per cent of these suburbs. Applying a 20 per cent discount to rents makes accessible over half of these suburbs, thereby significantly increasing housing options if a sufficient supply of NRAS dwellings were available. Of the 1.2 million NRAS eligible households represented in the HILDA survey, 460,000 were in housing stress, as defined by the 30 per cent rule. Of these, nearly 153,000 or one-third, would, in principle, be lifted out of housing stress by NRAS if the program had been made available to all those who qualify.

Given the affordability and accessibility impacts of subsidised affordable rental housing for eligible households, combined with opportunities to support transitions from social housing, a new program to build on the investment momentum generated by NRAS should be introduced as soon as possible. However, time for the scheme to build investor confidence is needed. In the US, the LIHTC scheme was made permanent after seven years and has subsequently delivered around 2.6 million rental units (required to remain affordable for at least 30 years). In stark contrast, NRAS was discontinued after almost six years.

An Investigative Panel discussed the strengths and weaknesses of NRAS. Overall the panel expressed the view that the majority of scheme outcomes were very positive, although there were considerable weaknesses in the scheme administration. It was noted that in the last three funding rounds the scheme was oversubscribed, with four applications for each incentive, suggesting it was successful in attracting investment. The panel was generally of the view that a long-term commitment to NRAS would have generated large-scale institutional investment. Lack of certainty regarding government commitment to NRAS, however, undermined institutional confidence.

The panel discussed a number of priorities for any new subsidised affordable rental scheme. There was agreement that any such scheme should have clear and measurable targets and objectives, with consistent policy settings underpinned by long-term government commitment. If tax credits were again the basis for the subsidy—and the general view of the panel was that this would have to be the case, because no government would be prepared to deliver a capital subsidy that would sit on the balance sheet—then an alternative approach would be required which would enable the development of a secondary market for trading those incentives. Administrative reorganisation should see each state taking responsibility for a share of credits, to be distributed according to policy priorities, prevailing market conditions and the availability of other resources. This would also allow states to use their own assets, such as land, in the way they believe is most effective.

Outcomes and lessons from international subsidised affordable housing schemes

International approaches to subsidised affordable housing offer a number of important lessons for Australia.

Finance and funding—The delivery of financial incentives from national level government, with the involvement of state/local governments, is the most widespread means to encourage institutional investment in affordable rental housing.

- A government created and guaranteed finance intermediary could deliver the low-cost funding required to expand the social housing sector. This could be supported by a subsidised affordable rental scheme specifically targeted to attract small-scale private investors funded through tax credits.
- The case for a specialised intermediary, as in the United Kingdom (UK), which can aggregate demand for debt finance for affordable housing providers, appears strong. However, success would depend upon some form of government guarantee because of the lack of strong balance sheets at this stage.
- While tax credits can attract large-scale institutional investment when the market matures and a secondary market develops, current policy settings governing tax credits do not favour institutional investors in Australia. Unless there is tax reform in this area, a different approach is required to attract investment specifically into subsidised affordable rental housing from this sector.

Diversity of product delivery—Internationally, there are examples of subsidised affordable rental schemes supporting new housing supply beyond new-build construction. For example, a number of international schemes have diversified the nature of affordable housing supply to include the use of existing buildings through conversion or renovation, or the development of dwellings for affordable home ownership. The success of such schemes might prompt Australian policy-makers to consider the option of utilising existing dwellings within the housing market to benefit the supply of affordable rental housing.

Defining affordable rent and incorporating housing assistance—As in Australia, international schemes reviewed in this study defined the structure of affordable rental schemes including tenants' ability to access additional financial support from government (e.g. CRA). Affordable rents are defined either by their relationship to the local rental market or by the local area incomes (or both, as in the case of social rents in England). Rents under the LIHTC scheme in the US and under the Irish Rental Accommodation Scheme (RAS) cannot exceed 30 per cent of the Area Median Income (AMI) or county-wide incomes, respectively. Some international policy approaches also require utilities or service charges to be taken into consideration when determining affordable rent levels. The inclusion of utility payments into the affordable rent structure is likely to have a substantial impact on the overall affordability of the property.

Spatial patterns of delivery and housing mix—The spatial delivery of dwellings under any subsidised rental housing scheme is important in terms of access to education and employment opportunities, as well as services. While NRAS had the effect of concentrating the developments in areas with average socio-economic characteristics (and investment potential), affordable rental properties under the scheme in England have been distributed through a much greater range of socio-economic locations, offering tenants greater social and economic opportunities, largely because of the way land is made available through planning policy.

Policy implications

Government should introduce a replacement for NRAS as soon as possible, building on the momentum generated during the last three funding rounds. Such a scheme should work in parallel with other financing arrangements that could increase the availability of funds to the community housing sector. A consistent and robust definition of affordable rents and, indeed, affordable ownership, is needed to further develop the sector in Australia.

While large-scale institutional investment in affordable housing is essential to build scale, individual investors also have a significant role to play. Individual investors may be able to offer the variety of housing product and locations that can be unattractive to institutional-scale investors. The NRAS experience demonstrated that 'mum and dad' investors are attracted by tax credits, and that tying the incentive to new dwellings helped generate new supply rather than investment in the existing dwelling stock. With reform of negative gearing arrangements, tax credits for affordable housing delivery could be very attractive to private investors.

From a review of international programs, it is clear there is no single, correct way to deliver subsidised affordable rental housing, as it is dependent upon country-specific policy settings. With this in mind, below are some broad recommendations to support the design of a scheme to deliver subsidised affordable rental housing in Australia.

- *Scheme design*—No single investment option will deliver the supply and variety of affordable housing required in Australia to meet housing need. Rather, the scheme design needs to include a number of options working in parallel to target various elements of affordable housing provision accommodating tenants with different needs.
- *Finance and funding*—Ideally, a subsidised affordable rental housing scheme would be funded through a tax credit system attracting small-scale private investment, supported by a capital-based program that could attract investment from institutions. Government could deliver the capital by rebalancing existing outlays for housing and real estate tax subsidies, and directing funds towards a subsidised affordable rental scheme.
- *Capacity building*—Capacity building measures must be put in place, in addition to the provision of long-term, large-scale and stable capital and land-use policy commitments. These include: building the capacity of the community housing sector; building the capacity for private institutional capital from banks and investors for affordable rental housing production; and building the capacity for public–private partnerships among for-profit and non-profit private development and within financing entities. Moreover, there is a need to recognise opportunities to provide service-enriched very-low-income rental housing for

persons with disabilities and other service needs, in combination with support from the new National Disability Insurance Scheme (NDIS).

It is critical that government moves away from a reliance on demand-side subsidies that attempt to make housing more affordable for individual households, and instead sets in place supply-side alternatives. Although its administrative problems have been well documented, NRAS was successful in attracting interest from small-scale investors and was starting to generate interest from institutions. This report sets out recommendations for a future scheme. Robust consultation and engagement with all sectors of the housing industry could develop a successful program to deliver affordable rental homes on the type of scale required in Australia.

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