



EXECUTIVE SUMMARY

Australian demographic trends and implications for housing assistance programs

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EXECUTIVE SUMMARY

- The combined impact of demographic change, and shifts in the Australian population's tenure profile, will be large. We forecast a 61 per cent increase in the number of households eligible to receive Commonwealth Rent Assistance (CRA) from 2011 to 2031. CRA payments are forecast to rise from \$2.8 billion in 2011 to \$4.5 billion in 2031—a 62 per cent addition to real budget expenditures. About half of the predicted increase is due to demographic changes, and the other half to an increase in private rental housing's tenure share.
 - The rise in the budget cost of providing rent rebates to public housing tenants is more modest: an increase in budget cost from \$1.1 billion in 2011 to \$1.5 billion in 2031 is forecast.
 - We estimate that in 2011, 730,000 home owners received higher income support payments (ISPs) than would have been the case in the absence of home owner asset test concessions. The budget cost of meeting these higher payments is predicted to rise 38 per cent above 2011 levels to \$8 billion in 2031.
 - Housing tax subsidies have a much larger budget cost than either housing assistance or the asset test concession. However, the predicted steep falls in rates of home ownership over the time horizon mean that projected increases in the aggregate real value of tax subsidies are *relatively* modest: we forecast a 23 per cent increase, from \$15.3 billion in 2011 to \$18.8 billion in 2031.
 - In aggregate, the 2011 budget cost of housing subsidies (including the asset test concession) cost government \$25 billion. By 2031 that figure is likely to have risen to around \$33 billion.
 - An alternative form of housing assistance is a secure leasing scheme, designed to provide more stable housing for especially vulnerable households that are eligible for public housing but currently reside in private rental, while curbing increases in the budget cost of housing subsidies.
 - Simulations show that, in the absence of a secure leasing scheme, CRA payments to secure-lease-eligible tenants would amount to an estimated \$8.6 billion over a five-year period (2010–14). On the other hand, accommodating these tenants in public housing would have cost the government \$13.1 billion over the five years.
 - Under the proposed secure leasing scheme, governments would be required to pay private landlords an incentivising premium of \$14,891 or, on an annual basis, \$3,498 in each year of the five-year lease. The annual equivalent budget cost is \$2.38 billion with the total real budget cost summing to just over \$10 billion over the five years.
 - Secure lease tenants would continue to be eligible for CRA payments which would sum, over five years, to \$7.4 billion, instead of \$8.6 billion under status quo conditions. This \$1.2 billion budget saving can be deducted from the estimated \$10.1 billion budget cost of implementing the secure lease program.
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Key findings

Budget costs: housing subsidies

A key task of this research has been to estimate the future budget cost of housing subsidies. The combined impact of expected demographic change, and shifts in the tenure profile of the Australian population, will be large. We forecast a 61 per cent increase, over 20 years, in the number of households eligible to receive CRA: from 952,000 in 2011 to 1,500,000 in 2031. At constant 2011 prices, CRA payments are forecast to rise from \$2.8 billion in 2011 to \$4.5 billion in 2031—a 62 per cent addition to real budget expenditures that represents an average 3.1 per cent per annum increase. This large increase is predicted despite a conservative assumption that real rents remain unchanged over the time horizon (2011–31). About half of the increase is due to demographic changes, and the other half to an increase in private rental housing's tenure share, as public housing's *share* continues to contract and home ownership stagnates. The budget cost of providing rent rebates to public housing tenants increases more modestly, because the number of households residing in public housing is expected to remain constant; an increase in budget costs from \$1.1 billion in 2011 to \$1.5 billion in 2031 is forecast.

Home owners benefit from an 'asset test concession' arises, because the value of an owner-occupier's home is not included alongside other assets assessable under the asset test. This preferential treatment of home owners is partly offset by a lower owner-occupier asset threshold (below which income support program entitlements are unaffected) as compared to that applied to rental tenants. Nevertheless, we estimate that in 2011, 730,000 home owners received higher ISPs than would have been the case if they were treated in the same way as tenants. The budget cost of this is calculated to be \$5.8 billion for 2011—more than double the total actual cost of CRA payments in the same year. This budget cost (at constant 2011 prices) is predicted to increase to \$8 billion in 2031 (a 38% increase on 2011 levels). This increase is based on the conservative assumption that real house prices remain constant over the 30-year time frame.

Housing tax subsidies have a larger budget cost than either housing assistance or the asset test concession. However, the predicted steep falls in rates of home ownership in middle age groups means that projected increases in the aggregate real value of tax subsidies are *relatively* modest: we forecast an increase from \$15.3 billion in 2011 to \$16.2 billion in 2021 and then \$18.8 billion in 2031 (a 23% increase on 2011). Growth in the real value of tax subsidies is restrained by falling rates of home ownership in middle age groups, the historically high 2011 loan-to-value ratios (LVRs) (that are assumed to continue) and the relatively low 2011 interest rates, which are also assumed to remain stable.

In aggregate, the 2011 actual budget cost of housing subsidies (including the asset test concession) drained \$25 billion from government 'coffers'. In 2011, Australian gross domestic product (GDP) was \$1,401 billion. Thus, housing subsidies accounted for 1.8 per cent of Australia's GDP in 2011. Housing subsidies are expected to rise to \$32.8 billion in 2031, a 31.2 per cent real increase.

Despite conservative assumptions, housing subsidies are expected to show large real increases in future years. One of the most important drivers is growth in CRA payments due to growing numbers of households in private rental housing, especially older households that have either failed to get into home ownership, or have fallen out of home ownership. This is a scenario that Australian governments will be concerned about given currently high budget deficits and the limited amount of secure rental housing available to older households. There are a number of possible policy responses to the challenges posed by these trends. In the second half of this report we investigate one option: the introduction of a secure lease program, which is designed to incentivise landlords into offering long-term five-year leases.

Secure leases would offer a greater degree of housing security than is commonplace in private rental housing, but at a lower budget cost than expansion in public housing. Such a scheme would, in effect, harness private rental investments for social housing purposes; however, this is only achievable by offering private landlords a rent premium to incentivise their commitment to offer longer term leases to eligible families. Our scheme is modelled on a similar scheme introduced by the New York City Housing Authority in the 1990s under an *Emergency Rental Housing Programme* that offered private landlords US\$2,500 (per family member) to house families who would otherwise be residing in homeless shelters (Cragg and O'Flaherty 1999).

However, instead of targeting the homeless, our scheme is directed to those persons who are eligible for public housing but currently resident in private rental accommodation. Candidates for a secure lease would be drawn from the population of private rental households that are in fact eligible for public housing under income and asset tests. The household must also have at least one of the following three characteristics:

1. contains one or more person(s) aged over 64 years of age
2. contains one or more person(s) with a long-term health condition or disability
3. contains one or more school-aged dependent children (children aged 15 years or under).

Landlords participating in the scheme are expected to raise rents by no more than the increase in the consumer price index (all goods and services) over the five-year lease term. Secure lease tenants will continue to receive CRA, provided they remain eligible. The central idea is that secure leases offer more stable housing, while CRA and 'light touch' rent regulation (rent capping) concurrently help support affordability goals. From the perspective of government budgetary pressures, it is hoped that savings will be made by avoiding the high capital costs associated with the construction of new public/social housing.

Need for secure lease

To derive population estimates of the need for secure leases, we make use of the AHURI-3M microsimulation model and apply cross-section population weights from the 2010 Household, Income and Labour Dynamics in Australia (HILDA) Survey. We take each state housing authority's assessable income thresholds as at 2016 and to align with the 2010 wave of the HILDA Survey we deflate them to 2010 price levels.

It is estimated that a little over 650,000 Australian households (1,035,863 persons) form the potential client base for secure leasing arrangements. This is equivalent to one in three Australian households currently living in private rental housing. Within the client base, there are three main subgroups. Low-income households with dependent children form the biggest client subgroup (390,000), and almost all of these households are composed of adults under 65 years of age. The second largest client group consists of households containing one or more adults with a disability; but many (27%) of these households also contain persons aged over 65 years (the third main subgroup). Indeed, there are 178,000 households that belong to two or more of the three client subgroups.

The key demographic for this kind of affordable housing option has a youthful age profile relative to those households currently resident in public housing. In terms of life cycle stages, the 25–34 year age group, typically in the early stages of household formation, is the largest source of clients. This age group accounts for nearly one in three potential secure lease clients, with the 35–44 age group the next largest (22% of all clients). Furthermore, households with dependent children account for nearly two-thirds of the clientele. Relative to public housing tenants, the secure lease client base has a marginally higher representation of households with equivalised incomes below the 40th percentile. Younger families on low incomes are especially prominent.

Budget costs: secure leases

To compare the budget cost of our proposed secure lease program with the cost of continuing status quo housing subsidies, we began by estimating the housing assistance cost of continuing to accommodate the secure-lease-eligible tenants in private rental housing. Using AHURI-3M, we calculated the sum of CRA payments made to households that we identified as eligible for secure leases—that is, the current budget outlay of the Commonwealth Government required to meet its housing assistance obligations to these households under the CRA program. Our estimates cover a five-year time horizon (2010–14) and we assume that those households eligible to receive CRA in 2010 continue to receive CRA throughout that time. A budget cost of \$1.72 billion is estimated for 2010, increasing by 2.9 per cent to \$1.77 billion (at 2010 prices) in 2014. Over the time period, estimated budget costs sum to \$8.6 billion.

The second stage of this costing exercise estimated the incentivising premium that we consider necessary in order to entice a sufficient number of private landlords to offer secure lease agreements, and abide by an agreement to limit increases in rent to annual movements in the consumer price index (CPI). One way to think about how governments might incentivise private landlords is to recognise that long-term leases require landlords to sacrifice liquidity. By offering a one-year lease term, the landlord has the option of being able to exploit alternative investment vehicles, offering superior returns, at the end of the first one-year lease term. When the investor commits to a five-year lease, s/he effectively sacrifices this option and thus would need to be compensated. We have estimated the liquidity premium (net of transaction costs) necessary to compensate landlords for foregoing alternative investments over the period 2010–14. The average (median) one-off incentivising premium would be \$14,891 (\$10,694) or, on an annual basis, \$3,498 in each year of the five-year lease. If the premium were paid on this yearly basis, then the annual equivalent budget cost is \$2.38 billion. The total real budget cost of incentivising landlords sums to just over \$10 billion over the five years.

Secure lease tenants would continue to be eligible for CRA payments. However, because secure lease rents are capped to increase in line with consumer price inflation, budget costs for this item would be slightly lower than under actual market rents that increased in real terms over the time frame (2010–14). The estimated CRA bill would have totalled \$7.4 billion over the five years to 2014 under secure leases, compared with \$8.6 billion under status quo conditions. This \$1.2 billion budget saving can be deducted from the estimated \$10.1 billion budget cost of implementing the secure lease program.

In the absence of a secure lease program, an alternative scenario would be the construction of additional housing units to accommodate the secure-lease-eligible tenants in public housing. Evaluation of the budget cost of such a solution, on a comparable five-year basis, was conducted by estimating the difference between the rebated rent that eligible households are charged in public housing and the market rent if their housing were leased in the unregulated private rental market. On a population-weighted basis, the mean (median) value of the public housing subsidy per year is estimated to be \$4,664 (\$4,174). This average subsidy remains constant in real terms over the five-year forward estimates (given our *ceteris paribus* assumptions). The average subsidy is equivalent to an annual budgetary cost of around \$3 billion, or \$13.1 billion over the five years (when discounted at a rate of 8% per year). This total is \$3 billion more than the estimated \$10.1 billion budget cost of instituting the secure lease program.

The study

This report presents the findings from two programs of research. In the first program (Part 1), we explore the implications of demographic change for government outlays on housing assistance, and the government tax revenues foregone as a result of concessions extended

to home owners. Population ageing, growth in the numbers of single people, and anticipated falls in the rate of home ownership are key motivations for this first program of research, because these changes are expected to raise government outlays on housing assistance and increase the amount of tax revenue foregone as a result of tax and asset test concessions to home owners. In view of these expectations, federal and state governments are showing a keen interest in innovative housing assistance programs that offer more cost-effective support to those least able to 'pay their own way' in housing markets.

The second program of research (Part 2) therefore investigates a differentiated form of housing assistance that supports those people who are both vulnerable to housing affordability stress and in need of secure housing. It offers a costing of what we term 'secure leases', which is then compared to the estimated cost of alternatively delivering public housing to the expected clients of such a program.

In our first program of research we address two key research questions.

1. What is the real value of housing subsidies received by Australian home owners and renters in 2011, 2021 and 2031, and how is the budgetary cost of financing these subsidies expected to change over this time frame?
2. What challenges do these trends pose for a sustainable Australian housing policy in the twenty-first century? In particular, what are the implications if home ownership rates were to decline as forecast by Yates and Bradbury (2010)?

The second program of research addresses three key research questions.

1. How many households require subsidy in the form of our proposed secure leases? What is their breakdown by age cohort, household type, income group and geographical location?
2. What subsidy is required in order to incentivise a sufficient number of landlords to offer eligible low-income households with long-term (five-year) security of tenure?
3. How might this alternative housing assistance arrangement impact on the Federal Budget, as compared to current subsidy programs? And would there be savings to government budgets if they provided the 'incentivising' payment to landlords instead of accommodating eligible households in public housing?

To conduct the first program of research, we used the 2011 HILDA Survey as the base from which future demographic profiles were generated for the study time frame (2011–31). The year 2011 is used as the base year for measurement of Australia's housing subsidies and tax expenditures because this is the latest year of the updated AHURI-3M (the microsimulation model used to simulate the operation of Australia's tax and income support systems). The most relevant Australian Bureau of Statistics (ABS) population projections are sourced from the *Household and Family Projections, 2011 to 2036* issued in March 2015 (ABS 2015). We use the population growth rates from this ABS source to 'age' the HILDA data by adjusting the 2011 HILDA cross-section population weights corresponding to each responding person that is aged 15 years or older and financially independent. We also apply the long-run trend estimates in home ownership over the time frame 2011–31 that are presented in Yates, Kendig et al. (2008).

To derive population estimates of the need for secure leases, we make use of AHURI-3M and apply cross-section population weights from the 2010 HILDA Survey. We take each state housing authority's assessable income thresholds as at 2016 and deflate them to 2010 price levels, to align with the wave of the HILDA Survey that is used for base year calculations.

The investigation of the secure lease option is not meant to suggest that this is a favoured approach relative to others. The choice of secure leasing for in-depth study reflects discussion in policy circles on how best to respond to resource constraints.

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