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Submission to the IPART review of rent models for social and affordable housing in NSW

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Contents

- Key points2**
- 1. Introduction.....4**
- 2. The wider context for the review5**
 - The operation of the wider housing system.....5
 - Quantifying unmet housing need6
 - Social housing and affordable housing in NSW7
 - Future Directions for Social Housing in NSW9
- 3. Review assessment criteria..... 11**
 - Incentives for workforce participation11
 - Affordability for tenants13
 - Simplicity for tenants.....13
 - Horizontal and vertical equity13
 - Flexibility and choice for tenants.....14
 - Efficiency: allocative, productive and dynamic14
 - Impact on future demand for social housing15
 - Impact on demand for other housing tenures and products15
 - Impact on financial sustainability of the social housing system.....16
 - Impact on concentration of disadvantage.....16
- 4. Eligibility and allocation issues 17**
 - Evolution of approaches on social housing eligibility.....17
 - Further restricting eligibility18
 - Continuing eligibility18
 - Other assistance measures.....19
- 5. Rent setting frameworks and options 20**
 - Rent-setting: the necessity for balancing conflicting objectives20
 - Weighing up rent setting approaches and hybrid models21
 - Income assessment for rent-setting purposes21

Key points

- The deep and intensifying shortage of social and affordable housing provision in NSW creates an overwhelming constraint on attempts to restructure the social housing rent setting system to optimise utilisation of resources and to achieve other desirable outcomes. Similarly, the system's chronically underfunded condition, the understanding that proposed changes must be revenue-neutral, and the 'out of scope' status of Commonwealth Government policy settings all severely restrict any freedom of manoeuvre in terms of reform directions.
- Equating social housing with dependency unfairly demeans tenants. This characterisation is highly questionable since effective housing subsidies flow in larger volumes to owner occupiers and private landlords.
- An important advantage of the income-related rent setting model, where charges are capped at market rent, is that this enables the withdrawal of subsidy as a tenant's economic circumstances improve, with no necessary requirement that the tenant must exit their home to enable this.
- Any income-related rent-setting system imposes an effective marginal tax rate on tenants as their income rises. Under the NSW public housing system, the resulting work disincentive effect is damagingly compounded by two other system components: (a) the 30 per cent rent-gear-to-income band applicable to 'moderate income tenants' and (b) the fixed term tenancy regime where the income threshold for continuing social housing eligibility will – at least in Sydney – result in ejected ex-social renters paying unaffordable rents in the private sector.
- As we see it there is no strong case for retaining the reviewable tenancy regime in public housing. While imposing workforce participation disincentives the resulting 'gains' in terms of filtering-out better-off tenants have been nugatory. However, if the fixed term tenancy model is kept in place, it would be in our view undesirable to reduce the 'continuing social housing eligibility' income threshold as floated by the Issues Paper – because of the workforce participation disincentive problem.
- In respect of the affordability criterion for rent system evaluation, it is very unfortunate that the review's remit excludes any consideration of Commonwealth Government social security policy. This precludes any challenge to the unjustifiable status quo under which social landlords must effectively self-fund subsidies required to maintain rents at levels affordable to the least well-off tenants
- Regarding allocative efficiency within the housing system, the existing needs-based allocation regime in fact results in a level of stock utilisation superior to that in private rental or owner occupied housing. The stated extent of public housing 'under-utilisation' as cited in the Issues Paper is in fact erroneous. An amenity-based framework where rents are partly linked to property size could possibly drive further 'efficiency' in this respect, but the existing shortage of suitable small-size accommodation currently imposes an overriding constraint.

- Switching from income-based rents to property-specific rents would have attractions from the social landlord perspective because it would create more certainty about future income streams, thereby providing a sounder basis for business planning. However, serious contemplation of such a reform would be difficult without incorporating consideration of social security settings under Commonwealth Government control.
- We do not favour the tighter restriction of eligibility since this will not reduce wait times for priority applicants. Moreover, yet tighter limits on income eligibility to access (and to remain in) social housing would further intensify the social polarisation of the sector, further damaging the social diversity of neighbourhoods and would (under the current income-based rent setting model) further erode the financial sustainability of the social housing system.
- Assuming that income assessment remains an important component of rent-setting, we would advise against a switch to scaling rents according to net (instead of gross) income – this would complicate assessment and create risks of manipulation. Similarly, the current treatment of the income of other household members is founded on underlying logics that need to be fully appreciated if reforms in this area are to be seriously suggested.

1. Introduction

UNSW's *City Futures Research Centre* is Australia's leading urban policy research centre. Over the past decade we have been heavily involved in researching a wide range of issues and policy options that have a bearing on the current independent review of rent setting and eligibility in the social and affordable housing system.

This submission is based on our extensive research record in this field especially as it relates to housing needs; international social and affordable housing systems, policies and financing; the viability of the Australian social housing system; housing assistance options, policies, regulation and delivery; management costs and effectiveness in social housing; Indigenous housing; the private rental market institutions, laws and products; housing pathways; and the profile and capacity of the affordable housing industry. Material drawn on for the submission is referenced throughout. This includes our own work and other recently published evidence in support of our arguments.

In the submission, we first consider the wider context of the review, highlighting those strategic issues which have a key bearing on how social affordable housing operates within NSW. Next we specifically address the proposed assessment criteria for the IPART review. This provides the context for the third part of our submission which gives our views on the questions and issues raised by IPART in those areas of the Review in which we have specific expertise. We have grouped our responses to the questions selected around two key themes:

- Eligibility and allocations issues
- Rent setting frameworks and options

We support publication of our submission. We would be happy to provide additional information and answer questions concerned with any of the matters covered by the submission.

2. The wider context for the review

Relevant question:

Are there any other issues with the current social and affordable housing system in NSW that are relevant to designing the eligibility criteria and rent setting framework?

Social housing is described in the Issues Paper as “rental housing ... to assist people who are unable to access suitable accommodation in the private rental market.” (Box 1.1, p1). The review is required to look “broadly at the housing assistance system and the ways in which eligibility criteria and rental models may be used to deliver assistance more flexibly on the basis of need, efficiency and equity.”

Below we discuss a number of issues outside the specific terms of reference of the review that we consider have an important bearing on the potential for reform of eligibility criteria and rent setting as they apply to social and affordable housing in NSW. While some of these are mentioned in the Issues Paper, we consider the following issues need greater emphasis and debate.

The operation of the wider housing system

In determining appropriate eligibility criteria and rental models for social and affordable housing in NSW in terms of need, efficiency and equity, regard must be had to the structure of the housing system and trends in housing markets.¹ Australian governments deliver a range of forms of assistance and subsidy to households throughout the housing system – owner occupiers, private tenants, and social housing tenants. The largest subsidies are the tax expenditures that go to older, wealthier owner occupiers and are capitalised in high house prices²³. Over recent decades, many lower income, and even moderate income, households have been excluded from home ownership and thus from the security of tenure, the protection that home ownership provides from housing poverty in retirement, from the control that owners have over their housing circumstances and from the significant contribution that tax-advantaged ownership of private property makes to household wealth. The exclusion of growing numbers from these positive aspects of home ownership raises significant questions about intra-generational equity as well as inter-generational equity, the role that social housing plays in accommodating those who miss out home ownership benefits, and the basis for determining what constitutes an equitable treatment of social housing tenants.

In parallel with the decline in the home ownership rate, social housing has also declined. Households excluded from home ownership by their limited economic resources and unable to access social housing because of its restricted supply have no choice but to rent privately. Many of these are unable to access suitable housing, face significant affordability problems and have little control over their housing circumstances.

¹ Yates, J., and Milligan, V. (2007) *Housing affordability: A 21st century problem; National Research Venture 3: Housing affordability for lower income Australians*; Final Report No. 105; Melbourne: AHURI

² Yates, J. (2009) *Tax Expenditures and Housing*, AHURI, Melbourne

³ Kelly, J-F., Hunter, J., Harrison, C., and Donegan, P. (2013) *Renovating Housing Policy*, Melbourne: Grattan Institute

The question of whether housing equity should be assessed against those fortunate to have secure housing via owner occupation or those renting unaffordable or poorly located housing in the private market needs to be addressed. Australia's system of housing tenure does not treat home owners and renters neutrally. Considering the significant financial benefits that accrue to the former, the question of whether social renters should be treated more like owners or like private renters is a fundamental question that needs to be answered.

This goes directly to the subject matter of the present review. To presage our detailed discussion of rent models, below: cost rent structures within social housing enable some comparability with owners⁴. The increasing implicit subsidy to social housing tenants (bridging the difference between market rent and rent paid) is one that is also enjoyed by home-owners (because of exemption of imputed rents from income tax) and, as such, can be regarded as equitable. By contrast, market rent structures in social housing provide some comparability with private renters. Under a market rent system, failure to provide sufficient assistance to private renters will leave lower income tenants with ongoing affordability problems, or result in renter households relocating to areas where rents are generally more affordable – but where services are likely to be less readily accessible and employment opportunities fewer. In general, non-housing costs are likely to be higher. Failure to provide sufficient assistance to social renters will result in a non-financially viable social rental system.

Quantifying unmet housing need

The need for more affordable housing arises largely from the affordability pressures faced by lower income households in the private rental market. Census-based estimates of the current national shortfall of rental dwellings affordable to such households vary from around 200,000 to around 550,000, depending on how rental stress and affordable supply are measured⁵.

Looking forward, it is estimated that of the projected 1.7 million newly forming households across Australia over the next decade, 203,000 (12 per cent) are likely to face housing stress in current market conditions. In NSW the equivalent estimate is 86,000 (20 per cent)⁶.

Forward commitments to expand social housing and affordable housing are difficult to estimate accurately from current data sources, but it is clear that it falls well short of what is required to address the problem. For example, in an analysis of current policy documents, Milligan, Martin et al. (2016: 12 and Appendix 1) could only identify commitments for approximately 32,000 additional social and affordable dwellings (net of demolitions and sales) to be provided across all jurisdictions between 2015 and 2020. Offsetting at least some of the indicated additional supply, however, will be

⁴ Historic cost rents mean that social tenants are protected against future increases in dwelling prices in the same way that existing owners are. In an environment where real dwelling prices generally rise, average cost rents (the sharing of the benefits of lower cost at the point of entry into housing across existing and new tenants) provide a collective substitute for the individual protection that owners can provide for their children by using their increased housing wealth to assist the next generation into home ownership.

⁵ Hulse, K., Reynolds, M. and Yates, J. (2014) *Changes in the supply of affordable housing in the private rental sector for lower income households, 2006–11*, AHURI Final Report No.235, Melbourne: AHURI

⁶ Rowley, S. (2016) [Modelling housing need in Australia to 2025](#); Presentation to AHURI conference: *The Future of Housing Assistance*; Adelaide 13 October 2016

progressive losses from the 37,000 dwelling portfolio of homes currently rented at below-market rates, as the 10-year National Rental Affordability Scheme (NRAS) subsidies that these dwellings attract expire between 2019 and 2026.

The scale of the affordability problem requires a major reset of housing policy and a major supply response. This is relevant to the present review in two ways: first, social housing rent models need a framework of corresponding subsidies to which governments are committed and which enable the sustainable growth and maintenance of the housing stock. Secondly, it also means acknowledging that governments cannot merely administer their way out of the affordability problem, by seeking to 'transition' households out of social housing so that others might move in. This would be to ignore the problem of there being too few affordable alternatives to transition to, and the consequent problem of setting up work disincentives and other damaging outcomes.

Social housing and affordable housing in NSW

In NSW, as in other Australian states, social housing is a key form of housing assistance for persons on very low and low incomes. Social housing comprises public housing, provided by the State Government, and community housing, provided by not-for-profit organisations (community housing providers (CHPs) and Indigenous community housing organisations or ICHOs) subject to state regulation. In both cases it is actually two forms of assistance delivered together: the non-financial benefit of access, determined administratively, to a rental house on relatively secure terms; and the financial benefit of an income-related rent subsidy.

'Affordable housing' is a widely used term with quite different general and specific meanings. At its broadest, it refers to a continuum of subsidised rental and ownership housing products for households on low to moderate incomes (which would make it a larger category than social housing). However, in NSW and other Australian states, it usually refers to a more specific rental housing product, usually delivered by CHPs and targeted specifically at households on low to moderate (as opposed to 'very low') incomes. In 'affordable housing' rents are generally discounted in relation to comparable market prices (e.g. 80 per cent of market rent for private providers and <75 per cent for NFP providers) rather than in relation to tenant incomes (e.g. 30 per cent of tenant household income) – although there are a number of variants. In other countries sometimes termed 'mid-market rent' or 'intermediate rent', the most commonly argued case for this class of housing is its function as a means of providing good quality accommodation within the reach of moderately paid essential workers. In the NSW context (e.g. as embodied in the NSW Government's Social and Affordable Housing Fund (SAHF) program) it is also now being promoted as a 'bridge' between social housing and full market housing. Beyond this specific context, however, the development of this sector too is stymied by the lack of a national policy and commitment to durable subsidies.

A considerable proportion of the current social housing portfolio dates from the immediate post war period; constructed mainly to accommodate low income working family households, many of whom would have been on a trajectory to home purchase and subsequent owner occupation. Since the 1970s, however, social housing has been seen as primarily a safety-net tenure for the most disadvantaged households with the weakest prospects of securing adequate housing via the market. Partly due to restrictions on entry through increasingly stringent eligibility criteria, social housing has become more and more socio-economically residualised with respect to the broader housing system.

Also because property prices have tended to run ahead of general inflation the scope for transitioning from social rental to home ownership has dwindled almost to zero. Nowadays, especially because of being administratively embedded with human services in Australia's largest states, social housing is increasingly seen by government as an adjunct to welfare services – primarily important as directly controlled accommodation for clients of the state.

Over a long period there has been public policy failure in Australia with regards to ensuring that the social housing system is financially and socially sustainable⁷. Key contributing factors to this situation include:

- The failure to make transparent the costs of provision of both new and existing social housing, including long term asset upkeep⁸
- A growing concentration of higher needs tenants (who add to management costs) and more smaller households with less income (mostly aged and disability support pensioners)
- An ageing and under-maintained dwelling portfolio
- The absence of a fit-for-purpose rent subsidy calibrated to bridge the difference between tenant capacity-to-pay and benchmarked provider costs
- No division in national funding designated for new supply and for operational subsidies (after 1996). This has led to a serious loss of accountability for how taxpayer funds are expended and has eliminated routine funding for social housing replacement and growth
- Lack of agreement and accountability between levels of government about their respective responsibilities for meeting the dual objectives of achieving affordability for low income tenants and financial viability for housing providers
- Long term decline in the choice and mix of housing assistance measures offered, especially the abandonment of low income home ownership support in NSW.

One of the key outcomes has been the operating deficit problem affecting public housing, intensifying since the 1990s⁹, leading to a contraction of the social housing sector.

As the social housing system has shrunk it has been impossible for state and community providers to meet the level of outstanding and emerging housing needs. The severity of this situation is illustrated by the declining capacity of the public housing system to house new applicants – between 2001 and 2015 this halved from 11,554 to 6,445 per annum, a trend only partly offset by allocations to community housing, which rose from 2,499 to 3,991 over annum over the same period (ROGS various years).

⁷ Yates, J. (2013) 'Evaluating social and affordable housing reform in Australia: lessons to be learned from history', *International Journal of Housing Policy*, vol 13:2, pp. 111-133

⁸ We note that the NSW Government's Social and Affordable Housing Fund (SAHF) has potential to assist in this regard if the pricing arrangements are made public.

⁹ Hall, J. & Berry, M. (2007) *Operating deficits and public housing: policy options for reversing the trend: 2005–06 update*, Final Report No. 106, Melbourne: AHURI

As Commonwealth annual funding to NSW is fixed, each additional unit of public housing is loss-making, providing no incentive for State Treasury to fund additional supply.

The revenue position of community housing is stronger because most of their tenants receive CRA which is transferred to their landlord. However, the current level of CRA is inadequate to fully fund both long term operating subsidies and service private debt for new supply (in the absence of public grants). Modelling shows that, post-NRAS, without additional sources of revenue or capital, CHPs will be unable to increase private financing of new supply and adequately maintain their housing over the long term¹⁰.

There is abundant evidence that current funding arrangements for public and community housing are completely inadequate to address even acute housing need and homelessness. As noted by the NSW Audit Office, current approaches to addressing this situation are unsustainable¹¹. Attempts to raise additional revenue through changes to rent setting (while preserving affordability and retaining strict targeting) cannot possibly address the scale of financial problems in the system – and, to the extent that they provide any such dividend, are likely to worsen the stigma and social sustainability of the tenure. The analogy of rearranging deck chairs on the Titanic comes to mind.

Unless they are part of a wider system overhaul, reforms to rent setting and eligibility can make little contribution to solving the social housing problem. What is required is a soundly-based national policy approach led by the Australian Government and negotiated through COAG, similar to the manner in which disability services reform was achieved.

Future Directions for Social Housing in NSW

Now cited by IPART and by NSW FACS as the Government's social housing 'strategy', the January 2016 *Future Directions* paper has specified some long overdue policy objectives as well providing impetus for system reform. As we commented at the time¹², all of the broad themes of *Future Directions* – modernisation, additional supply and supporting tenants – resonate with the affordable housing industry. However, the paper is restricted by its narrow focus on social housing issues in isolation from the broader housing system. Neither does the paper include any quantification of the State's overarching affordable housing and support needs nor costing of potential solutions. *Future Directions* therefore, falls far short of what could be fairly considered a well-founded 'strategy'.

Future Directions nevertheless incorporates a welcome recognition of the need to expand social and affordable housing. However, after allowing for the necessary replacement of demolished public housing in estate renewal projects, the paper's 10-year expansion target is far below what would be required even to keep pace with ongoing population growth, let alone remedy the historic shortfall in social and affordable housing provision (see 'Quantifying unmet housing need' above).

¹⁰ Sphere Company (2010) *Leveraging affordable rental housing for sustainability and growth*; Sydney: Shelter NSW

¹¹ NSW Auditor General (2013) *Making the Best Use of Public Housing*; Sydney: Audit Office of NSW

¹² Pawson H. & Milligan, V. (2016) More questions than answers in NSW 'strategic housing' announcement; City Futures Blog 26 January

Future Directions wisely recognises the reality that, thanks in part to the stringent access conditions that now apply, the social housing system contains a large number of tenants with complex needs that severely limit or rule out the scope for paid employment and, therefore, for a future ‘transition’ to the private housing market. More contentiously, however, the paper builds on this recognition by defining social housing needs with reference to two implicitly distinct groups: (1) those for whom long-term support will be provided in social housing – the ‘safety net group’, and (2) those who will be expected to ‘transition to housing independence’ out of social housing – the ‘opportunity group’.¹³

Philosophical and practical issues are raised by this conceptualisation and by the way it is presented in *Future Directions*. As to the first, we challenge the inbuilt assumption that social housing can be equated with ‘dependence’ on government assistance, and with the corollary that private market housing (owner-occupied or rental) equates with ‘independence’ from government assistance. The benefits that these owner-occupiers enjoy – and may experience as ‘independence’ – are in fact greatly assisted by governments¹⁴. It demeans social housing tenants to characterise their receipt of what may in fact be a lower level of subsidy as ‘dependence’.

It also obscures that the level of subsidy received by a social housing tenant – in particular, through the current system of income-related rents - depends on their circumstances, and that a social housing tenant whose household income is such that they pay market rent is not subsidised. It should be acknowledged that a household in social housing may, by increasing its income and reducing its subsidy, ‘transition to housing independence’ without actually having to move out of their home.

We would also argue that the ‘safety net group’ versus ‘opportunity group’ dichotomy is impractical and counterproductive. ‘Opportunity’, properly understood, should mean the prospect of improving one’s circumstances – specifically, through increased income from work. Opportunity, in this sense, should be open to all social housing tenants, without administrative distinction. If, on the other hand, ‘opportunity’ means being subject to measures intended to make a person leave social housing, this is not a genuine opportunity for improvement, and tenants will be discouraged from taking opportunities, or from thinking of themselves as being open to opportunities. This directly undermines the objective, set by *Future Directions* itself and now tasked to the review, of devising ways to reduce work disincentives in social housing, which we discuss in detail below.

¹³ These definitions are as given in *Future Directions*. According to *Future Directions*, assistance to the second group is not to come at the expense of the first (FD, p7).

¹⁴ See, for example, details on effective subsidies targeted on various sectors of the housing market via tax concessions and other forms of assistance, as quantified in: Kelly, J-F., Hunter, J., Harrison, C., and Donegan, P. (2013) *Renovating Housing Policy*, Melbourne: Grattan Institute

3. Review assessment criteria

Relevant questions:

3 Do you agree with our assessment criteria for the review?

4 Are some criteria more important than others and why?

Incentives for workforce participation

Clearly, this criterion is central to the review.

In any system of assistance targeted to socio-economic disadvantage, the level of assistance provided will be withdrawn as the recipient's income – particularly from work – rises and their need diminishes. It is inevitable that this withdrawal will reduce the rewards of work. How much of a work disincentive this will be is a function of the rate of withdrawal, and how it compounds with the withdrawal of other forms of assistance.

The income-related rents system used in social housing in New South Wales and other Australian states is such a system. Straightforwardly, social housing tenants paying 25 per cent of their household income in rent face an additional 25 percentage points on their effective marginal tax rate (EMTR).

At the same time, however:

- Income-related rents very effectively target subsidy to need, and can be supported by considerations of equity (i.e. contribution according to ability);
- Income tax and social security settings have a larger effect on EMTRs; and
- Research evidence shows similar persons have higher rates of unemployment when on the waiting list than when in social housing.¹⁵

This last point suggests two things: that the prospect of losing eligibility for social housing (under the tight income thresholds for eligibility to gain access) is a worse disincentive than rising income-related rents, and that the security and affordability of social housing helps some tenants get job-ready and into employment.

The particular problem in New South Wales is that public housing is beset with two additional policies with even sharper work disincentive effects.¹⁶

The first is the regime of higher rent rates for 'moderate income' tenants, by which the usual 25 per cent rate slides up to 30 per cent for households within a certain range of income defined as

¹⁵ Dockery, A.M., Feeney, S., Ong, R., Saugeres, L., Whelan, S. and Wood, G. (2008) *Housing Assistance and Economic Participation: National Research Venture 1*, AHURI, Melbourne.

¹⁶ For an extended version of this discussion, see Martin, C. (2016) 'Future Directions must address public housing work disincentives', City Futures Blog, 12 October 2016, <http://blogs.unsw.edu.au/cityfutures/blog/2016/10/future-directions-must-address-public-housing-work-disincentives/>

'moderate' by FACS Housing. Calling it a '25-30 per cent sliding scale' belies its work disincentive effect, because it is not a marginal rate that applies only to additional income in the moderate range (e.g. as progressive income tax rates do); instead, the moderate income rent rate applies to all the household's income, not just increases at the margin. Expressed as a marginal rate – which better represents the way people think about the costs and rewards of increasing one's income through more or better work – the rate is 45 per cent sliding up to 55 per cent over the moderate income range. Then it drops to 30 per cent past the top of the range.

In other words, if a tenant increases their income into the moderate range, on average half of the increase would go to FACS Housing in rent. The moderate income rent rate policy adds to EMTRs, on top of the usual 25 percentage points from income-related rents, another 20-30 percentage points. The marginal rate of income tax in the moderate income range is 32.5 percent – so moderate income households face EMTRs from these two factors of 77.5-87.5 per cent, with rent being the largest contributor.

This would weigh heavily on anyone's decisions about work. For some households, the policy affects other decisions about household composition too. For example, say a household includes a young adult child who is entering the workforce. Because the rent rate is determined by household income, the young person's wages can result in a higher rate of rent for all household members, including non-working parents whose income has not changed. This household is faced with decisions not just about work, but also about whether the young person can still live at home.

The second additional work disincentive comes from FACS Housing's periodic reviews of tenant eligibility to remain in public housing. Since 2005, all new public housing tenants have faced a review of their eligibility to continue in public housing every two, five or 10 years (coincident with the expiry of the fixed term of their agreement, which depends on FACS Housing's assessment at the start of the tenancy of the tenant's circumstances). If at review a household's income is above the top of moderate income range, FACS Housing will proceed to terminate the tenancy.

Particularly for households in Sydney, the income thresholds at which continuing eligibility is lost are well below the incomes required to affordably rent in the private market. A single person at the top of the moderate income range (\$988) will, in public housing, pay \$297 per week in rent (at the 30 per cent rate); in the private market, they would be looking at \$495 per week (median rent for two-bedroom units across Sydney) – equating to 50 per cent of income¹⁷. Even the lower quartile rent for such dwellings is currently \$400 – or 40 per cent of a gross income of \$988. Add to that the insecurity of private rental housing, and insecurity of employment, and it becomes rational – even wise – for a public housing tenant to knock back work opportunities in order to stay housed.

It appears that this is in fact what has happened under the post-2005 fixed term tenancies regime. As reported by the [NSW Auditor General](#), less than two per cent of tenants reviewed at the two-year period were found to be ineligible. The rate of exits from public housing has slowed since the introduction of these two policies 10 years ago – ironically, as part of a reform agenda aimed at moving employed tenants out of public housing.

¹⁷ NSW Government (2016) *Rent and Sales report 116 – Q2 2016* – rent table 4

In our view, therefore, the IPART suggestion that the income thresholds for continuing eligibility should be reduced is highly inappropriate. In our view, a much stronger argument could be made for the entire removal of the regime for reviewing continuing eligibility to remain in public housing. This would be a recognition that the system has yielded virtually no 'gains' in terms of enabling 'socio-economically mobile' tenants to be filtered out of the sector. More likely, it has simply compounded the work disincentive effect of income-based rents.

Affordability for tenants

This is clearly a well-justified review criterion. Unfortunately, however, the limitations on the review's scope make it difficult for the issue to be fully addressed.

This is because unlike, say, the Henry Review, the IPART remit does not extend to the social security settings under the control of the Commonwealth Government. In other words, the review cannot challenge the status quo principle that social landlords must effectively self-fund the gap between what tenants can afford to pay, on the one hand, and the cost of provision, on the other. The review therefore turns a blind eye to the Henry Review observation that the 'community service obligation' should be funded by the Government explicitly.

Simplicity for tenants

Again, a well-justified review criterion.

While income-related rents are simple in principle, in practice they involve systems for collecting and investigating information about incomes and household members that are burdensome and intrusive, and provision for the differential treatment of different types of income that is more complicated for tenants than a property rent model. However, income-related rents have an advantage in relation to ensuring affordability and adjusting responsively to changing household circumstances.

We note that 'simplicity for tenants' is another reason for rejecting the division of 'safety net' and 'opportunity' tenants with different rent models for each.

The review could usefully investigate ways in which the information requirements and assessment and compliance procedures of an income-related rent system could be streamlined.

Horizontal and vertical equity

Issues relating to the appropriateness of applying horizontal and vertical equity criteria to tenants alone, when owners and tenants have such different forms of support were raised in the housing needs and concepts and evidence section above. They can be illustrated by the example of older persons on the Age Pension. Those who are owner occupiers are generally protected from after-housing poverty because of their low housing costs; those who are private renters are more likely than not to be in after-housing poverty (and to lack security of tenure). Treating older social renters in the same way as private renters would have the same result.

On vertical equity, without a marked increase in the supply of social housing and/or subsidies provided to affordable housing, if the system responds primarily to those most in need of assistance, there is likely to be a growing cohort of households (in the low to moderate income categories) who will fall through the cracks. They won't be allocated a tenancy via a social housing wait list and the rent they can afford to pay will be inadequate to ensure financial sustainability for affordable housing providers (in part because the cost of providing housing is inflated by the land-value impacts of vertically inequitable tax subsidies to established owners and to landlords). While targeting assistance to those most in need is consistent with vertical equity principles, vertical equity is not consistent with providing assistance only to a subset of those in need.

Flexibility and choice for tenants

As recognised in the Issues Paper, the scope for choice is inherently limited under a system where resources are allocated administratively – according to assessed need – rather than through the market – according to ability to pay. The established direction of policy in favour of an even more tightly 'targeted' regime is at odds with a priority to maximise 'flexibility and choice' for tenants¹⁸.

The review could usefully investigate options for expanding choice by applicants and tenants in relation to allocations and transfers. In practice, a genuine expansion of choice would also require expansion and diversification in the social housing stock. In its final report IPART should strongly recommend a supply-focused strategy to tackle this problem.

Efficiency: allocative, productive and dynamic

Criteria as specified are narrowly defined. The role of social housing in improving the overall efficiency of the housing market should also be considered, particularly in light of shortages of private sector housing for low to moderate income households.

A well-functioning housing market is considered critical for labour mobility and efficient allocation of resources across the economy¹⁹. Shortages of affordable rental housing have problematic implications here, as low-wage workers are unable to live close to their jobs, or in areas of employment growth. This situation will make it more difficult for job seekers to respond to demand for labour outside their locality, and will impede geographic labour mobility. There are also concerns about security of tenure, due to short lease terms.²⁰

Conversely, poorly located social housing restricts tenant employment opportunities. Locational impact of where social housing is provided is also important. Youth unemployment, for example, is growing with concentrations in regions generally regarded as having more affordable housing than can be found in the larger capital cities.²¹ The impact that this has over time in entrenching disadvantage is likely to add to future pressures on the social housing system. Specifically regarding social housing rent models, under a market rent model the primary factor affecting market rents,

¹⁸ Fitzpatrick, S. & Pawson, H. (2007) Welfare Safety Net or Tenure of Choice? The Dilemma Facing Social Housing Policy in England; *Housing Studies* Vol 22(2) pp163-182

¹⁹ Productivity Commission (2014) [Geographic Labour Mobility](#); Melbourne: Productivity Commission

²⁰ Ibid

²¹ Ibid

both within the metropolitan region and between metropolitan and non-metropolitan regions, is location. Increasing use of market-related rents is therefore likely to result in the most disadvantaged households being forced to locate in areas where rents are cheapest. In the main, almost by definition, these will not be areas of high amenity. Efficiency criteria, and specifically dynamic efficiency criteria, need to take this bigger picture into account.

With regard to allocative efficiency *within* the social housing system, we note that the present regime of needs-based allocation results in an efficient use of the social housing stock, in terms of bedroom occupancy, relative to private market housing: social renters are, in fact, *less likely* to have one or more spare bedrooms than private renters (55 per cent and 62 per cent, respectively), and much less likely than owner-occupiers (86 per cent).²² It may be possible to drive further efficiency in the use of the stock through rent models that price the additional amenity of spare rooms, but associated implications would need to be considered: i.e. the corresponding need to allow applicants and tenants greater choice in allocations and transfers, so that they can respond to such price signals; and the acknowledged lack of smaller dwellings within the social housing stock.

In any event, as the Issues Paper rightly notes, the NSW Government has already introduced a ‘vacant bedroom charge’ policy²³ which – in our view sensibly – applies only when an underoccupying tenant has rejected a reasonable offer of (appropriately sized) alternative accommodation or has declined to register for such a move. The very modest number of cases where the VBC has been invoked is testament to the highly restricted availability of suitable small-size units within the social housing stock.

Impact on future demand for social housing

In relation to existing tenants, this seems to be the obverse of the ‘workforce disincentives’ criterion. That is, asking whether ‘demand for social housing’ could be further suppressed through making ‘continuing eligibility’ thresholds even more stringent – in the process, further dis-incentivising economic advancement among tenants subject to fixed term tenancy reviews. The idea that rent setting reforms could potentially affect demand to enter social housing seems curious; if this is meant to indicate interest in the idea that access eligibility income thresholds be reduced still further so as to ‘manage demand’, we submit that it should be rejected.

Impact on demand for other housing tenures and products

This criterion seems to be related to the aspiration voiced in *Future Directions* to enable or require social renters to transition into less heavily subsidised forms of housing – e.g. ‘affordable rental’. Again, this does not properly acknowledge that social renters may, under income-related rents, transition from deep subsidy to little or no subsidy without having to move house; nor does it acknowledge the shortfall in the supply of affordable alternative forms of housing. This is going to

²² ABS Housing Occupancy and Costs 2013-14, cat 41300DO001, table 14. We also note a significant error in the Issues Paper: the statement that there is ‘significant under-occupation [in social housing], with 30 per cent of properties having two or more spare bedrooms’ is an apparent mis-reading of the Auditor General’s report; this found that 30 per cent of properties *with three or more bedrooms* were under-occupied to that extent. This is equivalent to about 13 per cent of all properties.

²³ NSW FACS (2016) [Charging Rent Policy](#), 3 June 2016

become even more acute over the next decade as much of the portfolio constructed under the NRAS system reverts to market prices 10 years after its construction. This will involve up to 6,700 properties in NSW²⁴.

Impact on financial sustainability of the social housing system

The inclusion of this criterion will be welcomed by housing providers. All other things being equal it would probably militate in favour of a switch to a property-based rent regime where providers benefit from greater certainty about future revenues from a given property portfolio and tenants in need are assisted by government to pay the fixed rent. Again, however, it is highly problematic that the review remit is implicitly limited to considering different configurations of existing resource inputs. It should be able to comment on whether the quantum of these inputs is adequate, and on the case for proper Commonwealth Government recognition of social landlords' community service contribution as proposed by Henry (see above).

Impact on concentration of disadvantage

While this seems like a worthy issue to consider, it is hard to envisage how it might be affected by rent-setting system choices in the NSW social housing context. It is a defining characteristic of social housing that it breaks the link between socio-economic deprivation and poor (and therefore 'cheap') housing that existed historically. Any 'reformed' system of social housing rent setting that tended to reinstitute that situation would of course be undesirable.

²⁴ Australian Government (2016) [National Rental Affordability Scheme](#); Quarterly Performance Report June 2016

4. Eligibility and allocation issues

Relevant questions:

- 1 *How should the safety net and opportunity tenant cohorts be defined? Are there additional cohorts or sub-cohorts with distinct characteristics and needs?*
- 5 *Is it appropriate to more narrowly define the eligibility criteria for social housing to target people with the greatest need for this form of housing assistance? If so, how should the target group be defined?*
- 6 *What alternative assistance would be most effective for those applicants for social housing who meet the income threshold but do not have a priority need for housing?*
- 7 *Should people receiving housing assistance have their eligibility for assistance reviewed as their circumstances change? What criteria should be used?*
- 8 *What are appropriate transfer policy settings that take into account the principles of equity, and costs of transfers as well as the benefits?*
- 9 *Is the current income threshold for eligibility for public housing lease renewal set at the appropriate level? What are the pros and cons of reducing this threshold?*
- 10 *Is the order in which clients are currently housed appropriate?*
- 11 *Is the prioritisation policy the most efficient given the current supply/demand imbalance?*
- 12 *Are the current assistance measures sufficient or are there additional assistance programs that could be offered? How can the assistance measures be targeted appropriately?*
- 13 *Could the current suite of assistance measures be simplified?*
- 14 *Are there any other options for changes to eligibility, prioritisation and wait list policies that could be considered for this review?*

Evolution of approaches on social housing eligibility

Historically, eligibility for social housing was unregulated. The founding post war intergovernmental agreement (the Commonwealth State Housing Agreement) described social housing as for working families and returned servicemen and their families. Allocations were made on a turn waited basis and rents were based on historic costs. Additional assistance (a rent rebate) was provided for those on low incomes (e.g. widows and the elderly)²⁵. Eligibility criteria introduced from the 1970s were designed to target access to social housing to those unable to afford private housing. Accordingly income eligibility limits dating from that time were derived primarily from a metric of the 'widely adopted' level of income (usually 25-30 per cent of household income) that would be necessary for an applicant household to obtain appropriate market-priced housing in their region. Those with insufficient income were eligible to apply and wait for social housing.

²⁵ Yates, J. (2013) 'Evaluating social and affordable housing reform in Australia: lessons to be learned from history', *International Journal of Housing Policy*, vol 13:2, pp. 111-133

Subsequently, however, as demand exceeded supply by an increasing quantum, social housing income limits were rarely updated and jurisdictions increasingly have overlain a more complex (multiple criteria) needs-based assessment regime which aims to ensure that urgent housing needs (priority) are met first. In effect this means that clients meeting a set of specified criteria will have first access to available housing. In this respect the two tier system is self-managing. In low demand areas eligible households not in priority need can be allocated to vacancies. In high need areas²⁶ priority clients have precedence.

Further restricting eligibility

We cannot see any benefit in further restricting eligibility as it will not reduce wait times for priority clients; it will increase the cost and complexity of needs assessment; and, inevitably, it will lead to more people falling between the cracks. Applications for social housing also constitute an important and often-cited indicator of housing need, albeit an insufficient measure because it calibrates expressed demand only.

Additional eligibility restrictions may also have the perverse effect of requiring people's housing situation to worsen before they can even be considered for assistance (the so-called ambulance service model which militates against prevention and early intervention). At a system level, such a move would further concentrate the most vulnerable and needy clients in locations with high concentrations of public housing, which is both undesirable and ineffective in terms of promoting sustainable communities and adds to the service provision costs.

Continuing eligibility

Similar considerations apply to the question of continuing eligibility for social housing. As discussed above, removing the present regime of reviews of continuing eligibility would more consistent with the objective of reducing work disincentives; however, if this policy is to be retained, the thresholds should be based on a fair assessment of what alternative housing is available to meet the objective of providing affordable and appropriate accommodation. If an affordability test is going to be used (and noting the level of private rents in many regions), the income levels for ongoing eligibility must continue to be considerably higher than those currently applying to new entrants.²⁷ Otherwise governments will be destabilising tenancies (and implicitly de-incentivising tenants – see below) and placing exiting households in an unsustainable housing situation at a cost both to them and potentially to the wider human service provision system.

Noting how few social renters pay market rents (and the circumstances of some who do – e.g. as a result of the temporary presence of other income-earning household members), we consider very few of the present tenant cohort would be able to leave social housing satisfactorily via this means. An alternative positive approach would be to introduce shared equity opportunities for tenants who over time acquire some capacity to contribute equity to their housing. This has the dual benefit of

²⁶ It should also be noted that in the mid-2000s NSW introduced a locational needs test in high need areas such that applicants cannot elect to wait in designated zones unless they can establish a connection to the area.

²⁷ When continuing eligibility for NRAS was introduced, income limits were set at incomes about 40 per cent above entry eligibility levels.

being a revenue stream for providers and an incentive for tenants to gradually achieve a financial benefit from their housing.

Other assistance measures

While there is clearly a place for assisting tenants in the private rental market, we caution against additional scarce public funds being directed to rental subsidies for private tenants rather than investing in long term affordable housing supply. A summation of the extensive literature on this issue shows that:

- Demand side assistance in weakly regulated rental markets with low vacancy rates may actually inflate rents, pricing out low income households from well-located quality housing. Furthermore, demand assistance only assists those who have actually found accommodation and does not assist those households who are waiting for it.
- Experience of several decades of demand side strategies in Australia and elsewhere suggests government 'housing assistance' expenditure levels are higher than would have occurred with a more balanced mix of supply and demand side assistance.
- Providers of rental housing are typically small and accidental investors, oriented towards potential capital gains and taxation benefits, rather than to procuring a steady stream of income via rent revenue. Small scale private landlords tend to be unresponsive to rental market demand, selling when capital is required for other purposes and, for this reason, they make inherently insecure landlords²⁸.

Following extensive research on this issue, we consider that if governments want the private rental market to play a larger role in housing low and moderate income households the following dual approach will be required:

- Create a market for long term institutional investment in rental housing²⁹, as envisaged in the recently released report to the Council of Federal Financial Relations³⁰
- Provide an adequate subsidy to enable low income renters to access such long term rentals.

²⁸ Milligan, V., Gurrán, N., Lawson, J., Phibbs, P. and Phillips R. (2009) *Innovation in affordable housing in Australia: Bringing policy and practice for not-for-profit organisations together*, Final Report 134, Melbourne: AHURI

²⁹ Milligan, V., Pawson, H., Williams, P. & Yates, J. (2015) *Next moves? Expanding Affordable Rental Housing in Australia Through Institutional Investment*; Sydney: City Futures Research Centre

³⁰ Affordable Housing Working Group (2016) *Innovative Financing Models to Improve the Supply of Affordable Housing*; Report to Heads of Treasuries; Canberra: Council on Federal Financial Relations

5. Rent setting frameworks and options

Relevant questions:

- 15 Is a segmented rental framework appropriate for social housing? Could it also be applied to affordable housing?*
- 16 Should a tapered subsidy model be considered for social housing and affordable housing in NSW? If so, should it only apply to a segment of the tenant cohort?*
- 17 Should social housing properties be able to transition to affordable housing?*
- 18 Which specific rent model options do you prefer and why? Does a specific option work for all types of tenant or only a specific cohort? How do the different options contribute to the financial sustainability of the system? What further work is required on elements of the rent calculation, including subsidies, for each option?*
- 19 Do you think any of the rent model options are not worth assessing, and why?*
- 20 If an income-based rent model is retained, should the percentage of household income used to calculate social housing rent be changed?*
- 21 If an income-based rent model is retained, should payments such as Family Tax Benefits Part A and B be assessed at the same rate as income from other sources?*
- 22 If an income-based rent model is retained, should currently exempt income supplements be included in assessable household income?*
- 23 If an income-based rent model is retained, should income from work be assessed on an after-tax basis?*
- 24 If an income-based rent model is retained, what other possible improvements to the current rental model should we assess?*

Rent-setting: the necessity for balancing conflicting objectives

A social housing rent setting and eligibility framework prioritising workforce participation incentives inherently de-prioritises certain other objectives. It is not possible, for example, to set rents in accordance with capacity to pay by targeting assistance, while at the same time eliminating work disincentives. It may not be possible to charge similar rents to tenants with similar capacities to pay and, at the same time, to alleviate hardship. It is not possible to deliver housing assistance equitably to persons resident in different tenures when the different tenures are subject to different subsidy arrangements. A preoccupation with inequities between social tenants because of the very different implicit rent subsidies they receive ignores the fact that exactly the same inequities arise in the dominant owner-occupied market (between households who have benefited from unearned increases in property values and those who have not).

Thus, the approach taken to rent setting and eligibility rules requires a balancing of conflicting objectives. Whether or not current rent practices are efficient in achieving these conflicting objectives will depend on the relative importance attached to them. Any assessment of the impact of current rent setting practices, therefore, must be related back to these stated objectives, to any

other objectives which may have influenced rent setting practices, and to the relative importance attached to these.

Weighing up rent setting approaches and hybrid models

The standard Australian approach to rent setting in social housing focuses primarily on an affordability objective although, for many lower income households, the use of a 25 or 30 per cent ratio, high by historic and international standards³¹, does not ensure that housing is affordable (in the sense that households are protected from after-housing poverty). The strengths of the current (income-related) rent setting model in social housing are its (relative) simplicity; its vertical equity and its affordability compared with outcomes in the private rental market.

Proposals to move to market-related rents focus primarily on allocative efficiency and the presumption that price signals can be used to provide information on tenant preferences regarding affordability and dwelling size and location. The question of which is more appropriate will depend on the relative weights assigned to these two objectives (and on the more amorphous factors that need to be taken into account in determining what are the 'needs of the people').³²

Of the three different categories used to classify the eight rental models only the two hybrid models in section 6.2.3 recognise this trade-off, but even these do not recognise the possibility that many severely disadvantaged households face too many financial and non-financial constraints to enable them to make a choice between affordability and amenity.

The models in sections 6.2.1 and 6.2.2 focus entirely on affordability objectives and differ only in the way in which they define affordability. In the interests of ostensibly achieving allocative efficiency, the models in section 6.2.4 based on current market rents will have the same affordability outcomes as arise in the private rental market. Charging a market rent or market-related rent for social housing ensures that housing is allocated according to ability and willingness to pay. It does not provide any guarantee that housing is allocated according to need. Indeed, in the private rental market, a disproportionate share of affordable rental housing is occupied by moderate to high income households, and an extremely high proportion of lower income renters face rental stress in the private rental market even after CRA is taken into account.³³

The recognition of the need for supply and income-based subsidies in the proposed cost rent models suggests that further consideration of this model provides the most scope for ensuring that social housing can fulfil an objective of meeting the needs of those unable to access suitable accommodation in the private market. It is a cost rent approach that underpins many international social housing systems.

³¹ While much of North America uses the 30 per cent benchmark this includes the cost of utilities.

³² The working definition of allocative efficiency in the Review is that this "refers to resources being allocated to meet the needs of people."

³³ Hulse, K., Reynolds, M. and Yates, J. (2014) *Changes in the supply of affordable housing in the private rental sector for lower income households, 2006–11*, Final Report No.235; Melbourne: AHURI

Income assessment for rent-setting purposes

Assuming that income assessment remains an important component of rent-setting, issues arise around the precise framework. The consultation paper canvasses a number of reform options here. While not responding comprehensively, we would like to highlight a few considerations.

Gross or net income: In view of the profile of social tenants we think a move to net incomes would bring little benefit to the vast majority of tenants (whose incomes fall below tax free thresholds). Using net income would complicate assessment and is open to manipulation by some e.g. self-employed. To the extent that some tenants paid less rent revenues would fall.

Income of other household members (OHMs): The rationale for differential assessment of the income of OHMs should be considered in any changes in this regard. Rates applied, while increased over time, have generally been set lower than for primary tenant income, for several reasons:

- OHMs lack tenancy rights
- Increasing OHM housing costs may increase housing demand by encouraging household formation
- Many OHMs are carers of elderly parents or other relatives , thereby playing an important family support role, which may otherwise require public subsidy
- Requiring larger contributions from young adult children living at home may discourage their participation in education.

Assessment of specific payments: There is no doubt that different assessment rates applying to different sources or types of income add complexity and cost to the administration of an income-related rent system. However, past attempts by state governments to adjust income-related rents following changes in Commonwealth transfer payments have often been politically fraught. For example, in the past the Commonwealth opposed moves to collect additional rent (at the rate of \$1 in \$4) when transfer payments for children and the aged were increased. Another factor has been when payments were made for specific purposes (such as an energy supplement). Compromise deals are typically struck in this regard – this explains some of the complexities built into the current policy settings.