Tenants Queensland Inc

Rent Setting for Social Housing

A discussion paper on options and implications

Tenants Queensland Inc

December, 2012

December 2012

This paper was prepared and authored by Jon Eastgate and Helen Wallace of 99 Consulting for Tenants Queensland Inc.

Table of Contents

Executive summary 2

Introduction and Project Methodology 4

Discussion 5

Question 1: What are the options for calculating the maximum rent? 6

Question 2: What are the options for subsidising maximum rents for low income tenants? 8

Question 3: If rent is calculated as a proportion of income, what income and what proportion? 10

Question 4: Should rent be varied according to location or housing type to provide incentives for people to move to smaller housing or cheaper locations? 13

Question 5: How can social housing rents be set without creating disincentives for tenants to seek employment? 15

Question 6: How can rent setting deal with 'floating' family members such as the situation for many Aboriginal households? 18

Conclusion 19

References 21

Executive summary

This paper summarises the results of a brief Australian literature review into social housing rent setting policy issues and then analyses the pros and cons of the options identified.

It has been prepared for Tenants Queensland (previously known as the Tenants' Union of Queensland) as it considers how best to advise on and debate the merits of rent setting policies in the context of a social housing system that offers affordability but increasingly accommodates higher need households and therefore receives lower rental revenue to apply to an ageing portfolio that meets only a fraction of the demand.

As with most complex social policy matters, each choice includes some potential drawbacks, but solutions are in place elsewhere and could be implemented here in Queensland.

The paper assumes that the goals at the heart of a social housing system are:

- to offer affordable housing to those without other affordable options
- to offer social housing to those who need it in a way that is fair and doesn't discriminate against particular households types
- to calculate rents in ways that don't discourage tenants from improving their circumstances where that is possible
- to be a sustainable system with well-maintained stock in locations and forms that suit the needs of those seeking it.

Some of the most relevant conclusions from the literature are that:

- Australia is unusual among advanced countries in expecting the cost of rent subsidies to be met from the internal revenues of housing providers – in most countries these are met by an explicit subsidy paid either direct to the provider, or as an allowance to the tenant.
- Australia's current income-based system for calculating household rents is highly effective in delivering affordability, with very few social housing tenants in housing stress.
- A number of key problems have been identified with the current system, including:
    - its complexity and intrusiveness, with a variety of income sources and household structures treated in different ways which can lead to confusion by both tenants and social housing provider staff
    - a perception of unfairness because tenants on the same income pay the same rent for dwellings which differ substantially in size, location and quality
    - the potential of income based rents to provide a disincentive for tenants to seek paid work or to increase their income, as increased income leads to increased rent.

A number of solutions have been proposed to these problems in the literature. Some of these are worked out in some detail, while others are only described in outline and would require further development.

To some extent the complexity issue is inherent in any income-based rental system, and proposals to improve this appear to only marginally decrease the complexity. The growth of affordable housing options using a discounted market rent provides an option which is both simple and non-intrusive, but does so at the expense of guaranteed affordability.

A number of options have been suggested to address the issue of differing amenity. These include:

- the Industry Commission's proposal to calculate a subsidy for each household based on the average rent for a house that meets their needs, and then give tenants the option to choose a property with greater or lesser amenity at either greater or lesser cost to themselves;
- the option of charging a premium over and above the basic household rent for particular types of housing or locations to reflect a greater level of amenity.

To be effective, both these options rely on tenants having a fairly wide choice of housing options and easy access to transfers as their household needs change.

The question of work disincentives is made complex by the interaction between rent policy and the treatment of extra income in the tax and income support systems. This makes definitive policy directions quite difficult. However, a number of options are also proposed to address the potential disincentive for tenants to increase their income. These include:

- the use of "rent holidays" to delay any increase in rent for a period after income increases
- the use of a graduated withdrawal of subsidy, so that the main increases in rent occur as tenants' incomes increase substantially, rather than applying equally to marginal increases in income.

Further work is needed on this quite complex policy problem, but it appears that alternatives to our current system exist which can benefit tenants without putting further strain on the financial viability of providers.

Introduction and Project Methodology

Rent setting is one of the key elements of social housing policy. It determines the affordability of housing for its tenants, who are overwhelmingly on low or very low incomes. It is also the main source of income for the social housing provider, whether this be a State public housing authority or a community housing organisation.

A number of developments in social housing policy in Queensland and Australia have recently put rent policy in the spotlight.

- The trend towards increased targeting of social housing to high need households has placed increasing strain on the financial and human resources of social housing providers as they struggle to support higher need households while receiving reduced rental income.
- A push from the Commonwealth Government to transfer substantial amounts of public housing to community housing organisations has led to concern by tenants about potential changes and increases in rent.
- Long-standing concerns about the financial viability of public housing authorities have increased as a result of both falling rental income, and ageing stock in need of renewal.
- The recent concern by Queensland's new housing minister about under-occupation of public housing has spotlighted a perceived inequity in which tenants pay the same rent whether they are in a three bedroom house or a one-bedroom unit, leaving no incentive for tenants to move as their needs change.

The Tenants Queensland (TQ) has a mandate to advocate for social housing tenants in Queensland. Current debates in Queensland include a focus on possible changes to the method for calculating social housing rents to balance equity and affordability with an incentive to move as housing needs change. This paper aims to provide background to TQ's advocacy on this issue, providing a summary of the literature on social housing rent setting to help TQ ensure any advocacy is well grounded.

This paper draws on available Australian research (which includes comparisons with other countries' approaches to rent setting) to answer a set of seven key research questions. It does not involve any original research and is reliant on previously published sources. It should be noted that while we have attempted to use the most up-to-date research available, some of the best information is drawn from as early as 2003-2004, and hence some of the data on which it is based may now be out of date.

Discussion

Social housing rent policy in Australia serves the dual function of providing operating income for the housing provider (whether government or not-for-profit) and ensuring affordability for the tenant. These two core functions attempt to meet a number of different objectives. For tenants these include:

- ensuring a basic level of affordability, to prevent households from living in after-housing poverty
- providing incentives, or reducing disincentives, for tenants to return to work or increase their skills and income
- ensuring a level of fairness between tenants in the system
- providing a level of simplicity and transparency so that tenants are able to understand rent decisions and comply with the system's requirements.

For providers they include:

- ensuring a sufficient level of income to sustain the operation of the system, including rates, insurance, loan repayments, maintenance and administrative costs
- ensuring a sufficiently predictable income across the housing portfolio to be able to plan with confidence
- providing a level of administrative simplicity and transparency so that rent calculation is not unnecessarily costly
- assisting in the effective management of a housing portfolio.

There is currently considerable pressure for change in the system for calculating social housing rents in Australia. Much of this pressure comes from the declining revenue base of Australian public housing authorities, driven by increased targeting of social housing to high need households. Other pressures include:

- a perception that the current system is inequitable in that tenants on similar incomes receive different levels of subsidy depending on their location and housing type
- a perception that that the current system promotes inefficiencies in management by not providing incentives for households to move from under-occupied housing
- a perception that it provides a disincentive for people to enter the workforce.

In a presentation at the 2012 National Housing Conference, Professor Terry Burke of Swinburne Institute of Technology identified six objectives of social housing rent policy, as follows:

- tenant affordability/capacity to pay
- revenue generation
- horizontal and vertical equity
- efficiency
- transparency (i.e. can it be understood)
- participation (i.e. does the tenant have the opportunity to negotiate).

These objectives are often in tension – for instance, the need to generate revenue can be in conflict with the need to keep rents affordable.

Speaking from a housing provider perspective in the same forum, Alex Dordevic from the Department of Housing Services Victoria provided a slightly different list of principles for rent policy reform, as follows:

- simplicity

- affordability
- market signals
- equitable treatment of social housing tenants
- equitable treatment with low income tenants in the private rental market
- workforce incentives.

The history of social housing in Australia, and comparisons with other countries, show there are a number of ways to achieve these objectives.

This research project aimed to address seven key questions about social housing rent policy.

1. How do you calculate the maximum rent (tie it to the market or cost of provision)?
2. How do you subsidise it for low income tenants (calculate rent as a proportion of income, have a flat deduction on the market price, pay a rent subsidy direct to the tenant, some combination thereof)?
3. If you calculate on the basis of income, what income and what proportion?
4. Should you vary it for location or housing type to provide incentive for people to move to smaller housing/cheaper locations?
5. How do you ensure there is not a disincentive to increase income by seeking employment?
6. How do you account for 'floating' family members, for example in the Aboriginal community?
7. In general, what are the potential positive and negative implications for any approach, from a tenant perspective, housing provider perspective and wider housing program and systems perspectives?

The following sections address Questions 1 to 6, with Question 7 addressed as part of the discussion on each issue.

Question 1: What are the options for calculating the maximum rent?

Currently in Australian social housing there are two parallel systems for rent calculation. One is the calculation of the 'property rent' – that is, the maximum rent payable for any particular dwelling. The second is the 'household rent' – the actual rent to be paid by the household currently occupying the dwelling. Calculating the household rent is dealt with in Question 2 – this section deals with options for calculating the property rent.

Since 1978 Australian public housing authorities have used a market-based system for setting property rents, and similar systems are used in New Zealand and Canada (McNelis and Bourke). The precise methods used for calculating this 'market rent' differ between States. The cost and complexity of doing individual property valuations means that it is more often based on an average rent for the type of dwelling within a particular area, rather than a specific market rent for the individual property. The justification for moving to market rents in the 1978 Commonwealth-State Housing Agreement (CSHA) was couched around fair competition with the private rental sector and the provision of 'choice' for tenants (McNelis and Bourke).

The main alternatives to a market-based property rent are rent systems based on the cost of provision. This kind of system is used in a number of other countries including the United Kingdom, Germany and Sweden (McNelis and Burke) and as at 2011 was still used in NSW by many Aboriginal community housing organisations (Eastgate and Moore). There is a wide range of different methodologies for calculating a cost rent, including:

- the ‘historic costs’ approach which factors in the cost of acquiring the housing at the time of its acquisition along with current management costs
- the ‘current costs’ approach which is based on the cost of acquisition and management at current values
- approaches which base the cost around the acquisition of the specific dwelling, or average the costs over the geographical area or the whole portfolio.

Table 1 below provides a brief summary of the potential advantages and disadvantages of each of these three methods.

Table 1: Methods of Calculating Property Rents

Calculation method	Advantages	Disadvantages
Market-based rent	• Administratively simple overall • Provides fair competition with private sector • Easy to explain and justify	• May not reflect full cost of provision, especially in depressed rental markets and remote areas • Hard to calculate in areas where there is no effective market e.g. large public housing estates, remote communities
Historic cost method	• Reflects actual costs of provision	• Administratively complex and difficult to explain • Difficult to allow for replacement costs • May result in low maximum rents comparative to market, reducing incentives for better off tenants to move on
Current cost method	• Reflects the actual cost of provision in today’s terms and hence can include a replacement cost • Will move with inflation, avoiding artificially low rents	• Administratively complex and difficult to explain • Can potentially result in maximum rents above market level, particularly in remote areas where costs are high

Question 2: What are the options for subsidising maximum rents for low income tenants?

In practice, setting the property rent is a largely academic consideration for most social housing tenants. As at 2003, 89% of public housing tenants in Australia paid a subsidised rent rather than a full property rent (McNelis) and this is unlikely to have increased in the intervening years given the nation-wide shift to targeting higher need tenants.

The Australian system for setting these 'household rents' uses a proportion of household income as the basis for calculating the rent. In general, this proportion is 25%, but some forms of income are excluded from this calculation – for instance, family allowance and recent pension increases. (See Question 3 for further detail) This calculation is further complicated for community housing providers because the rent formula is designed to capture the highest possible rate of Commonwealth Rent Assistance (CRA). This system is quite effective in ensuring affordability and only 1.3% of low income households in public housing are in housing stress as compared to 47.5% of low income private renters (National Shelter).

While this is the predominant means of calculating household rent, a growing proportion of government-funded housing in Australia is rented on the basis of a 'discount to market'. This includes projects funded under the National Rental Affordability Scheme (NRAS) and housing provided under other State-based arrangements for what is generally loosely referred to as 'affordable housing'. The conditions of NRAS funding mandate a minimum 20% discount, and the most common approach from not-for-profit providers is to discount by 25.1% as this level of discount allows the rental to be considered 'charitable supply' for tax purposes.

Australia is unusual amongst advanced nations in that the cost of this reduced rent is expected to be met from the income of the housing authority or community housing organisation. As a result, the financial viability of social housing providers is placed at risk if they house tenants on the lowest incomes. This means that in practice Australian public housing authorities operate in deficit, in that rental income does not meet their costs of operation (Hall and Berry). Despite having lower rents per household than public housing, community housing organisations surveyed by Hall and Berry operated at a slight surplus, although Hall and Berry questioned whether some of this was due to underspending on certain aspects of property management. Community housing organisations have also expressed concern that the practice of linking rent payments to income makes their rental incomes unpredictable and hence makes it difficult to carry out any form of financial planning (NSW Federation of Housing Associations).

Other countries subsidise the rents of social housing tenants in different ways. In New Zealand, the USA and Canada, each of which have social housing portfolios of a similar scale to Australia relative to population, the household rent is set based on the household's income, and the difference between this and the cost of operating the housing program is made up through financial subsidies from the general government budget. In European countries including the UK, Germany, the Netherlands and Sweden, where social housing makes up a substantially larger proportion of housing, tenants pay the full property rent irrespective of their income, and low income tenants are eligible for housing allowances assessed and paid independently through the income support system. (McNelis and Burke)

In recent years most Australian states and territories have addressed this problem to some extent by shifting some of their housing to non-government housing providers. Tenants of these providers may be eligible for Commonwealth Rent Assistance (CRA) where tenants of state and territory housing departments are not, and this enables providers to charge slightly higher rents and improves their viability. However, CRA still falls short of the full cost of the social housing rent subsidy, and so does not provide a complete solution to the problem of viability.

Table 2 summarises the three main options and their potential impact on tenants and providers.

Table 2: Methods of Subsidy

Subsidy method	Implications for tenants	Implications for providers
Internal funding by provider	Advantages: • system provides affordability for them Disadvantages: • viability issues in the system can lead to deteriorating housing and poorer quality service provision • can be seen to limit choice and mobility as the subsidy may not be portable across housing tenures	Advantages: • encourages efficient operation and financial responsibility Disadvantages: • cannot ensure viability • financial disincentive to house higher need tenants
Direct subsidy to provider	Advantages: • affordability is preserved as above • a more viable system will improve the likelihood of better service delivery and housing quality Disadvantages: • still retains limits on choice	Advantages: • better financial viability • removes disincentive to house high need tenants Disadvantages: • could encourage inefficient practices • depending on the structure of the subsidy, could involve administrative complexity
Direct subsidy to tenants	Advantages: • if set at the right level, can ensure affordability • allows for choice and flexibility, especially if subsidy is able to be applied to any form of housing. Disadvantages: • subsidy may not keep pace with increases in housing costs • subsidy is ineffective if housing is not available	Advantages: • administrative efficiency – issue of assessing tenant income is shifted to another agency • predictable income • financial viability through charging full property rent Disadvantages: • depends on ability to collect rent from tenants • if the subsidy does not ensure affordability the result can be increases in rent arrears

Question 3: If rent is calculated as a proportion of income, what income and what proportion?

McNelis and Burke report that in the first Commonwealth-State Housing Agreement signed towards the end of World War 2, the maximum rent for a household was set at 20% of household income. This percentage was based on the 'Harvester Judgement' of 1908, which set the minimum wage by calculating a typical household expenditure and allowed 20% of the wage for rent or housing costs. In the years since, the proportion has gradually increased and has fairly consistently been at 25% since the 1990s.

This calculation is, however, quite complex in practice, as income from different sources is treated in different ways. In Queensland, while earned income and basic Centrelink payments are assessed at 25%, some types of income (including Pharmaceutical Benefits, Family Tax Benefit Part B and other special purpose payments) are excluded altogether, while others including Family Tax Benefit Part A and maintenance payments are assessed at 15%, and the income of extra household members under 25 is assessed at 10%. In addition, for tenants of community housing who are eligible for CRA this payment is assessed at 100% with rents set at a rate to attract the maximum possible CRA payments. The overall result is quite a complex calculation which relies on accurate information about the tenants' income from a wide variety of sources. (Department of Housing and Works fact sheet 'How to Work Out Your Rent', accessed 6 August 2012). The same situation applies with variations in other States and Territories. In a presentation at the 2012 National Housing Conference Alex Dordevic from the Department of Housing Services Victoria identified 30 different types of income that are not assessed for rent calculation. He estimated that depending on source and level of income, Victoria social housing tenants could pay anywhere between 14 and 25% of their income in rent, with those on the lowest incomes often paying the highest proportion of their income.

This complexity was identified by participants in the Australasian Housing Institute's series of workshops on rent policy in 2003. Participants raised a number of issues including the difficulty experienced by both staff and tenants in explaining the system, the administrative complexity of checking and verifying income, the rate of mistakes in rent calculations, the incentive for tenants to conceal income and to not declare all members of their household, and the practice of some public housing authorities at the time of backdating rent increases to the date the income increased, creating immediate arrears situations. Some community housing participants said the cost of assessing rents under this system outweighed the likely increase in rental income. However, participants were also well aware of its benefits, including its ability to consistently deliver affordability, its degree of certainty for tenants, its overall fairness and equity and its potential to reduce work disincentives if structured right.

The NSW Federation of Housing Associations examined variations on two approaches to affordability – the ratio approach, where rent is set as a fixed proportion of income, and the residual income approach, where rents are set at a level which allows households enough income after housing to pay for necessities. They suggest the best affordability outcomes can be achieved from a variation on the residual income approach which they term the 'budget standard', developed by the Social Policy Research Centre which identifies a 'standard' household budget based on the ABS Household Expenditure Survey and uses this as the basis for rent setting.

Table 3 provides a summary of the main options identified in the literature, and their potential implications for tenants and providers. The four key options are:

- the income ratio method currently used by Australian social housing providers, which calculates household rent as a proportion of their income
- the discounted market rent used in Australian affordable housing programs
- an income related rent revised to add a premium for more desirable properties. This could be done in a number of different ways – the example suggested by NSW Federation of Housing Associations involves varying the income ratio between 18% and 30% depending on the quality and location of the property
- a subsidy-related approach which calculates the maximum subsidy available to any particular household as opposed to their maximum rent payment –CRA is a form of this paid to private rental tenants.

These approaches can also be applied in combination. For instance, the Brisbane Housing Company (BHC) currently sets its rents at either 74.9% of market rent (the discounted market method) or at 30% of the income of a “typical” household eligible to occupy that dwelling plus the amount of Commonwealth Rent Assistance for which that household would be eligible. This method aims to strike a balance between ensuring rents are affordable, and providing a secure income stream for the housing provider. Incidentally, BHC also estimates that this level of rent provides them with a financially sustainable income and capacity for a modest level of borrowing to finance growth.

Table 3: Rent Calculation Methods

Calculation method	Implications for tenants	Implications for providers
Income Ratio Method	Advantages: • ensures affordability by gearing rent to income Disadvantages: • increases effective marginal tax rate as rent rises with income • complexity and intrusiveness • can be perceived as unfair as the same rent is paid for vastly different properties	Advantages: • ensures fairness and affordability for tenants • allows them to capture a proportion of extra income • provides incentive for tenants to move on if their income improves Disadvantages: • administrative complexity including enforcement issues • if high need tenants are housed, income will not meet costs - an incentive to house 'better off' tenants • income is unpredictable
Discounted Market Rent	Advantages: • rent is fixed and predictable • discount improves affordability • increased income does not result in increased rent • minimises intrusion by provider in household arrangements Disadvantages: • doesn't ensure affordability, especially for very low income tenants	Advantages: • income is stable and predictable • administrative simplicity Disadvantages: • rental income will not meet costs • unable to benefit from increased tenant income

Calculation method	Implications for tenants	Implications for providers
Income-related rent with ‘amenity premium’	Advantages: • can preserve affordability if the income ratios are still reasonable • greater sense of fairness from variable rents for different properties Disadvantages: • can limit options for lower income tenants and push them into undesirable locations – geographical segregation • could mean some properties are not affordable or some household rents fall short of affordability	Advantages: • encourages greater tenant mobility through price signals • allows increased earnings from more valuable/ expensive properties Disadvantages: • greater administrative complexity as both property and tenant assessments are needed • depending on the level, overall rental receipts may still not meet costs
Subsidy-related approach	Advantages: • if set at the right level, can ensure affordability • provides for increased choice – tenants can pay more for more amenity or less if prepared to compromise on housing quality Disadvantages: • danger the subsidy may not keep pace with inflation/may not ensure affordability • can retain the problems of intrusiveness and complexity • can retain the problem of high effective marginal tax rates	Advantages: • provides a clear limit on subsidy levels, increasing budget predictability • encourages greater tenant mobility through price signals • subsidy can reduce as income increases Disadvantages: • administrative complexity

Question 4: Should rent be varied according to location or housing type to provide incentives for people to move to smaller housing or cheaper locations?

One of the perceived drawbacks of the current Australian system for setting household rents is that a particular household pays the same rent irrespective of the type, quality or location of their home. This can be perceived by tenants as unfair, and can be seen as providing an incentive to under-occupy housing as there is no benefit to the tenant in moving to smaller housing as their needs change.

The literature we reviewed provided little evidence on this question. However a number of other countries do vary their rents by location. This occurs naturally in the European countries where tenants pay the property rent, as these rents are generally adjusted for the costs of providing different forms of housing in different locations (if a cost rent is used) or as a result of setting a market rent. By contrast New Zealand, the USA and Canada all set household rents based on household income, with no formal variation between locations or housing types (McNelis).

The providers surveyed by the NSW Federation of Housing Associations in 2006 rated a number of considerations in setting rent policy. Of these, 'Rents represent quality, location or amenity of dwelling' rated 11th of 12 in importance. Providers commented as follows:

> 'Some respondents felt that this option was antithetical to the basic idea of community housing, indicating that they felt it unreasonable that better homes be given to wealthier tenants. There was concern that this could increase stigma, and exacerbate marginalisation.
>
> Others felt that there was genuine possibility to empower tenants with choices, and that this approach satisfied requirements for equity and fairness for tenants. To keep properties affordable, it was suggested that a different percentage of income could be paid for different properties – between 18% and 30%. This was seen as having the advantage of making rents more equitable (for example inner city tenants would pay a higher rent to offset their savings in transport costs).' (pp22-23)

However, their discussion of options for rent policy includes two options for varying rent to take account of amenity:

- the use of a 'subsidy-related' approach which determines the level of subsidy a household should get, not the actual rent level, under which the actual rent paid would vary according to the level of the property rent
- the use of 'amenity pricing' which varies the household rent to take account of the quality of housing by adding a premium for certain types of housing.

A detailed example of the 'subsidy-related' approach is provided by the report of the Industry Commission's 1993 inquiry into public housing. Key features of their proposal were as follows:

- a 'standard rent' would be set for each household, based on the average rent of an appropriate dwelling for them (based on size) across the State or across a particular geographic area
- tenants would then receive a subsidy equal to the difference between the standard market rent and approximately 25% of their income, irrespective of the house they are actually in
- tenants would have a choice of potential public housing dwellings, and each would be valued at its individual market rent - their subsidy would be the same irrespective of the dwelling they chose, so if they chose a lower value dwelling they would pay less, if a higher value one they would pay more
- they suggest that the subsidy should decrease as income increases but that this should be 'non-linear' to reduce workforce disincentives
- they also suggest a small premium on the market rent (perhaps 2-3% extra) to reflect the security of tenure
- 'If tenants add significant value to their dwelling, such as through the addition of a carport, they would not pay a higher market rent for the greater amenity. Also, people with disabilities requiring support infrastructure would not have to pay a higher rent

because of the cost of providing the infrastructure. The standard market rent would be for housing appropriate to their needs.' (p 85)

They comment that to be effective, this system requires that tenants be given a wide choice of properties initially (at least four of different standards) and be able to transfer fairly easily. In the absence of such choice they suggest tenants should not be penalised and their level of subsidy be matched to the dwelling or limited dwellings on offer.

The 'discount to market' approach used in affordable housing programs also provides a way to reflect the value of the housing while still improving affordability – however the drawback of this approach is that it cannot guarantee affordability for the tenant. The mixed approach used by the Brisbane Housing Company (described on page 9 above) provides a way of ensuring a level of affordability for tenants while still varying rent in line with location and type of housing.

Question 5: How can social housing rents be set without creating disincentives for tenants to seek employment?

The potential for income-related rent systems to provide a disincentive for tenants to enter the workforce has been the subject of extensive research and policy discussion in the past decade. Put simply, the concern is that since increases in income result in increases in rent, this reduces the incentive for tenants to earn more. This question needs to be considered in the context of other policy areas, in particular the way the income security and taxation systems treat extra income.

Gavin Wood, Rachel Ong, Mike Dockery and Paul Flatau's 2005 study investigates this question by estimating two key figures for public housing tenants:

- the 'Effective Marginal Tax Rate' (EMTR), which measures 'the proportion of an incremental increase in private earnings that is lost through taxation and the clawback of government transfer payment'
- the 'Replacement Ratio' which calculates 'the proportion of disposable income that is 'replaced' when not employed, taking full account of taxes and transfer entitlements in each state'. (p 3)

This research involves a highly technical financial modeling exercise to estimate these two figures for a variety of hypothetical scenarios involving households receiving assistance through either Commonwealth Rent Assistance (primarily in the private rental market) and through discounted rents in social housing. They find that:

- Public housing rent setting methods have a substantial impact on EMTRs - in the hypothetical simulations, a removal of housing assistance results in a halving of the proportion of public housing tenants with EMTRs exceeding 60%.
- Part-time workers have particularly high EMTRs and are most prone to 'severe' poverty traps (EMTRs exceeding 60%).
- For the typical person not presently employed, nearly three-quarters of predicted income (from all sources) in employment is replaced by non-wage income from all sources.
- 77% of CRA (Family Payment) beneficiaries (those with dependent children) face Replacement Ratios exceeding 75%, as compared to 41% of public housing tenants and 20% of the CRA group without dependent children.

In summary, they found that while workers were not ‘trapped’ in poverty, as their incomes did increase as the result of work, the rates of marginal taxation and their reverse, the rates at which lost earnings were replaced by government payments, were very high which meant the incentive to work was not great. In their hypothetical examples this picture changed significantly if housing assistance measures were removed from the equation.

In a related report in 2008 using data from Western Australia, Dockery and colleagues examined the following questions:

1. How does the length of public housing tenure vary across socio-demographic groups and what are the main causes of exits from public housing?
2. How are the labour market outcomes of actual and potential public housing tenants affected by the rationing of public housing stock – that is, how are labour market outcomes influenced by the presence of a public housing wait list?
3. How does the labour market activity of those on the wait list change following transition into public housing?
4. For those in public housing, do public housing rental rebates depress labour market outcomes?

In relation to the second question, they found that the data did not allow the researchers to be sure as to whether a welfare lock (i.e. an incentive to remain on Centrelink payments) does or does not exist as a result of the rationing of public housing (i.e. the presence of a wait list). However, they found that ‘around one-third of wait-turn applicants later become priority listed during their time on the wait list. A very significant proportion of applicants thus appear to experience a major deterioration in their life circumstances of one form or another while they wait for public housing to become available.’ (p 70)

In relation to the third question, they found that overall, entry into public housing increased tenants’ likelihood of also entering employment. ‘…(T)hese figures represent an increased likelihood of being employed of 14 per cent at entry to public housing and 43 per cent during a tenancy. The employment rate increases by 25 per cent between entry to public housing and the most recent observation while in public housing. In this light, the change in employment rates following entry to public housing is of considerable magnitude.’ However, they attribute part of this increase to a likely ‘lock-in’ effect of being on the waiting list – in other words, while people are on the waiting list they hold off seeking employment to increase their chances of being allocated housing. ‘On this basis it appears that the increase in employment outcomes for tenants can be mostly attributed to the lock-in effect of the wait list. Notwithstanding this, the evidence still points to a small positive enabling effect arising from the stability of tenure and affordability offered by public housing.’

In relation to the fourth question, they found that the rate of exit from public housing and the ‘market rent’ or maximum property rent on a public housing property had a strong influence on depressing extra earnings – that is, the higher the market rent, the greater the maximum possible subsidy and the less incentive tenants had to increase their income and move on from subsidized public housing. An obvious example of this can be seen in towns where housing demand from the mining industry has radically increased average rents in the private sector. On the reverse side, economic independence has a significant impact on the likelihood of a household leaving public rental.

Their policy recommendations are not so much around changes to rent policy, as around greater linkage between housing programs and social and economic participation support, which may be particularly well-targeted toward people on a social housing wait list.
Both these reports present a relatively inconclusive direction for future rental policy. However, they do indicate that increases in rent are a significant factor in reducing the benefits of extra employment to the tenants and potentially provide a disincentive to enter the labour market or increase employment for those who currently work part-time.

The Industry Commission also examined this issue in some detail. They suggested the following approach:

> ‘Two conflicting objectives need to be balanced in order to determine an appropriate rate at which to withdraw assistance. First government must maximise the cost-effectiveness of public housing by targeting assistance to those most in need. Second they must minimise any income effect that would discourage those targeted from improving their situation.
>
> Pursuing a rapid increase in rent discourages the targeted low-income individuals from availing themselves of income increasing opportunities. At the very least the residual income they have for other expenditure ought to increase as income increases. Similarly, pursuing the second objective by adopting ‘too gentle’ a rate of rent increase would involve too many unintended payments. The implied trade-off must not be considered in isolation but only after taking into account marginal tax rates and the rate of withdrawal of social security benefits.’ (Appendix I, p220)

However, the Industry Commission did not spell out in detail how this would work.

Participants in the Australasian Housing Institute forums indicated that irrespective of the objective effect on their overall income, perception was important for tenants. If they believed they would be no better off when working then this would act as a disincentive, irrespective if the actual policy settings. This analysis dovetailed with their concerns about complexity discussed under Question 3 – because many tenants struggle to understand the rent formula it is difficult for them to estimate what will happen to their rent as their income increases, particularly where their earned income also impacts on a Centrelink payment.

Their discussion raised two possibilities for addressing work disincentives, also not worked through in detail:

- the use of ‘rent holidays’ or periods of grace before tenants’ rent increases in line with their income
- a ‘guaranteed affordability’ approach which aims to ensure that rent will always be affordable as income increases.

The fact that proposals for addressing this issue are at this level of generality across the board possibly suggests that the problem is fiendishly complex and extremely difficult to solve in practice.

Question 6: How can rent setting deal with ‘floating’ family members such as the situation for many Aboriginal households?

There are two perceived drawbacks of calculating rent as a proportion of household income which were mentioned in the literature we reviewed – its administrative complexity, and its intrusiveness.

McNelis lists administrative complexity as one of the drawbacks of an income-related rental system. He identifies five key issues related to this complexity:

- Do social housing workers and tenants understand how household rents are calculated?
- Administering income-related rents is time consuming.
- Confusion about what and when to pay as incomes change means a greater risk of arrears.
- Obtaining the necessary documentation for all household members to base calculations on can be difficult.
- To what extent does income-based rent calculating and arrears complicate the relationship between tenant and landlord?

On the subject of intrusiveness, the NSW Federation of Housing Associations found that organisations only rated this issue as moderately important, and saw it as a necessary tradeoff to achieving affordability. Some Aboriginal housing organisations have expressed a different view (Eastgate and Moore), seeing the level of intrusion in family arrangements needed for this type of system as culturally inappropriate. Options discussed in this context included the use of a fixed property rent, and the calculation of rent based only on the incomes of principal household members or on the basis of household type rather than individual income.

Participants in the Australasian Housing Institute workshops also commented on this issue, noting that in some Aboriginal communities a person may have a number of adults in the household but be culturally unable to collect extra rent from them. They commented on this issue more generally suggesting that where the income from extra family members is assessed at a high rate this can increase work disincentives for all family members, as well as leading to high levels of arrears where tenants are unwilling or unable to collect the extra rent from family members. As noted above they also commented generally on the complexity of the issue and the administrative difficulty of collecting and verifying income data.

Policy options to address this question include:

- using property or cost-based rents as is done in some Aboriginal organisations
- assessing ‘extra’ household members’ income at a lower rate, as is currently done for household members under 25 in the Queensland social housing system
- refraining from applying the extra rent for a period of time (for instance, 3 months) to exclude transitory household members from rent calculations.

Conclusion

Of the six research questions examined in this brief review, three issues stand out as the key to a fair and sustainable social housing rent system. These are summarised in this concluding section.

1. *How do you set the maximum rent the tenants pay?*

There are essentially two options in answer to this – basing a maximum rent on the cost of providing the housing, or basing it on the price the housing would fetch in the private rental market. Within these are two options are many questions of detail about methodologies for estimating cost or value and distributing it among properties. The predominant method in Australia at present is to set the maximum rent, at least notionally, at the market price of the dwelling. While important to the overall management of the system, this question is only of relevance to a small and decreasing proportion of tenants.

2. *How do you set the rent the tenants actually pay?*

Given that most social housing tenants are on low incomes and the purpose of social housing is to provide them with affordable housing, this is the key question for most tenants. From a maximum of 20% of household income in the immediate post-war years, household rents have gradually crept up to 25% of income. However, there is considerable complexity in calculating this because income from different sources and/or income for different purposes through the income security system is treated in different ways, some being excluded from rent assessment and some assessed at a lower rate.

This system presents a number of policy challenges including:

- how to make sure the system is transparent and easily understood and interpreted by tenants and staff
- how to make sure it is fair, providing equity between tenants and households
- how to structure rents so as to provide incentives for tenants to improve their income and employment situation, and to move to smaller housing as their household size decreases?

While these questions are complex, a number of options for responding to them have been explored over the years and are summarised in this paper.

3. *How to you pay for subsidised rents?*

The final question, given that approximately 90% of tenants pay less than full market price for their housing, is 'how do governments pay for the shortfall?' In Australia, uniquely amongst developed nations, this shortfall is largely expected to be met from within the social housing system itself. This expectation has become increasingly unrealistic as social housing has been targeted more and more to high need households. Other developed nations solve this in one of two ways – either by providing an explicit government subsidy to the social housing providers, reflecting the difference between the rents their tenants are able to pay and the cost of provision; or by providing the equivalent subsidy directly to the tenant, allowing social housing providers to charge tenants the full market or cost rent.

This brief review of the literature suggests that there are a number of shortcomings in the current approach to rent calculation. However, while the solutions to these shortcomings are not simple, they do exist, and could be put into practice for the benefit of both tenants and providers.

References

Australasian Housing Institute, *Rent Policy Issues, Directions And Options For Social Housing In Australia: Report From Practitioner Forums,* March 2004

Burke, Terry, *Setting Rent Policy,* presentation at the National Housing Conference, Brisbane, 2012

Dockery, Alfred Michael, Rachel Ong, Stephen Whelan and Gavin Wood, *The relationship between public housing wait lists, public housing tenure and labour market outcomes,* National Research Venture 1: Housing assistance and economic participation, AHURI Research Report No. 9, August 2008

Dordevic, Dr Alex, *Setting rent policy – a policy perspective,* presentation at the National Housing Conference, Brisbane, 2012

Hall, Dr Jon and Professor Mike Berry, *Financial outcomes of Community Housing Organisations*, AHURI Research and Policy Bulletin ISSUE 110 March 2009

Hall, Dr Jon and Professor Mike Berry, *Operating deficits and community housing: policy options for reversing the trend,* Australian Housing and Urban Research Institute AHURI RMIT Research Centre, January 2009, AHURI Final Report No. 126

Hall, Dr Jon and Professor Mike Berry, *Operating deficits and public housing: policy options for reversing the trend: 2005/06 update,* October 2007 AHURI Final Report No. 106

Industry Commission, *Public Housing, Volume 1: Report and Volume 2: Appendices*, Report No. 34, 11 November 1993

Lawson, Julie and Vivienne Milligan, *International trends in housing and policy responses,* Australian Housing and Urban Research Institute Sydney Research Centre, December 2007, AHURI Final Report No. 110

Meyer, Kathy and Samantha Evans, *Setting Rent Policy*, presentation at the National Housing Conference, Brisbane, 2012

McNelis, Sean and Professor Terry Burke, *Social Housing Rental Policy in Australia and Overseas,* AHURI Research and Policy Bulletin, Issue 75 June 2006

McNelis, Sean and Terry Burke, *Rental systems in Australia and overseas,* Australian Housing and Urban Research Institute Swinburne-Monash Research Centre, April 2004, AHURI Positioning Paper No. 74

McNelis, Sean, *Rental systems in Australia and overseas,* Australian Housing and Urban Research Institute, Swinburne Institute for Social Research, June 2006, AHURI Final Rep No. 95

NSW Federation of Housing Associations, *New trends and models in rental income,* April 2006

NSW Federation of Housing Associations, *Taking stock of stock transfers: sector based review of the tenanted stock transfer program*, June 2007

Wood, Gavin, Rachel Ong, Mike Dockery and Paul Flatau, *Housing assistance programmes and their contribution to poverty and unemployment traps,* AHURI National Research Venture 1:Housing Assistance and Economic Participation Research Paper 1 July 2005.