

# Rental Policy: Financial Viability or Affordability in Australian Public Housing<sup>1</sup>

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## Abstract

*Hall and Berry (2004) in Operating Deficits and Public Housing: Policy Options for Reversing the Trend highlight the financial crisis facing public housing in Australia. One way in which policy makers can respond to this crisis is by increasing rents. But are such increases justified?*

*This paper locates the current dual rental system within the Australian social housing finance system, comparing it with finance systems operating in other countries. It will show that financial viability is the objective of the social housing finance system. As such it is not an objective of social housing but it is a necessary prerequisite for the functioning of social housing and the ongoing achievement of the objective of social housing.*

*The paper will also explore the relationship between affordability and the objective of social housing. It will argue that this objective is 'to ensure that all households have access to housing which is adequate and appropriate as a key component of an equitable standard of living'. While affordability is not an objective of social housing, it is a key indicator of whether social housing is achieving its objective and thus integral to social housing.*

*On this basis, the paper argues that there can be no trade-off between financial viability and affordability. It concludes by proposing a solution to the current financial crisis.*

## Introduction

Rental policy is a constitutive element of social housing and critical to the achievement of its objective, along with eligibility/allocations policy and the supply of housing stock.

Since the early 1940s Australia has adopted dual rental systems, with one rental system determining the property rent<sup>2</sup> and another rental system determining the household rent.<sup>3</sup> New Zealand, Canada and the United States also operate a dual rental system but with variations in their property rental system and their household rental system. On the

<sup>1</sup> This paper is based on some prior research which was funded by the Australian Housing and Urban Research Institute.

<sup>2</sup> A property rental system determines the rent for a dwelling. They include historic cost, current cost, market and market-derived rental systems (McNelis, 2005).

<sup>3</sup> A household rental system determines the rent according to the household occupying a dwelling. They include income-related, subsidy-related and flat rental systems (McNelis, 2005).

other hand, most European countries only operate a single property rental system, usually a cost-rent system

Hall and Berry (2004) in *Operating Deficits and Public Housing: Policy Options for Reversing the Trend* highlight the financial crisis facing public housing in Australia. At the same time, many tenants are struggling to pay even reduced rents. Rental policy, then, poses a major challenge for social housing providers. Do they raise rents and ensure their financial viability, or do they provide housing at affordable rents? Do they trade off affordability for financial viability? Why has this trade-off become an issue for Australian public housing when it isn't an issue for many other countries? What directions should rental policy take?

These are the questions that this paper aims to address. It seeks to throw some light on a range of complex issues in order that we find a resolution to this dilemma facing public housing in Australia. The paper begins by putting the issue in an historical context. It then distinguishes two dimensions of rent: the aggregate of rents which relates to the financial viability of a social housing organisation (SHO), and individual rents which relate to affordability and equity for tenants. The paper locates the Australian rental system within a broader social housing finance system and briefly compares this with those operating in other countries. It seeks to develop our understanding of affordability and equity in relation to the objective of social housing. Finally, it proposes one policy response to the current financial crisis.

## **An historical perspective**

The current financial crisis facing public housing in Australia as outlined by Hall and Berry (2004) is not new. Such crises have been a recurrent feature since State Housing Authorities (SHAs) were established in the early 1940s. These emerged as public housing progressively became more targeted in a context where Commonwealth and state governments provided funds for capital purposes through the Commonwealth-State Housing Agreement (CSHA) but expected SHAs to operate on a self-financing basis.<sup>4</sup>

The traditional response has largely seen a change in rental policy and marked increases in rents as the Commonwealth government, state governments and SHAs ensured the financial viability of public housing by trading off affordability on the basis that new rent arrangements were equitable (see, McNelis, 2001, 2004). The following briefly outlines the recurring financial crises within public housing in Victoria and then discusses equity as the basis for these changes.<sup>5</sup>

## ***Recurring financial crises and their resolution***

### **1945 establishment**

The 1945 CSHA established a dual rental system: a property rent based upon the costs of each dwelling or project (a dwelling-based historic cost-rent system), and a household

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<sup>4</sup> This illustrates Hayward's (1996) description of the involvement of Commonwealth and state governments in public housing as 'reluctant landlords'.

<sup>5</sup> The following outline is based on a study of rental policy in Victoria (see, McNelis, 2001). For the most part, however, it broadly reflects changes in rental systems throughout Australia.

rent with a rent-to-income ratio of 20% (lower for those on very low incomes). The Commonwealth provided loans at concessional rates. On this basis, they envisaged that SHAs would be largely self-sustaining. However, the Commonwealth and state governments agreed to share any cash losses which were expected to be minimal because the cost of constructing dwellings was determined with reference to a rent equal to 20% of the basic wage.

### Mid-1950s

Throughout the early 1950s, approximately 10% public tenants received minimal rental rebates. Despite increases in operating costs, rents on dwellings remained unchanged from the time of their acquisition due to rent controls and the anticipated political backlash if public housing rents were increased. Construction costs increased substantially and, as a result, cost-rents generally rose above 20% of the basic wage.

Thus, in the mid-1950s Housing Commission Victoria (HCV) had its first financial crisis. The Victorian government rejected a request to cover their increasing losses. Despite the loss-sharing arrangement between the Commonwealth and the states under the 1945 CSHA, the Commonwealth strictly enforced the provisions of the CSHA and rejected a request for funds.<sup>6</sup> To resolve their financial crisis, HCV progressively introduced a range of measures:

- In 1955, after a major inquiry and a royal commission, HCV adjusted the rents of all tenants to reflect the real, rather than estimated, costs of each dwelling/project as well as increases in the costs of maintenance, rates and administration
- At the same time, they introduced 'vacancy rents' whereby tenants moving into dwellings were charged a higher rent reflecting their real costs
- The terms of the 1956 CSHA allowed HCV to shore up its financial position by selling public housing<sup>7</sup>
- In 1963 HCV introduced rent averaging, a form of historic cost-rent whereby the ongoing costs of public housing were covered by distributing rents among tenants based upon the type and size of dwellings, rather than upon when a particular dwelling was constructed. It also included the cost of rental rebates. The objective was to ensure that rental revenue was sufficient to meet the cost of both outgoings and rental rebates. Thus, as rental rebates increased, so too did rents (see, Jones, 1972).

### 1970s

The 1970s saw the end a long period of economic growth in Australia. The income profile of public tenants changed as social conditions changed, with a higher incidence of unemployment and single parent families. HCV suffered substantial losses as the cost of rental rebates increased dramatically and could no longer be sustained through increases in rents.

<sup>6</sup> Only a couple of states received funds under this 1945 CSHA loss-sharing arrangement.

<sup>7</sup> It was only later that this purpose was overtaken by the state government's commitment to owner-occupied housing and HCV's interest in the construction of new dwellings and in urban development.

The states strongly argued that rental rebates were a Commonwealth responsibility. As a stop-gap measure, the Commonwealth provided them with an additional grant of \$1.25 million each year over five years. However, the Commonwealth did not accept the states' view on rental rebates. The long-term resolution of this crisis saw the introduction of a national market-related rental policy in the 1978 CSHA and this allowed the states to continue with annual rent increases.

### **1980s**

The optimistic expectations of both the Commonwealth and the states that market-related rents would produce significant surpluses (to fund new housing stock) were not realised. The cost of rental rebates continued to rise.

In response, one measure proposed by a Commonwealth-State Working Party on Financial Viability was partly adopted in 1984 and then fully in 1989 (after further work by the National Housing Policy Review): the Commonwealth provided CSHA funds as grants rather than concessional loans, reducing the cost of debt in the long term. Despite a return to current cost-rents in the early 1980s in some states, property rents continued to increase in real terms. Along with the change to grants, the 1989 CSHA introduced an opportunity cost on capital into the current cost-rent formula, forcing further increases in property rents.

Two financial propositions underpinned the 1989 CSHA. First, by utilising grants rather than loans, SHAs would continue to acquire new stock rather than have future CSHA funds eaten up by loan repayments. Second, grants did not impact on the costs of capital and it was anticipated that SHA rental revenue would be sufficient to meet operating costs (administration, rates, insurance and maintenance).

During the early 1990s, property rents progressively increased in real terms until they reached market levels. Where current cost-rents or other rental formulas had been introduced in early 1980s, they were abandoned and market-derived rents were formally adopted by most SHAs.

### **1990s**

The 1990s saw two interrelated problems emerge, both of which undermined the financial viability of SHAs. First, the deteriorating condition and quality of public housing stock required urgent action. Second, even tighter targeting resulted in a further decline in rental revenue per dwelling (see, Hall and Berry, 2004).

SHAs adopted two strategies to shore up their financial viability. First, increasingly, they allocated CSHA funds towards the cost of upgrading and redeveloping existing stock rather than acquiring new stock, such that nearly all CSHA funds are now allocated to meeting the cost of past debts (to the Commonwealth) and the cost of upgrading/redevelopment of existing stock. They now face the prospect of having to sell stock in order to refurbish other stock.

Second, with property rents at maximum levels, SHAs now focused on household rents and increased the rent-to-income ratio from around 20% to 25%. In addition, they have significantly increased the rent-to-income ratio for other residents living with the

tenant and earning an income. For example, in Victoria this has increased from 10% to 25% over the past decade.

### ***Equity and changing rental systems***

Changes in rental systems have been justified by an appeal to equity, but to different notions of equity.

#### **1940s: historic equity**

The dwelling-based historic cost-rent system established *historic equity* between public tenants and owner-occupiers acquiring or renting housing at a particular point of time. For example, if an owner-occupier and an SHA purchase the same type and quality of dwelling in the same location and raise a loan with similar terms and conditions, the housing costs of the owner-occupier and the rents of the public tenant will be similar over the life of the loan.

#### **1960s: internal equity**

Rent averaging established a larger cost-pool and distributed rents according to a limited number of factors – the type of dwelling (whether house or flat) and the number of bedrooms. This system achieved *internal equity* between public tenants while maintaining some elements of *historic equity* between public tenants and owner-occupiers. It achieved *internal equity* because public tenants in the same size and type of dwelling paid the same rent whereas, under the previous rental system, rents varied according to when the dwelling was purchased. But rent averaging also maintained some elements of *historic equity*. Equity between public tenants and owner-occupiers was achieved for the stock as whole. Rather than a dwelling by dwelling comparison at the time it was acquired, the pooled historic cost-rent system compared the whole stock of dwellings. The costs of each dwelling continued to follow the same pattern as an owner-occupier purchasing at the same time. However, the benefits of the ownership of stock were spread throughout the rental pool.

#### **1970s to 1990s: market equity**

Rent averaging did not sufficiently differentiate between the location, quality and type of housing stock: it only partly took account of the differences in housing services received by each tenant. The market-related rental system (late 1970s), the current cost-rent system (early 1980s) and the market-derived rental system (early 1990s) took into account a larger number of factors by introducing *market equity* but in different ways.

Under the current cost-rent system, *market equity* involved equity between public tenants based upon the capital improved value of each dwelling. It was only with the market-related rental system that *market equity* involved not only equity between public tenants but also equity between public tenants and private tenants. The introduction of market-related rents made a decisive break with *historic equity* between public tenants and owner-occupiers. No longer were rents based upon their historic costs but rather on market rents (and their current market value). *Market equity* shifted equity from

comparability of public tenants with owner-occupiers to comparability of public tenants with private tenants.

### **1990s: subsidy equity**

Market-derived rents highlighted both the differences in subsidies between public tenants and between public tenants and private tenants: public tenants can pay the same rebated rent for dwellings with markedly different property (market-derived) rents; public tenants received higher (nominal) subsidies than private tenants. Rather than focusing on the rent paid by public tenants, the focus shifted to the subsidy they received and whether the relative level of subsidy is equitable, i.e. *subsidy equity*.

*Subsidy equity* has driven recent changes in the rental rebate formulas where the rent-to-income ratio for rebated rents has increased from around 20% of income to 25% of income on the grounds that it would reduce the difference in subsidy between public tenants and private tenants. A more radical version proposed by the Industry Commission (1993) sought to abolish rebated rentals altogether, with public housing tenants receiving a subsidy based on a benchmark rental for a standard dwelling.

The focus on *subsidy equity* marks a fundamental conflict within public housing rental policy. *Subsidy equity* focuses on the level of subsidy paid to a household, rather than on the outcome achieved or the capacity of tenants to pay rent or *outcome equity* (Yates, c. 1994).

Changes in rental policy and increases in rents have played a significant role in maintaining SHAs' financial viability. On the other hand, they have had a marked impact on public housing outcomes.

First, the increase in the rent-to-income ratio from less than 20% for low income tenants to the current 25% raises a question as to whether public housing is still affordable.

Second, the increase in property rents and the shift from one property rental system to another has also involved a shift in the notion of equity – from equity between public tenants and owner-occupiers, to equity between public tenants, to equity between public tenants and private tenants.

These changes raise important questions. What is affordable housing? What are equitable rents? How do equity and affordability relate to one another? How do they relate to the objective of social housing? If we are to address the current crisis in financial viability facing SHAs, how can we make changes while at the same time ensuring that social housing continues to meet its objective? Do we have to compromise this objective and trade off affordability for financial viability? Indeed, what is the objective of social housing and how does rental policy contribute to this?

### **The rental system within the social housing finance system**

The purpose of a rental system is to determine a rent. It is constituted by a unifying principle or set of principles and those interrelated processes that are relevant to the determination of this rent. Different rental systems are based on different principles, but we can distinguish two dimensions: individual rents paid by tenants, and the aggregate of

these individual rents. The latter is the subject of this section while the former is the subject of the next.

A social housing finance system consists of two parts: the production and holding of housing as an asset, and the ongoing provision of housing services or rental operations. These are interrelated insofar as capital for the production or acquisition of housing can be raised in various ways and each of these has a different impact on rental operations.

The business of SHOs is the management, maintenance and replacement of its housing stock. Thus ongoing costs include administration, maintenance, rates and insurance, asset utilisation<sup>8</sup> (the cost of paying for or replacing the current dwelling as it is 'used up') and the costs of capital. The interrelationship between rental operations and capital operates through the impact of the costs of capital on ongoing costs. The costs of capital reflect the outcome of different capital arrangements (types of capital, instruments, conditions, terms and rates of interest). These capital arrangements thus introduce an historical element into the costs of capital.

Different types of subsidies also operate within a social housing finance system: income subsidies paid to the tenant for general purposes, rent subsidies paid to the tenant, rent subsidies paid to the SHO, subsidies paid to the SHO to reduce ongoing costs, and subsidies paid to the SHO to reduce the cost of capital.

A social housing finance system, then, consists of four primary elements: rent, subsidies, ongoing costs and capital. The purpose or objective of a social housing finance system is to ensure the financial viability of social housing. The particular characteristics of each of the elements can vary from one social housing finance system to another. Yet within each system, these elements have a determinate relationship with one another such that the system is financially viable. A change in one element requires a change in one or more of the others. Financial viability is the fulcrum around which the other elements operate. At a minimum, it requires that SHO rent is equal to or greater than net ongoing costs (net of any subsidies provided to ongoing costs).

The Australian public housing finance system is outlined below and compared with other social housing finance systems overseas.<sup>9</sup>

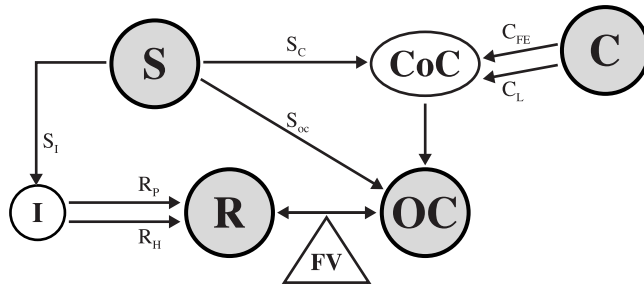
### ***Australian public housing***

The starting point for the Australian public housing finance system, around which the other elements are built, is the rental system. As illustrated in Diagram 1, rent takes two forms: a property rent ( $R_p$ ) and a household rent ( $R_H$ ). The property rent is a market-derived rent. The household rent is an income related rent with a rent-to-income ratio of 20 to 25%. The predominant form of rent is the household rent which is paid by around 90% of tenants. Moreover, the level of household rents largely depends upon the income profile of tenants, most of whom are in receipt of Centrelink payments or income subsidies ( $S_i$ ). Rent, then, is severely restricted because Centrelink payments are relatively low.

<sup>8</sup> Asset utilisation is imprecisely referred to as 'depreciation'.

<sup>9</sup> McNelis (2005) outlines in more detail the different social housing finance systems operating in New Zealand, the United States, Canada, the United Kingdom, the Netherlands and Sweden. As illustrated in the diagrams in this paper, this type of analysis focuses on the functions of the each of the four elements rather than on their specific institutional arrangements.

Diagram 1: The public housing finance system in Australia



- |                          |  |
|--------------------------|--|
| I = Income               | S = Subsidy  |
| R = Rent                 | $S_1$ = Subsidy paid to tenant for general purposes  |
| $R_p$ = Property rent    | $S_{oc}$ = Subsidy paid to SHA to reduce ongoing costs (allocation of CSHA funds)                                |
| $R_H$ = Household rent   | $S_c$ = Subsidy paid to SHA to reduce the cost of capital (allocation of CSHA funds to meet some debt repayment) |
| OC = Ongoing costs       | C = Capital  |
| CoC = Cost of capital    | $C_{FE}$ = Free equity   |
| FV = Financial viability | $C_L$ = Loans  |

Currently SHAs acquire new stock by utilising CSHA grants or free equity ( $C_{FE}$ ), a form of equity which does not require SHAs to provide a financial return to an ‘external’ equity holder and so does not impact on the cost of capital.<sup>10</sup> Prior to the 1989 CSHA, however, SHAs acquired stock using a mixture of loan funds – concessional loans from the Commonwealth government, state government loans and commercial loans ( $C_L$ ). The cost of capital is the cost of repaying principal and interest on these accumulated debts. SHAs can and do meet some or all the cost of capital by allocating CSHA funds, i.e. insofar as CSHA funds are allocated to this purpose, they are a subsidy to the cost of capital ( $S_c$ ). SHAs also meet some of their ongoing costs, in particular the cost of major upgrades, refurbishments and redevelopment of stock, by allocating CSHA funds, i.e. insofar as CSHA funds are allocated to this purpose, they are a subsidy to ongoing costs ( $S_{oc}$ ).

How then do SHAs achieve financial viability? They can only achieve do so by allocating CSHA funds to ongoing costs. By receiving them as grants, SHAs allocate them as subsidies towards the cost of capital and the cost of replacing/refurbishing existing stock. Only then can any remaining funds be allocated as capital for the acquisition of new stock and, as grants, this form of capital does not increase the cost of capital within rental operations.<sup>11</sup> They remain financially viable as long as the remaining ongoing costs can be met by rent.

<sup>10</sup> Some jurisdictions such as Queensland may have a requirement to pay an equity return to Treasury, but this is a notional rather than actual requirement.

<sup>11</sup> If SHAs utilised loan funds for capital purposes, then their ongoing costs will increase (as the cost of capital increases) and they require additional subsidies to achieve financial viability.

### *A comparison with other social housing finance systems*

Some features of the Australian public housing finance system are unique. This can be illustrated by a brief comparison with the systems operating in other countries: New Zealand (see, Thorns, 2000), the United Kingdom (see, UK. DETR, 2000a, 2000b), the United States (see, USA. HUD, 2003), Canada (see, Sewell, 1994; Ditch et al., 2001), the Netherlands (see, Milligan, 2003; Ditch et al., 2001) and Sweden (see, Ditch et al., 2001).

#### **New Zealand, United States and Canada**

**Rental systems:** The common feature between the New Zealand, United States and Canadian social housing finance systems is that they, like Australia, have adopted a dual rental system with a property rent and a household rent. The property rental system varies from country to country, with New Zealand operating a market-derived rental system, Canada a discounted market rent, a ‘low end of market’ (LEM) rent or a market rent, and the United States a flat rent system based on market rent. The household rental systems also vary in relation to either or both their rent-to-income ratio or the income basis for assessing their rents: New Zealand and Canada have 25% as their rent-to-income ratio whereas the United States has 30% (see, McNelis and Burke, 2004).

**Capital arrangements:** New Zealand and Canada use some mixture of ‘free equity’ and loans. In Canada, the mixture is driven by a particular property rent outcome that they want to achieve. In New Zealand, the mixture is determined by the overall equity:debt ratio they want to achieve. The United States, like Australia, funds acquisitions from free equity in the form of federal grants. These different capital arrangements impact on the level of ongoing costs that rent has to cover.

**Subsidies:** In both New Zealand and Canada, subsidies take the form of rent subsidies paid directly to the SHO, with the level of the subsidy being the difference between the property rent and the household rent. In the United States, subsidies take two forms: a rent subsidy paid directly to the SHO with the amount based on the difference between a benchmark for operating costs determined by the federal Department of Housing and Urban Development (HUD) and the household rent, and a subsidy to the SHO to reduce ongoing costs (for major refurbishment of dwellings).

In all three social housing finance systems, SHOs receive rent subsidies based on the difference between the household rent and the property rent or the cost benchmark. Financial viability depends upon whether property rents (in New Zealand and Canada) and the benchmark costs and refurbishment grants (United States) can cover the ongoing costs of providing social housing. This contrasts with the Australian public housing finance system where SHOs charge household rents (with rent revenue dependant upon the income profile of their tenants) and are expected to meet their net ongoing costs (reduced by subsidies to both the costs of capital and to ongoing costs for major refurbishment).

### **United Kingdom, Netherlands and Sweden**

The United Kingdom, the Netherlands and Sweden have adopted a single property rental system based broadly upon the ongoing costs of providing social housing. A major driver of these costs is the capital arrangements where free equity either in the form of government grants or internal reserve funds is combined with loan funds. A rent subsidy is also paid to the tenant (who pays the property rent) or directly to the SHO. In the United Kingdom, for some tenants, the rent subsidy is the equivalent of the property rent. In the Netherlands and Sweden, the rent subsidy or housing allowance is based upon a variety of factors such as household type and size, rent, household income and number of children (see, McNelis and Burke, 2004).

Again, SHOs in all three social housing finance systems operate on the basis of property rents which are broadly determined in relation to the ongoing costs of providing social housing. Moreover, the decision about rent subsidies is separated from the decision about the rental system.

The function of rent (as an aggregate) within a social housing finance system is to cover the ongoing costs of providing housing. An SHO is financially viable where it has sufficient rent revenue to meet both the short- and long-term ongoing costs of providing social housing, but the nature of both rent and ongoing costs varies from one social housing finance system to another.

The preceding analysis focuses purely on the social housing finance system. It has not considered any of the objectives of social housing. The purpose of the social housing finance system is to achieve financial viability for the SHO by balancing the interrelationship between four core elements of a social housing finance system: rent, ongoing costs, capital arrangements and subsidies. While a range of factors enter into the determination of these four core elements, financial viability is a function of a social housing finance system. No doubt financial viability may be an objective of an SHO but it is not an objective of social housing. On the other hand, unless social housing is financially viable, then SHOs cannot continue to achieve the objectives of social housing. Unless social housing is financially viable, SHOs cannot continue to provide social housing and ultimately this results in the demise of social housing. But financial viability is not an objective of social housing; rather, it is a necessary prerequisite for the achievement of this.

### **Rent and the objective of social housing**

Affordability and equity are often regarded as objectives of social housing. The achievement of affordability and equity are related to rent paid by a tenant. This section seeks to explore these relationships. It begins by asking about the objective of social housing and then discusses the relationship between this objective, rent and both affordability and equity.

#### ***The objective of social housing***

For most of us, social housing has a range of objectives (see, Bramley, 1991; McNelis, 1992). We can list them. We can differentiate between the objectives of different parties (tenants, SHOs, governments etc.). Depending upon our perspective, we can rank these

objectives, giving some a higher priority than others. We may even accept that governments are the major sponsors of social housing and that their objectives (changing with different parties and with different times) are **the** objectives.<sup>12</sup>

Such an approach assumes that one among a whole range of parties has the capacity to impose their objectives and priorities upon the whole system and that other parties are powerless in the process. An alternative approach is one which takes as its starting point the multitude of social and economic processes involved in the provision of social housing. The objective of social housing orders and structures these various processes.

Social housing comprises an interrelated set of processes or systems<sup>13</sup> among which are:

- As outlined above, a **finance system** which relates different financial transactions – capital and operating – with processes for determining ongoing costs, with processes for determining rents and with processes for allocating subsidies, and whose overall purpose is to ensure the financial viability of social housing
- An **eligibility/allocations system** which relates specific characteristics of applicants with the processes for determining who is eligible for social housing, the processes for determining their priority and the processes by which dwellings are chosen or allocated to applicants
- A **housing acquisition system** which relates a standard of housing with the processes for raising of capital funds, the processes for determining these standards and the processes by which land and dwellings are acquired
- An **asset management system** which relates a standard of housing with the processes for maintaining that standard, the process for bringing dwellings up to that standard and the processes for deciding whether and when to upgrade, demolish or dispose of dwellings
- A **property management system** which relates an ongoing standard of maintenance and repair of properties with the processes whereby they are maintained
- A **tenancy management system** which relates management of tenancies with processes whereby tenants and staff can interact and processes whereby tenants rights are ensured etc.

Each of these systems, consisting of many processes, has its own specific objective. However, each achieves this within the larger context of social housing and the achievement of social housing objectives. Social housing cannot be reduced to one or other of these systems, nor can it operate properly if one or other of these systems fails. Each must not only achieve its specific objective but also contribute in some way to the achievement of social housing objectives. Such objectives cannot be achieved at the expense of these

<sup>12</sup> In discussing the objective of social housing, it is important to distinguish between the objectives of the SHO (the institution through which social housing is realised) and the objective of social housing itself as outlined below.

<sup>13</sup> By a 'system' is meant a scheme of recurrence which has its conditions for emergence and survival. Thus, the scheme is not closed; rather, the occurrence and recurrence of the scheme is subject to a probability of emergence and a probability of survival. See Lonergan (1957, p. 118 ff.) and, in relation to private property, Melchin (2003).

specific system objectives. Rather, these social housing objectives can only be achieved in ways which are consistent with the specific objective of each system. For example, the specific objective of the finance system is financial viability. Unless this is achieved, then the SHO cannot continue to provide social housing – it would just go out of business.

What then draws all these different systems together in such way that they constitute social housing? It is the answer to this question that is the objective or purpose of social housing. What draws these various systems together into a single purpose is the following:

*The objective of social housing is to ensure that all households have access to housing which is adequate and appropriate as a key component of an equitable standard of living.*

Five points can be noted about this objective. First, it incorporates the unique features of social housing distinguishing it from housing broadly. It incorporates a synthesis of the various systems and processes that constitute social housing without superseding or destroying them. However, it is an interim not definitive formulation – it will be subject to ongoing refinement, development and even re-formulation. It is not arbitrary for it has its basis in understanding the functioning of social housing and what brings this functioning together. It does not look forward to some future goal and is not externally imposed. Rather, it is commensurate with the internal systems of social housing.

Second, it allows for a developing appreciation for what is incorporated in the key terms, adequate and appropriate. ‘Adequacy’ refers to the standard and quality of the housing relative to community standards as they evolve and the general standard of living improves. ‘Appropriate’ can incorporate a varying number of elements such as the relationship between the size of the dwelling and the number of occupants, the type of housing and security of tenure, its location in relation to industry, the style of its management, the concentration of social housing in particular areas, linkages with other support services, the relationship between neighbours (social cohesion) and the relationship to employment (workforce incentives).

Third, this objective of social housing remains constant regardless of the particular and shifting objectives of the different participants. Without it, social housing would collapse or become something else. These particular objectives of participants are legitimate and can be supported provided that they are consistent with the objective of social housing. They are not legitimate if they undermine this objective. So tenants can use social housing to meet their particular housing preferences. Governments can use social housing to ensure equitable subsidies between households as well as the efficiency and transparency of social housing and the subsidies it provides.

Fourth, this formulation of the objective refers to an ‘equitable’ standard of living. Equity is a complex term. It refers to the fair distribution of opportunities and rewards. It can also refer to the relationship between organisations and their clients. Equity is closely connected with social equality and equality before the law. Equity is often the basis for government policies both in housing policy and in other areas, e.g. equity is used as the basis for the allocation or distribution of many government subsidies. As used in the formulation of the objective of social housing, it incorporates a standard of living which is comparable among all households. As such, it is the principle of equity that provides the

guide for determining what is adequate and appropriate housing at any time and place. As incorporated into the objective of social housing, equity is primarily an issue of the standard of housing. Equity as the level of rent paid for this housing is a secondary issue.<sup>14</sup>

Finally, this formulation of one objective does not include some characteristics of social housing which have often been regarded as objectives, particularly in relation to rental policy, viz. financial viability, affordability and equity. We have already noted that the purpose of the social housing finance system is to ensure the financial viability of social housing and as such it is not an objective of social housing but rather a specific objective of one system within the whole. The question to which we now turn is the relationship of affordability and equity to the objective of social housing and the relationship between affordability and equity.

### ***Rent and the objectives of social housing***

As outlined above, equity enters into the objective of social housing as a standard of social housing (adequate and appropriate) comparable with a standard among all Australian households. A rental system determines the rent (or price) paid for this comparable standard of housing. In relation to a household's income, this rent seeks to be affordable and equitable. This section seeks to unravel the complex relationship between affordability, equity, rent and the objective of social housing. It does so in stages exploring the mechanisms by which affordability is achieved, what we mean by affordability, and the relationship between rent, affordability, equity and the objective of social housing.<sup>15</sup>

### **Achieving affordability**

Different social housing systems achieve housing affordability for tenants in different ways. Diagram 1 outlined the social housing finance system in Australia. Within this system, public tenants are charged either a property rent ( $R_p$ ) or a household rent ( $R_H$ ). They receive no rental subsidies ( $S_R$ ) to assist with paying this rent. In Australia, then, whether public housing is affordable is determined by the rents that are charged. Property rents determine the maximum rent a tenant pays for any particular dwelling but the relationship between the income of the tenant and the rent charged is determined by the formula used to determine household or rebated rent. Insofar as this rent is for a dwelling which is adequate and appropriate as well as affordable, public housing in Australia achieves its primary objective.

But the formula for household rents is no guarantee that the rent is affordable. Indeed, the benchmarks for both property rents and household rents have changed considerably over the past 50 years. Further, while affordability concerns individual households, the rent-to-income ratio is usually applied across the board to all households. While rents are adjusted according to the income of each household, the rent-to-income ratio is common across all households with some variations, for example, in Australia

<sup>14</sup> As suggested in this discussion, equity is subject to various meanings and to disputes as to its proper meaning (see, Flood and Yates, 1987; Hicks, 2000; Rawls, 1973; Sen, 1987). This, however, is not the place to explore more rigorously its use and abuse, its role as the basis for public policy, whether it is an adequate basis for public policy and how it relates to other bases for public policy.

<sup>15</sup> The use of the term 'affordability' in this paper differs from its use in the term 'affordable housing' which has emerged in recent years. The use of 'affordable' in the term 'affordable housing' is more akin to our use of the term 'equity' where the rent is commensurate with the income of the tenant.

some income is exempt from assessment and also a different rent-to-income ratio applies to child-related payments.

New Zealand, the United States and Canada also rely upon the rental formula for household rents as the mechanism to deliver affordability to social housing tenants. Each has a different rent-to-income ratio: 25% in New Zealand, 30% in the United States and different ratios in Canada varying between the not-for-profit sector and the public housing sector, as well as between provinces.

In the United Kingdom, social housing tenants pay a property rent. For some, a housing subsidy to tenants, known as housing benefit, meets the full cost of their housing. For others, a part housing benefit meets some of the cost of their housing. Other tenants are not eligible for housing benefit and must meet the cost of their housing from other income sources. For the latter two groups, whether their housing is affordable depends upon the scope and structure of housing benefits. This includes such elements as eligibility criteria, the points at which the housing benefit begins to taper, the taper rate and the take-up rate. For those tenants who are not in receipt of any housing benefit, whether their housing is affordable depends upon the level of property rents.

Social housing tenants in the Netherlands, Sweden and Germany pay a property rent and those on low incomes receive some form of housing subsidy as the mechanism for achieving affordability. This varies according to household type, the level of rent and the level of income of the tenant. Social housing is affordable then insofar as the housing subsidy is sufficient.

### **What is affordability?**

Different countries use different mechanisms to achieve affordability, but is it actually achieved? Indeed, what do we mean by 'housing affordability'?

In Australia, the traditional approach is that housing is affordable when a tenant pays less than a specified proportion of their income on rent. Housing affordability is regarded as a function of income and a rent-to-income ratio. In this view, the debate tends to focus on whether that ratio should be 20% or 25% or 30% of a tenant's income. Under this approach, housing is regarded as affordable when the rent-to-income ratio is struck in such a way that a household has sufficient income to meet its other non-shelter household costs. Burke (2003) characterises this approach to rents as a non-shelter-first approach and contrasts it with a rent-first approach where SHOs set rents in such a way that their revenue is sufficient to maintain their financial viability.

The non-shelter-first approach recognises the centrality of housing costs in achieving a minimum standard of living and that it is often housing costs which undermine this achievement. It implies that social housing will play the primary role in assisting households to achieve a minimum standard of living – social housing will ensure that a household's income is adequate by reducing the cost of housing to such a point that this minimum standard can be achieved. Further, it indicates that SHOs have primary responsibility for tenants achieving this standard of living and that this is a priority even though the SHO will not collect sufficient revenue to remain financially viable.

On the other hand, a shelter-first approach implies that social housing will play a secondary role in assisting households to achieve a minimum standard of living. SHOs will charge the rent they require for financial viability, and whether the household achieves

the minimum standard of living depends upon the adequacy of a household's income. Further, it indicates that SHOs have a primary responsibility to ensure their financial viability and to provide adequate and appropriate housing, but are not responsible for whether tenants have adequate incomes to achieve a standard of living.

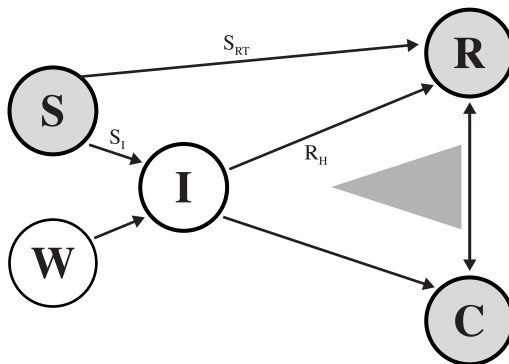
But this traditional measure of housing affordability is inadequate. It does not take into account other costs of living and assumes that housing is a priority. We cannot talk about housing affordability without taking into account these other costs of living. It must be addressed in the larger context of a minimum standard of living with adequate and appropriate housing as one component.

Saunders et al. (1998, p.4) in their discussion of a minimum standard of living define a budget standard as 'what is needed, in a particular place at a particular point in time, in order to achieve a specific standard of living'. In this context, the rent-to-income approach is not relevant. It doesn't matter whether rent is 20% or 30% or 40% of income. What is relevant is whether a household has sufficient income to achieve a minimum standard of living. Income is the means by which a minimum standard of living is achieved, and thus the budget standard is a measure of the capacity of a household to achieve this standard of living. It is not a measure of whether a household has achieved this standard.

As illustrated in Diagram 2, housing affordability is not simply a function of income and household rent (as assumed by the rent-to-income ratio approach). Rather, it is a function of the complex interaction between three elements:

- A tenant's income
- A tenant's rent (as the cost of one component within a minimum standard of living)
- The cost of the remaining components within a minimum standard of living.

Diagram 2: Affordability and the capacity to achieve a minimum standard of living



S = Subsidy

$S_I$  = Subsidy paid to tenant as income for general purposes

$S_{RT}$  = Subsidy paid to tenant as a rent supplement

W = Work income

I = Income

R = Rent

$R_H$  = Household rent

O = Other (non-housing) living costs

The overall goal is the achievement of a minimum standard of living. One of the critical components of this standard of living is housing. It is critical because it has the capacity to undermine the achievement of this standard of living. While households may have sufficient income to achieve this standard, particular housing situations can undermine it. The key difficulty is the variability in the cost of housing (rents) according to the location, size, type, style and materials etc. To some extent, the cost of some of the other components such as transport will offset the cost of housing (see, King, 1994). This points to the complex relationship between the elements of affordability. In this larger context, a more sophisticated measurement of housing affordability is required.

Within this context, measures of housing affordability can play a critical role as an indicator of whether the cost of housing is undermining this standard of living. Housing affordability operates within the framework of a budget standard. The measure of affordability is a function of income, the cost of housing (rent) and the cost of other components within this budget standard. Housing is affordable when a household has sufficient income to meet both the cost of housing and the cost of other components of a standard of living.

Two interrelated points are made here. First, that housing affordability can only be understood in the context of three elements: income, the cost of housing (rent) and the cost of the other components of a minimum standard of living. Second, that housing affordability is not a component of a standard of living. Rather, it is a measure of the capacity of households to achieve this standard. It is not an objective in itself but rather a measure or indicator of the capacity of households to achieve a minimum standard of living. As such, affordability is not an objective of social housing, but rather an indicator as to whether a minimum standard of living is being achieved and the extent to which the cost of housing is undermining the achievement of this standard.

### **Rent, affordability, equity and the objective of social housing**

The objective of social housing is to ensure that all households have access to housing which is adequate and appropriate as a key component of an equitable standard of living. Social housing is equitable when it provides a standard of housing which is comparable to that provided for the community as a whole. This is the primary meaning of equity. Equity in relation to rent and subsidies is a secondary meaning.

The brief history of the recurring financing crisis and their resolution through changes in rental policy justified on the basis of equity highlights the complexity and variations in the meaning of equity. It can vary by two particular characteristics:

- The scope of equity – whether it applies to all households or is limited to some households, i.e. equity between public tenants and owner-occupiers, between public tenants and private tenants, and among public tenants. Further, we can note the narrowing of the notion of equity over time
- The measure of equity – whether it is measured on the basis of outcomes or on the basis of subsidies.<sup>16</sup>

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<sup>16</sup> Given these varying meanings, how do we decide among them? Why would one meaning take precedence over another? What does equity mean in the context of housing policy? These are larger, more difficult questions beyond the scope of this paper. However, what it has done is indicate something of the complex relationship between equity and housing policy.

The practical implementation of equity is complicated by:

- The preferences of households which can vary by location, style, quality and size of dwellings, with consequent variations in the standard of living
- Variations in house prices and capital gains which reflect the historical and current preferences of a particular set of households – those with the financial capacity for effective demand

The differential impact of different subsidies, e.g. the capital required by SHOs to acquire new stock is higher than it otherwise would be because of dominance of owner-occupiers in the marketplace and the taxation subsidies they receive.

Whatever the complexities within the notion of equity, we can at least note that it relates the standard of living of one household with that of other households. Policies based on equity recognise the stratification of society, the extent to which different households and different groups have different standards of living, and that payments for these standards of living may vary according to a household's capacity to pay. On the basis of equity, rents will be commensurate with a household's income.

Rent, on the other hand, is affordable when the tenant can achieve a minimum standard of living. Affordability, then, is 'absolute' in the sense that it relates a household to a minimum standard of living. It would seem that affordability is a specific sub-set of equity where affordability relates to a minimum standard of living within a community, while equity relates to the comparability between those households who have already reached this minimum standard. Equity operates at a level above a minimum standard of living and is concerned with comparability between households.

Thus affordability has priority over equity. It is only when affordability is already achieved that issues of equity begin to be considered. As an indicator of whether a minimum standard of living is achieved, affordability has priority over equity.

### **Affordability and financial viability**

A finance system is one of a number of systems that constitute social housing. Rent as an aggregate is one element of a social housing finance system. As such, rent has a particular role within the social housing finance system – its function is to meet the ongoing costs of providing social housing. The social housing finance system can be analysed and understood without reference to the objectives of social housing. Its function is to ensure the financial viability of social housing. Rather than being an objective of social housing, it is a necessary prerequisite for the ongoing provision of social housing and the continued achievement of its objective.

Both the rental system and the finance system are specific elements within the larger context of social housing. Within this context, rent has another role, a role in relation to the achievement of the primary objective. Affordability is a key indicator as to whether social housing is achieving this primary objective. Equity, on the other hand, is the basis for determining what is adequate and appropriate housing and for determining a property and household rental system where tenants pay a rent commensurate with their capacity

to pay (compared with other households). Without affordability (and equity), we do not have social housing.

Neither affordability nor financial viability is an objective of social housing. Yet both are necessary to social housing. While there is a tension between financial viability and affordability, there can be no trade-off between them.

The propensity for Australian public housing to trade-off affordability for financial viability arises because Australian public housing seeks to mesh two aspects of rental policy within one decision, viz. the decision about household rents. Household rents have to achieve two objectives: the purpose of social housing (providing adequate and appropriate housing at an affordable price), and the ongoing financial viability of social housing as the necessary prerequisite for the continued achievement of the above purpose.

In other countries, these are dealt with in separate decisions (though they may be linked). In the United States, financial viability is a function of the adequacy of the cost benchmarks as determined by HUD. In most other countries, as outlined above, it is a function of the adequacy of property rents. While affordability in New Zealand, Canada and the United States is a function of the household rental system and internal to processes of SHOs, in most European countries it is a function of a decision regarding the level of rental subsidies to be provided to households. Such a decision is external to SHOs and places the responsibility for affordability in the hands of governments.

This highlights a unique aspect of Australia's social housing finance system.

### **Policy response: financial viability and affordability**

Once again, the Australian social housing finance system is in crisis. The solutions of the past five decades have not addressed its fundamental problems.

The social housing finance system does not stand alone and there is a range of possible responses. It achieves financial viability in the context of other systems that constitute social housing. Diagram 3 further expands Diagram 1 of the public housing finance system in Australia and illustrates the broader connections with these other systems.

#### ***Eligibility/allocations***

Rent links with the eligibility and allocations system. But as access to social housing is restricted to particular income groups and priority is given to households with the lowest incomes, an increasing proportion of households are paying household rents, and as their average income decreases so too does average household rent.

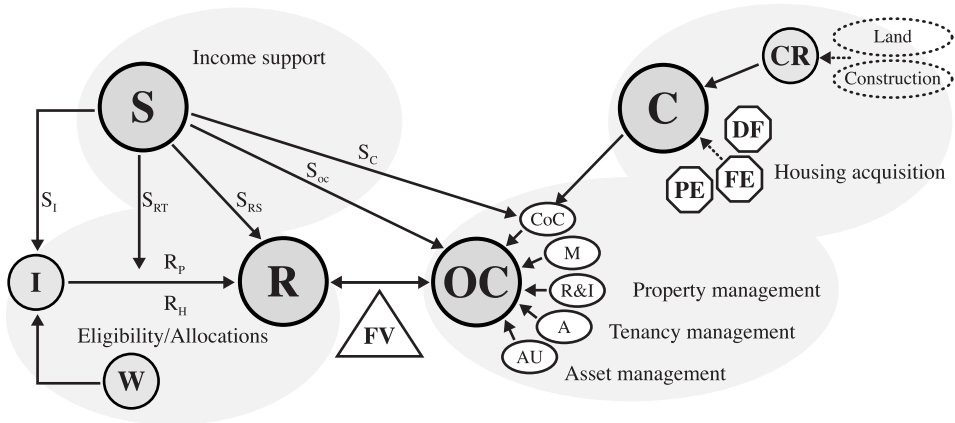
But the critical issue for the financial viability of social housing is not these two factors, but rather that too many of those paying household rents are paying rents which do not cover the ongoing costs of providing public housing.

As the household rental system is a function of income, the lower the average income of tenants, the lower the level of aggregate rent. In this way, the eligibility and allocations system plays a significant role in the financial viability of social housing. Thus one option to ensure financial viability is to:

Option 1:

*Manipulate the eligibility and allocations system and allocate housing to households with higher incomes using one of two strategies: either segment allocations such that a specified proportion of stock is allocated to one or more higher income groups, or allocate stock in such a way that an average household income profile is maintained.*

Diagram 3: The social housing finance system and its links with other systems within social housing



R = Rent  
 R<sub>p</sub> = Property rent  
 R<sub>H</sub> = Household rent  
 OC = Ongoing costs of providing housing  
 CoC = Cost of capital  
 M = Maintenance  
 R&I = Rates and insurance  
 A = Administration  
 AU = Asset utilisation  
 FV = Financial viability

S = Subsidy  
 S<sub>1</sub> = Subsidy paid to tenant for general purposes  
 S<sub>RT</sub> = Subsidy paid to tenant as a rent supplement  
 S<sub>RS</sub> = Subsidy paid to SHO as a rent supplement to compensate for reduced rental revenue  
 S<sub>OC</sub> = Subsidy paid to SHO to reduce ongoing costs  
 S<sub>C</sub> = Subsidy paid to SHO to reduce the cost of capital

I = Income  
 W = Wages, salaries and other sources of income  
 C = Capital  
 CR = Capital requirement  
 DF = Debt finance (including borrowings, bonds and debentures)  
 FE = Free equity  
 PE = Private or other equity

**Ongoing costs**

Ongoing costs link to the costs of tenancy management, asset management and property management, as well as indirectly to housing acquisition through the cost of capital. The proper operation of each of these systems with their particular objectives makes particular demands on the public housing finance system. Each has its own dynamics. Each has its own imperatives. Each has its own standard for measuring whether it is achieving its specific objective. Each is necessary for the functioning of social housing. Each is necessary for social housing to achieve its primary objective. Ongoing costs are a function of the cost of each of these systems but one option to achieve financial viability is to:

## Option 2:

*Reduce the ongoing costs of public housing by increasing its efficiency (where efficiency means achieving the same or better standard for each cost area but at less cost).*

The issue here is whether any efficiencies can be made without compromising the specific objective and standard of each of these systems.

**Capital**

Capital links with housing acquisition, the capital required to acquire adequate and appropriate housing, and the different sources and conditions for capital finance. Already public housing acquisition is funded through ‘free equity’ and so does not impact on the cost of capital. The extent to which housing acquisition can contribute to financial viability is limited to:

## Option 3:

*Forgive past debt.*

**Subsidies**

Subsidies link income support and broader government policies which redistribute income and provide other services at a particular cost to tenants. An assessment of overseas social housing finance systems indicates that the Australian public housing finance system could achieve financial viability in one of three ways:

## Option 4:

*Adopt the European model of providing housing subsidies (at higher levels than current Commonwealth Rent Assistance ) with SHAs charging property rents only.*

## Option 5:

*Adopt the New Zealand model where Housing New Zealand is subsidised the difference between household rents and market-derived rents.*

## Option 6:

*Adopt the US model where public housing authorities are subsidised the difference between the aggregate of household rents and agreed cost benchmarks.*

On the other hand, it is likely that the Australian social housing finance system will be characterised by three features: capital arrangements based on free equity in order to minimise the cost of capital, subsidies to the cost of capital to meet the cost of past loan arrangements, and rental revenue based predominantly upon household rents.

Any future change requires some clarity in relation to the cost of asset utilisation:

first, a realistic determination of its cost; second, a determination as to how this will be met. The current situation where CSHA funds are used for both capital purposes as well as to plug gaps in ongoing costs (asset utilisation) is unsatisfactory. A stable financial system requires a separation between capital funds and operating subsidies, with the latter taking account of rental revenue. Such a separation can only occur where households are paying rents which cover the operating costs and asset utilisation costs of providing social housing. To ensure that these rents are affordable, tenants will require sufficient income to achieve a minimum standard of living.

To achieve both financial viability for public housing and affordability for tenants, a further two-pronged option is proposed:

Option 7:

*That public housing add a third dimension to the current rental system: a minimum household rent based on the ongoing costs of providing public housing.*

*That the Australian and state governments adopt a budget standard for social housing and, where required, the Australian government increase Centrelink payments to ensure that public housing is affordable.*

The questions, then, are: (i) at what level should the minimum rent be set, and (ii) whether and by how much Centrelink payments need to be increased to ensure that these minimum household rents are affordable for tenants.

## **Towards a budget standard for public housing**

Currently, the most appropriate budget standard is that proposed by Saunders et al. (1998). They established two sets of budget standards: a 'modest but adequate' standard and a 'low-cost' standard. These vary according to household type, age of children and workforce status.

As an indication of the changes required in Centrelink payments to achieve a budget standard for public housing, Table 1 presents the results of modelling one particular household rent scenario where rents for different sized dwellings are based on the operating and asset utilisation costs of Victorian public housing. It presents the surplus (shortfall) in income for different household types receiving different types of Centrelink payments if they are to meet the low-cost budget standard.

For example, a single person (H1) requires an income of \$207 per week for their non-housing living costs. The rent on their 1-bedroom dwelling is \$92 per week. This rent is based upon the operating and asset utilisation costs of Victorian public housing. Thus they require a total income of \$299 per week to meet the low-cost budget standard. Some single persons are eligible for Newstart Allowance while others are eligible for a pension (such as the Disability Pension) and thus receive different rates of payment. The shortfall in income required by a single person on Newstart is \$102 per week while the shortfall for a single person on a pension is \$61 per week.

Table 1: Surplus (shortfall) per week in income to meet the public housing low-cost budget standard for different household types and Centrelink payments<sup>a</sup>

Household type	Household type descriptors	Other living costs	Rent	Rent as % total costs	Surplus (shortfall)	
					Newstart	Pension
H1	Single female 35 years	\$207	\$92	31%	(\$102)	(\$61)
H5	Single aged female 70 years	\$187	\$92	33%	n.a.	(\$41)
H2	Couple male 40 years, female 35 years	\$314	\$92	23%	(\$50)	(\$10)
H6	Couple aged both 70 years	\$290	\$92	24%	n.a.	\$14
H4	Single plus 1 child female 35 years, girl 6 years	\$263	\$97	27%	n.a.	(\$15)
H12	Single plus 2 children female 35 years, girl 6 years, boy 10 years	\$352	\$108	24%	n.a.	(\$49)
H7	Couple plus 1 child male 40 years, female 35 years, girl 6 years	\$389	\$97	20%	(\$63)	(\$23)
H8	Couple plus 1 child male 40 years, female 35 years, boy 14 years	\$418	\$97	19%	(\$75)	(\$35)
H9	Couple plus 1 child male 40 years, female 35 years, girl 3 years	\$368	\$97	21%	(\$42)	(\$2)
H3	Couple plus 2 children male 40 years, female 35 years, girl 6 years, boy 14 years	\$494	\$108	18%	(\$94)	(\$55)
H10	Couple plus 3 children male 40 years, female 35 years, girls 3 & 6 years, boy 14 years	\$563	\$108	16%	(\$97)	(\$57)
H11	Couple plus 4 children male 40 years, female 35 years, girls 3 & 6 years, boys 10 & 14 years	\$651	\$119	15%	(\$129)	(\$89)

Source: McNelis (2005, Table A2-10)

Notes:(i)Rent for the public housing low-cost budget standard is based on the operating and asset utilisation costs of Victorian public housing as presented in Table 16A.6 Financial indicators of public housing 2003-2004 in Attachment 16A SCRGSP (Steering Committee for the Review of Government Service Provision) 2005 Report on Government Services 2005 Productivity Commission, Canberra. These costs have been allocated across different size dwellings. See McNelis (2005, Table A2-5) for more details. (ii) Other living costs are based upon the overall low-cost budget standard as determined by the Budget Standard Project less housing costs. It has been updated by CPI to December 2004. See Saunders et al. (1998, Table 12.3, p. 441). (iii) Current income is based on Centrelink entitlements as at December 2004. Centrelink payments vary according to type of household, type of payment, age of recipient and age of children. Public tenants are not eligible for Commonwealth Rent Assistance.

Even on a very conservative basis (the low-cost budget standard and rents based on the lowest-cost SHA), Table 1 indicates that most households require an income higher than their current Centrelink entitlements in order to have sufficient income to meet a minimum standard of living. All households receiving Newstart require higher incomes, with the shortfall ranging from \$42 per week for a couple with one child (under three years) to \$129 per week for a couple with four children. Only one pensioner household achieved the low-cost budget standard: an aged couple. For other pensioner households, the shortfall ranged from \$2 per week for a couple plus one child (aged three years) to

\$89 per week for a couple plus four children. The table also indicates the disparity in rents as a proportion of total living costs between households, ranging from 15% for a couple with four children to 33% for a single aged person.

A further option envisages public tenants becoming eligible for Commonwealth Rent Assistance. The results of this modelling are outlined in Table 2. Some households receiving a pension – couple, aged couple, single person with one child, and couple with one child (under three years) – would have sufficient income to meet the budget standard. However, while the shortfall is reduced, most households would still not have sufficient income to meet the budget standard. All households receiving Newstart would require higher incomes, with the shortfall ranging from \$32 per week for a couple plus one child (under three years) to \$103 per week for a couple plus four children. The shortfall for pensioner households ranges from \$4 per week for a single aged household to \$63 for a couple plus four children. The table also indicates that the disparity in rents is less as a proportion of total living costs between households, ranging from 12% for a couple with four children to 20% for a single aged person and an aged couple.

**Table 2: Surplus (shortfall) per week in income to meet the public housing low-cost budget standard for different household types and Centrelink payments (with Commonwealth Rent Assistance)**

Household type	Household type descriptors	Other living costs	Rent	Net rent as % total costs	Surplus (shortfall)	
					Newstart	Pension
H1	Single female 35 years	\$207	\$92	18%	(\$65)	(\$24)
H5	Single aged female 70 years	\$187	\$92	20%	n.a.	(\$4)
H2	Couple male 40 years, female 35 years	\$314	\$92	19%	(\$33)	\$7
H6	Couple aged both 70 years	\$290	\$92	20%	n.a.	\$31
H4	Single plus 1 child female 35 years, girl 6 years	\$263	\$97	19%	n.a.	\$16
H12	Single plus 2 children female 35 years, girl 6 years, boy 10 years	\$352	\$108	15%	n.a.	(\$10)
H7	Couple plus 1 child 40 years, female 35 years, male girl 6 years	\$389	\$97	18%	(\$53)	(\$13)
H8	Couple plus 1 child male 40 years, female 35 years, boy 14 years	\$418	\$97	17%	(\$65)	(\$25)
H9	Couple plus 1 child male 40 years, female 35 years, girl 3 years	\$368	\$97	19%	(\$32)	\$8
H3	Couple plus 2 children male 40 years, female 35 years, girl 6 years, boy 14 years	\$494	\$108	15%	(\$76)	(\$36)
H10	Couple plus 3 children male 40 years, female 35 years, girls 3 & 6 years, boy 14 years	\$563	\$108	13%	(\$78)	(\$39)
H11	Couple plus 4 children male 40 years, female 35 years, girls 3 & 6 years, boys 10 & 14 years	\$651	\$119	12%	(\$65)	(\$24)

Source: McNelis (2005, Table A2-12)

Notes: (i), (ii) and (iii) See Table 1 above. (iv) Commonwealth Rent Assistance is based on the tenant's entitlement.

## Concluding comments

Affordability and financial viability are not objectives of social housing. Yet both are necessary to social housing: affordability is a key indicator as to whether social housing is achieving its objective of providing adequate and affordable housing; financial viability ensures that social housing can continue to achieve this objective. While there is a tension between financial viability and affordability, there can be no trade-off between them. Any changes in rental policy which trade off affordability for financial viability will ultimately destroy social housing.

Recent work by Hall and Berry (2004) has highlighted the current financial crisis facing SHAs. This paper has shown that this financial crisis is endemic to the Australian social housing finance system, with responses to that crisis over the past 50 years based on changes in rental policy: first, with changes predominantly in property rents justified with appeals to equity; then, with changes in the benchmark for household rents again justified with appeals to equity and giving equity priority over affordability and, finally, progressively allocating capital funds to operational purposes.

The Australian social housing finance system is inherently unstable because, unlike all others, it relies predominantly upon household rents to achieve financial viability, whereas in other finance systems this is guaranteed by some minimum rent (usually based upon a property rent). The level of household rents depends upon the income of tenants, an income now largely determined by Centrelink payments (income subsidies). Consequently, as public housing has become increasingly targeted, revenue per dwelling has declined.

The Australian social housing finance system is now facing a new crisis. It is clear that social housing in Australia requires a more stable social housing finance system, one which provides SHOs with a stable revenue base regardless of changes to the income profile of tenants.

While the above analysis suggests a range of possible responses, within the key parameters of the Australian social housing system, this paper proposes two interlinked and complementary policy changes which will ensure both the financial viability of social housing and affordability for tenants:

- That Australian public housing add a third dimension to the current rental system: a minimum household rent based on the ongoing costs of social housing (administration, maintenance, rates, insurance and asset utilisation). Thus a tenant would pay either a minimum rent, a maximum rent based on the property rent, or an income-related rent between the minimum and maximum rent based upon a rent-to-income ratio.
- That the Commonwealth and state governments adopt a budget standard for social housing and, where required, increase Centrelink payments to ensure that public housing is affordable.

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