

Policy Options for Housing for Low Income Households

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This paper is benefited greatly from discussions and comments by Ed Glaeser, Ian Harper, Elvis Jarnecic, Warwick McKibbin, Adrian Pagan, Malcolm Turnbull and, especially, Chris Joye. Richard Hayes provided outstanding research assistance. We also thank the Menzies Research Centre for financial support. All views expressed here are our own and do not necessarily reflect those of the above individuals and organisations.

June, 2003

Executive Summary

A longstanding social welfare tradition is for the government to help low income households who face housing problems. Various programs to address low income housing have been implemented in Australia and throughout the world. Many of these programs, at best, have been only moderately successful and some have significant limitations and failings. For this reason, the Menzies Research Centre commissioned us to revisit low income housing policy in Australia – to analyse the economic issues underlying low income housing policy, evaluate existing policy options and highlight new options that are worthy of closer investigation.

We first characterise the housing affordability problem and then use this to define a set of criteria for evaluating alternative policy approaches designed to improve the housing services available to low income households. We use these criteria to evaluate a range of policies concentrating on new innovative policy approaches. Thus we provide the framework and preliminary evaluation required for a systematic reformulation of housing policy by the Federal Government.

The Affordability Problem

The problem of housing affordability is easily stated: low income households are unable to purchase housing services that satisfy minimum levels of quality. Not surprisingly, this problem is most salient in larger cities where factors such as population density have driven high land prices.

Upon closer examination, however, affordability problems fall into two classes: long and short-term. The long-term affordability problem involves households who, for the foreseeable future and for whatever reason, will be unlikely to have an income that would allow them to purchase appropriate housing services. The short-term affordability problem concerns households who over time have an *average* income that would be sufficient to purchase appropriate housing in the private market, but who face short-term *fluctuations* in income that precipitate housing stress or crises. That is, a household may face the short-term loss of employment or the illness of a primary income provider or a rise in interest rates or rents precipitated by macroeconomic conditions. Such households may find themselves unable to afford their current accommodation in the short-term and face hardship from being forced to move; losing personal capital incorporated into their homes. These short-term fluctuations harm both the households and the parties providing them with housing. As a result, households with a higher risk of short-term income fluctuations may find it difficult to gain appropriate housing in the private market.

The long-term and short-term affordability problems have different causes and, hence, require different policy approaches. The long-term problem is a problem of low income as opposed to an issue of housing policy per se. Government interventions that are designed to improve conditions in the housing market are no solution to this type of problem: there is no sense in improving the operation of a market that these households cannot effectively access. The long-term affordability problem requires anti-poverty programs with housing as a key element. For

this reason, while it is an important aspect of overall social welfare programs, the long-term affordability problem is not the focus of this report.

The short-term problem is a problem of income fluctuations rather than a permanent lack of income and earning power. Left untreated it can lead to transitions to longer-term problems but at its heart the problem is the lack of a mechanism to deal with short-term income loss. The reason the short-term problem is a concern for government is that the market is unable to provide a solution to housing stress caused by income uncertainty. While, in principle, capital markets should be able to provide short-term finance to get households through rough patches, in practice, this does not occur. The main economic reason for this is that, for quite understandable reasons, banks and other lenders are reluctant to extend loans to households that have just suffered a dramatic loss of income or a rise in housing prices. Here we focus on how to address this problem.

Effective and Efficient Housing Policies

As a matter of economics, long-term housing prices in any region are driven by the long-term stock of housing. To improve housing affordability we need to consider how the supply of housing can be expanded.

Some government policies attack the supply-side constraint directly by providing incentives for increased private construction or by providing public housing itself. The problem with these policies, however, is that housing stock is not a simple homogeneous commodity. There is a hierarchy of dwellings in terms of quality and interventions and improving supply in one sub-market has flow-on effects to other sub-markets. In some situations, this flow-on can be a good thing with improvements in high quality housing filtering back to the price of other dwellings. In other situations, the flow-on can move stock in the quality hierarchy in ways that offset any reduction in lower housing prices, short-circuiting the objective of the policy. Thus, any supply-side intervention must be assessed as to its overall impact on housing prices for low income households; is the policy encouraging increased housing stock availability at the lower end of the quality hierarchy of housing submarkets?

Alternatively, constraints on the stock of housing can be tackled indirectly through demand-side policies. By improving the ability of low income households to pay for housing, in the long-run, investors will have an incentive to provide housing that satisfies this additional demand. However, this type of policy involves two key choices. First, on what basis are demand-side policies provided? Are they awarded on the basis of a close examination of need or are they an entitlement? Current rent assistance policy requires close micromanagement of eligibility while the first home owners' scheme is an entitlement to all households who have never owned a dwelling. We argue that micromanagement is a poor option compared with an entitlement. Entitlements tend to be clearer in their operation and objectives, empower individual households to make their own housing choices and facilitate appropriate market responses. Entitlements do not require the government to make judgments as to individual housing requirements, leaving that judgement to those most affected.

Second, who should receive demand-side housing benefits? Most housing policies select eligible recipients on the basis of income. What this means, however, is that as income rises, households that currently receive benefits might risk losing them or having them curtailed. For households requiring assistance due to a short-term affordability problem, this creates a poor

incentive for them to restore their income levels (they are effectively being taxed at extremely high marginal rates). At best, this prolongs the burden on the government. At worst, it may turn a short-term problem into a long-term one (i.e., a poverty trap). For this reason, we believe that housing policy directed at alleviating the short-term affordability problem must be vigilant in avoiding implicit incentive traps.

The Housing Lifeline

The short-term problem of housing affordability arises because of income risk faced by low income households and an inability of the private market to provide appropriate services to overcome that risk. Standard approaches to low income housing policy often pay scant regard to this short-term income risk and are designed in a way that assumes a long-term affordability problem. In particular, the eligibility criteria for these programs often create poverty traps that exacerbate the plight of low income families over the longer term.

Rental and interest guarantees provide one way to help overcome market failures for low income households. These types of programs help to remove the risk from lenders and landlords. However, these programs often lack flexibility and cannot address income shocks when they arise.

Our proposed alternative approach would involve governments addressing the income risk associated with low income households directly. We propose that the government establish a housing lifeline – essentially, a line of credit – that would be available to *any household with limited wealth* (as defined by an assets-based means test). This could be then utilised if these households finds themselves in a short-term housing crisis. The lifeline would be a form of insurance to low income households, to ensure that short-term income fluctuations do not create long-term housing problems.

How would this work? Suppose that a household suddenly finds itself facing a crisis where they are likely to be unable to meet short-term commitments for housing payments. A housing lifeline means that the household would be able to draw down a payment from the federal government to tide it over the short-term crisis. For example, the government might allow a household that is able to demonstrate a short-term drop in income, due to say unemployment or temporary lay off, to draw down a payment (say up to an eventual maximum of \$5,000 - \$10,000) towards rental or mortgage costs. This payment would be a loan to the household, but the loan would be automatic. In other words, the household would not need to prove relevant need or satisfy other eligibility requirements, other than a liquid assets test in the short-term. However, the household would incur a future tax liability associated with this loan. The payment of this liability would be tied to future income, like the Higher Education Contribution Scheme (HECS).

Payments to a household would be capped both in terms of the maximum weekly drawdown and the maximum total drawdown. The housing lifeline is designed to provide short-term relief, not to provide a permanent source of support for those families who will not have the means to adequately fund housing in the medium to long-term. Thus, the lifeline *does not replace* other long-term poverty programs but supplements these programs providing more appropriate assistance to low income households facing temporary crisis. For example, it might be possible to ‘borrow’ up to \$200 per week under the cap up to a total of \$10,000. Thus, the scheme would provide up to 50 weeks (or more if less than \$200 was drawn upon) support for a relevant household.

Nonetheless, *a primary benefit of this scheme is that it would potentially enable to the government to save on social security costs by preventing short-term income problems from transitioning into longer-term poverty.*

The payments under a housing lifeline would be tied to housing. Thus, funds would be paid directly to a (registered) landlord or lender specified by the relevant household. This would require a contractual agreement that ensures that the funds do reduce the household's liability to landlords and lenders directly.

Drawing down the lifeline would be a choice made by the relevant household. But because this access to an instant 'line of credit' removes a substantial amount of the risk that would otherwise face lenders and landlords who provide housing solutions to low income families, the lifeline directly addresses the problems embedded in the rental and mortgage markets. Put simply it reduces the problems of income risk facing both the households and their housing providers.

While the government takes on board the risk associated with low income households, through the housing lifeline insurance, the government is also in a good position to deal with that risk. The government has the substantial advantage of ensuring appropriate repayment of any lifeline loan through the taxation system. A low income household can use the lifeline in periods of crisis and then would repay the loan when their circumstances improved. This may be in the short-term or in the longer term, depending on the relevant household's circumstances. For example, modest repayments to the government may begin when household income approaches a set level above poverty-line income.

In terms of implementation of this scheme, we envisage that it would naturally apply, in the first instance, to home owners with mortgages. This should be constituted so as to create a statutory second mortgage for the benefit of the government and provide a natural way of underwriting the program. If this proves successful, then a broader applicability to renters could be achieved as issues of compatibility with existing rent assistance and other government programs are resolved.

In summary, the housing lifeline is essentially a government provided insurance product. It has a number of similarities to HECS in that it is based on lifetime income rather than current income, it limits the impost of government funds while providing short-term relief for relevant households and it is a product where benefits are determined by the needs and requirements of the low income household themselves. For these reasons, we believe that it is a policy worthy of close examination by the Federal Government.

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1 Background

This report considers the design of appropriate policies to deal with low income housing problems in Australia. Housing is an essential requirement for all individuals and households. But in the past government policies have often attempted to address the housing needs of low income households through highly interventionist procedures, such as the design and construction of low income housing estates. In this report, we consider a range of options and alternatives for low income housing. We provide background to the problems facing low income households and present economic criteria for evaluating low income housing policy. We then review some broad categories of existing policy as well as presenting and reviewing some innovative alternative policies that might significantly progress housing policy in Australia.

The focus of this report is on low income housing. In other words, we consider those households who might face problems in gaining access to adequate housing due to having inadequate current income. These households often operate at the edge of the housing market. The market is unable to provide appropriate housing for these families for reasons that we discuss below.

We do not, however, consider emergency shelter and other provision of temporary accommodation in this report. Rather, our focus is on the longer term needs of low income households and how the government can best act to meet those needs over time.

Adequate housing is a key requirement for all Australian households. In 1999-2000 there were around 7.2 million households in Australia. 71 per cent of these households lived in their own home while 26 per cent rented accommodation. Of home owners, almost 90 per cent currently live in a stand-alone or separate house while less than 4 percent of households live in a flat, unit or apartment. Of tenants, almost 74 per cent rent from private landlords while the remainder rent from a State or Territory Housing Authority. 53 per cent of renting households live in separate houses and 26 per cent live in flats, units or apartments.

Renting is more likely to be an option for low income households than for other households. Further, these low income households are more likely to be dependent on government housing. For example, for a household comprising an adult couple with children, 79 per cent owned their own house and only 20 per cent were renting.

Conversely, for one-parent families, only 49 per cent were home owners, 30 per cent rented from private landlords while 17 per cent rented from State or Territory Housing Authorities.¹

For both owners with a mortgage and renters, housing costs Australia-wide come to approximately 20 per cent of gross income. But housing costs as a percentage of income vary significantly between geographic locations and between households. Housing affordability becomes a problem when households are unable to adequately fund housing from their current income. We discuss the definition of affordability and alternative approaches to improving affordability below.

Government assistance for low income housing can relate to either rental dwellings or to owner-occupied dwellings. The differences between these dwellings and the relationship to government policy are discussed in this report. Assistance can also take on many forms and, as becomes clear through this report, we believe that many past and even present policies do not carefully address the underlying economic issues that relate to low income housing policy. For this reason, we present a number of alternative policy approaches at the end of this report. We commend these approaches to the government for further consideration.

¹ These statistics are from the Australian Bureau of Statistics 2003 *Year Book Australia*.

2 The Economics of Housing

As with all markets, the price, quality and quantity of housing services are driven by the basic forces of demand and supply. Housing in a particular location tends to be more expensive when there is a high demand by individuals and households to live in that area, whether due to work commitments, life style or some other factors. In contrast, housing services tend to be cheaper in regions where demand is relatively low or where there is a large available housing stock and few constraints on the availability of land.

At the same time, the market for housing services is very different from markets for many other products. Housing has a variety of important attributes:

- A minimum level of housing quality is often viewed as a *necessity* for individuals and households. But above this minimum level, housing services are provided through a vast array of different dwellings involving different levels of amenity and quality.
- Housing is a *durable* good whose potential lifespan can be measured in decades or even centuries. But the good involves both an ‘unimproved’ component of land and an ‘improved’ component involving a building. As a result of the effective *spatial immobility* of land and buildings, the economic value of housing is location specific.
- Housing is traded both through the sale of the underlying assets and through the rental market. Home *ownership* is often a major goal of many households but this ownership involves a significant investment by a household in a highly concentrated form of wealth. Further, home ownership often involves significant household debt and, in Australia, exposure by households to interest rate fluctuations and risk of default due to adverse income shocks.
- The housing rental market is characterised by *incentive* problems. For example, house maintenance can depend on input from tenants and landlords and both parties can have a diminished incentive to optimally pursue maintenance. The rental market is also characterised by risks of default and performance failure by both landlords and tenants.

- Housing in a geographic region involves externalities. In other words, the amenity enjoyed by an individual or household from their dwelling can depend on the actions taken by other households.
- Partially as a response to the potential problems of externalities, governments intervene directly in housing markets through zoning laws and building codes.

Any meaningful analysis of housing policy needs to recognise and build on these key characteristics of housing. Three characteristics in particular – spatial immobility, durability and imperfect malleability, and heterogeneity – will influence housing policy and it is worth considering these in more detail.

2.1 Spatial Immobility

People move, houses don't. For this reason, location matters. House construction is largely an irreversible investment which is tied to a specific location. Further, the location of a particular home matters both for the market value of that home and for the economic and social prospects of the household occupying that home. Home location influences social groupings and networks, social status, job availability, access to private goods and services, the quality of public infrastructure and the environment. While an individual or household has some control over the location in which they live, they have relatively little control over changes to the social and economic environment of that location.²

The irreversible nature of housing investment, the fixed geographic nature of housing and the potential for idiosyncratic changes to specific locations, mean that in housing markets, there will be a large distinction between the “short run” and the “long run.” Changes in people's locational preferences can create mismatches between demand and supply that lead to short-term dislocation and may only correct over a number of years. For example, if the main income earner in a household is required to relocate for employment reasons then this may lead to onerous commuting or even household separation in the short term. In the longer term, other family members may be required to relocate with an accompanying change in housing. These short term dislocations can be exacerbated if the

² For Australian studies highlighting the links between location and economic prospects, see Gregory and Hunter (1995) and Hunter (1996).

source of dislocation is correlated between households in a particular location. For example, regional economic changes can affect an entire city and impact on the demand and supply of housing in that city. This can lead to substantial once off gains or losses to home owners which can intensify the short-term dislocation in the housing market.³

The spatial immobility of housing means that when considering any housing policy a clear distinction must be made between immediate effects (that can nonetheless last for a significant period of time) and long-run effects when mismatches in housing preferences are eventually resolved.

2.2 Durability and Imperfect Malleability

At any point in time, the vast majority of housing stock involves dwellings that have been in existence for a considerable number of years. Even the Prime Minister lives in a second-hand house! Thus, housing assets are extremely durable and represent an important investment decision by anyone who is constructing them.

The durability of the housing stock means that houses have important investment characteristics. This is most obvious for rental accommodation. The owners invest in a long lived, largely sunk capital asset. They then lease this asset to others who gain the flow of housing services from the asset. In return, the tenants pay rent to the landlords. The investment return to the landlords includes rental payments plus any capital appreciation in the value of the land associated with the dwelling, less depreciation (if any) of the housing stock.

These same joint investment-consumption characteristics are relevant for owner-occupied dwellings. However, for these dwellings, the investors and the consumers of housing services are the same individuals.

The long-lived nature of housing assets does not mean that these assets do not alter over time. Existing housing can be modified. These modifications range from standard maintenance such as painting, to significant renovations such as remodelling rooms or replacing wet areas, to complete re-development. But such

³ As an example of the potential strength of the short-term dislocation related to housing decisions, Oswald (1998) argued that a ten per cent increase in home ownership (as opposed to private rental) could increase unemployment by two per cent for Western European nations, due to the reduced mobility of workers.

modifications can be costly and can take significant time to implement. Thus, while the existing housing supply can change in response to market signals, these changes may take a significant period of time.

Because housing (1) has dual investment and consumption characteristics, (2) involves long-lived assets, and (3) has limited malleability particularly in the short-term, the supply of houses and welfare derived from housing will be closely related to the operation and efficiency of capital markets. Further, these same characteristics mean that the housing stock is likely to have a relatively low degree of turnover at any point in time. In other words, only a small fraction of households are active at any point in time as buyers and sellers of houses. The buying and selling of housing stock has more in common with the buying and selling of businesses than with the markets for standard consumer goods. As such, the households who participate in home ownership often make commitments and tie themselves to obligations that far exceed those associated with more familiar market-based transactions.⁴

2.3 Heterogeneity

Housing units differ considerably in many attributes. For example, even in a single urban area, housing size can range from small one or two bedroom apartments with floor space of 100 m² through to stand-alone five bedroom houses on 1000 m² of land. Housing differs in terms of neighbourhood environment and public service access. For example, residents of Rowville in outer-Eastern Melbourne have highly limited access to public transport, especially when compared to inner-urban residents. The houses themselves have different features, styles, building quality, and vintage. When people search for houses, they do not consider all houses but look for houses with certain characteristics. While houses with similar characteristics may be viewed as relatively substitutable, there is often limited substitution between houses with very different characteristics. “Housing is not, then, a single commodity but a complex of variously related commodities; the urban housing market is not one perfect market but a set of interrelated submarkets.” (Rothenberg et.al., 1991, p.3)

⁴ The degree to which households directly invest in housing assets rather than the purchase of housing services through private rental markets differs significantly between developed countries. For example, current home ownership rates are approximately 67 per cent in the United Kingdom and the United States, but are only approximately 42 per cent and 31 per cent for Germany and Switzerland respectively.

For this reason, it is useful to consider housing as a set of submarkets that are characterised by ‘quality.’ This does not necessarily mean that the quality of housing in one market is unambiguously superior to another (although that is true in some cases). Instead, ‘quality’ is defined broadly to mean that housing within a particular submarket is relatively substitutable from the consumers’ perspective but has less substitutability with housing outside that submarket. Nonetheless, for obvious reasons, it is sometimes useful to consider a hierarchy of submarkets ordered from the lowest to highest quality.

Housing submarkets will generally be linked. A policy that alters consumer behaviour in one submarket will tend to affect other submarkets as marginal customers move into or out of particular submarkets in response to the policy. This means that the analysis of any policy should consider its immediate impact on certain targeted submarkets and its ‘ripple’ effects on other submarkets. Some policies might impact on most submarkets but their differential impacts should be noted as well as how any ‘ripple’ effects resolve themselves.

2.4 Summary

Because the market for housing is intrinsically different from the markets for apples, fish or washing machines, government policy towards housing must carefully take note of the relevant market idiosyncrasies. Our discussion above has highlighted some of the most important characteristics of the housing market. In particular, housing has both an investment and consumption characteristic, home ownership is intimately tied to capital markets, and housing decisions can lead to ‘frictions’ in a household’s ability to adjust to other economic factors that impinge on welfare. Further, there is not a single ‘housing market’ but a series of interlinked submarkets, and these linkages can be important for understanding the impact of housing policy.

In summary, housing policy must consider the important differences between short-run and long-run effects on housing, and the disparate and linked effects on low, middle and high quality housing.

3 The Affordability Problem

A basic motivation behind policies for low income housing is a concern that housing is becoming less affordable for some households; especially in larger capital cities in Australia. The concept of affordability is directly linked to the price of housing. But there are at least three dimensions to that price. First, for home owners, housing is a dual good. As noted above, it involves both investment and consumption features. Physically it is a joint product of a long-lived physical housing asset that depreciates over time and land. Second, for the rental market, the price of housing services depends on the supply and demand for rental accommodation. This in part reflects the alternative investment opportunities that face potential landlords. Third, the rental price of housing services and the cost of housing are intimately linked as the flow of rent associated with a property makes up a considerable portion of the investment value of that property.

The nature of housing as an investment product and its large fixed nature links housing and investment markets. In Australia, the past decade has seen relatively low interest rates both for home owners and potential investors in housing. Unemployment has also been at a low level that is unmatched since the early 1970s. The low interest rates have raised housing affordability and lowered the risk of housing investment for many households. This has spurred demand for housing, particularly in a stable high-growth macroeconomic climate. As a result, house prices have risen significantly over the past decade in many Australian urban areas. For example, Australian Bureau of Statistics figures show that over the three years from July 1998 to June 2001 the weighted average price of existing dwellings in Australia's capital cities rose by almost 8 per cent per year.⁵ The increase in housing prices feeds directly into rental prices, although the rental market, for example in inner Melbourne and Sydney, has been complicated by a significant growth in apartment stock in recent years.

⁵ Australian Bureau of Statistics (2002) *Yearbook of Australia 2002: Housing prices*. At the same time it must be recognised that changing house prices are closely tied to regional factors, particularly outside Australia's urban regions. Thus some country areas have experienced huge rises in house prices in recent years (e.g. North coast NSW) while other rural areas have seen house prices fall.

While the increase in housing prices reflects general prosperity in Australia, this prosperity has not necessarily been evenly distributed over the population. In particular, a rise in general house prices can lower the affordability of housing to those families who are dependent on relatively low incomes.

What, however, is actually meant by housing affordability? How do we judge if low income families are facing an affordability problem for housing? Further, if there is an affordability problem, is this due to a rise in housing prices relative to other goods and services or a fall in the relative income of the poorest in society? It is well accepted in Australia that governments should take an active stance in alleviating poverty and the hardships faced by low income families. But an anti-poverty program is different from a housing policy and the linkage between the two may be very weak if an apparent fall in housing affordability for the poor actually reflects a reduction in real income for the poor rather than a rise in the relative price of housing.

In this section we consider the notion of housing affordability. It is not the purpose of this report to provide a complete welfare analysis of low income households in Australia. Rather, the aim of this report is to canvass alternative housing policies that can aid low income families. However, these policies will be intimately linked to the determinants of housing affordability. After all, if a policy to aid low income families merely raises general housing prices then it may provide little gain for low income families and simply lead to a windfall gain for existing home owners. Thus, it is important to understand the determinants of housing affordability in order to design policies to tackle problems of affordability. To do this we need to consider the constraints that operate on the supply of housing.

3.1 Defining Affordable Housing

Affordable housing is usually defined with reference to the income of a household. For example, the National Housing Strategy (1991) considered housing to be affordable if “housing costs ... leave households with a sufficient income to meet other basic needs such as food, clothing, transport, medical care and education.” In that definition, if a household is spending more than 25 percent (for rent) to 30 percent (for mortgage repayments) of its income on housing, then that household is experiencing an affordability problem. Of course, this definition could apply to high income households who spend a lot on housing. Thus, this benchmark on affordability is usually only applied to households that fall into the bottom 40

percent of the overall distribution of income. In Australia in 2001 the affordability threshold based on 30% of the second quintile of average weekly household income was only \$141 compared with the median weekly rent in Australia of \$183 and a median weekly mortgage repayment of \$230.⁶

Berry and Hall have determined that the proportion of private tenants in the bottom 40% of the overall distribution of income paying more than 30% of household income on rent is around 70%, with an even higher rate in Melbourne and Sydney (Berry and Hall, 2001).

This definition, however, does not allow us to easily distinguish between a housing problem and a low income problem per se. For this reason, Glaeser and Gyourko (2002) argue that an affordability problem arises when housing is expensive relative to its fundamental costs of production, including construction, taxation and regulatory costs. For this reason, they advocate using a benchmark of the physical costs of constructing housing as a means of determining whether and where housing is too expensive.

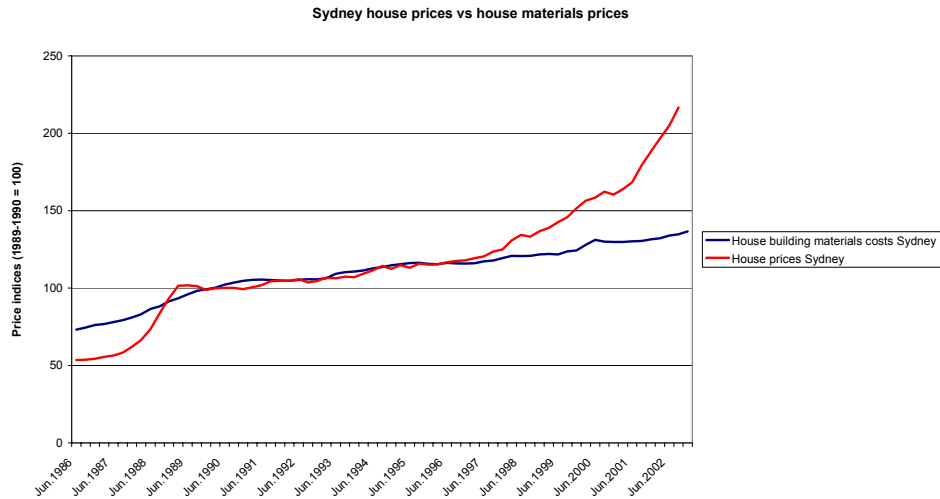
If we believe that there is a housing crisis, then presumably the correct housing response will be to build more housing. However, the social cost of that new housing can never be lower than the cost of construction. As such, for there to be a “social gain” from new construction it must be the case that housing is priced appreciably above the cost of new construction. (Glaeser and Gyourko, 2002, p.2)

Consequently, to get a sense of the affordability problem, we must compare housing prices in particular areas relative to construction costs in those areas.

As can be seen from Figure 3.1a, house prices have increased at a faster rate than the cost of building materials in Sydney. A similar pattern is evident in Melbourne in relation to house prices and construction costs in general (Figure 3.1b). In other capital cities, a divergence between house price increases and construction costs is a relatively recent phenomenon (occurring in the last two years or so).

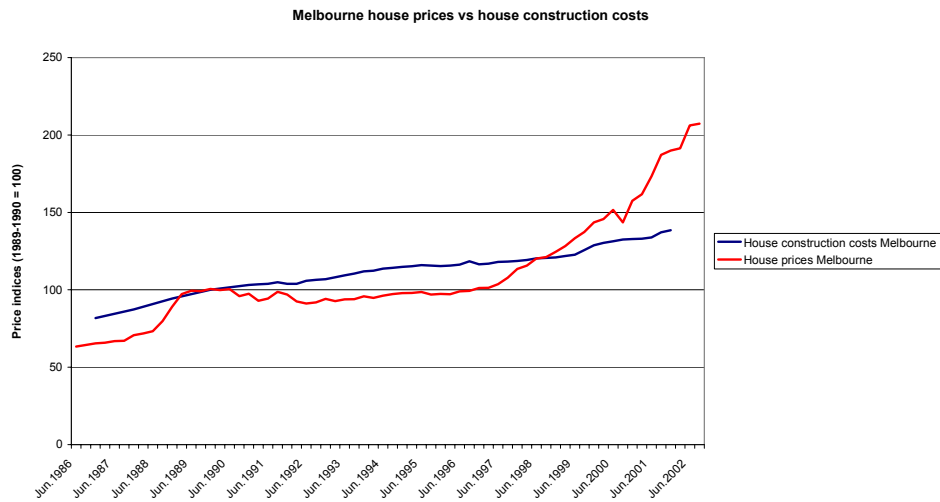
⁶ ABS figures presented in HIA (2003).

Figure 3.1a: Sydney House Prices and Building Materials Costs



Source: ABS Data

Figure 3.1b: Melbourne House Prices and Construction Costs



Source: ABS and Rider Hunt

The potential divergence between construction costs and overall house prices can be seen from the following table reproduced from the Australian Consumer Association’s submission to this taskforce. In that table, “project houses” include the costs of housing without land while “established homes” include both land and house prices as a package. Both categories are for freestanding places only.

Table 1 – Real price increases, percent, June 1986 to September 2002		
	Project houses	Established homes
Sydney	23	121
Melbourne	6	79
Brisbane	16	64
Adelaide	-3	11
Perth	5	50
Hobart	2	1
Darwin	27	17
Canberra	9	31
Average (weighted)	11	75

(Nominal price increases deflated by CPI - statistical series available only from 1986.)

Notice that, in Sydney, Melbourne, Brisbane, Perth and Canberra, there is a growing divergence between construction costs and house prices. This is not evident in other cities. Indeed, in Hobart and Darwin, there is a trend in the opposite direction; suggesting an improvement in housing affordability in those cities.

3.2 Affordability and the Supply of Housing

The data presented above suggests that there is a broad problem with housing affordability, particularly in the largest capital cities. Over the past decade, housing prices have risen significantly faster than underlying construction costs. There are two explanations for this trend, both of which impinge on potential low income housing policies. First, the gap between house prices and underlying construction costs could reflect adjustment problems in the housing market and the indivisible nature of housing assets. Alternatively, the gap could reflect the increased value of land, particularly close to urban centres. These explanations are not mutually exclusive and both are likely to impinge on housing affordability.

3.2.1 Short-term production lags

If you open up any economics textbook (for instance, Gans et.al., 2003), and look at the discussion of the operation of markets, the examples tend to be commodities for which individual units that can be purchased are very small. Consider apples, ice creams and CDs. These items can be readily viewed as easily scalable in terms of market and consumer demand.

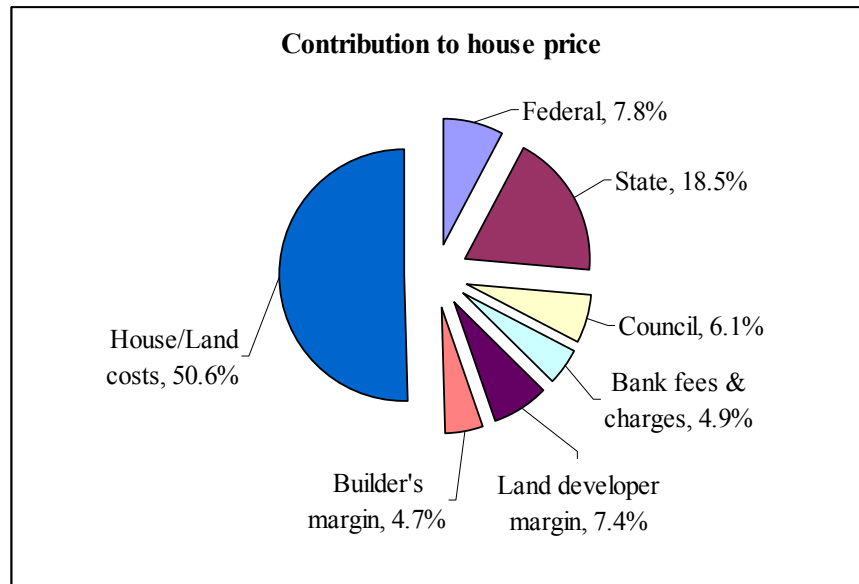
In markets where products are easily scalable, an increase in demand can quickly be met by a rise in the quantity supplied. For a relatively small country like Australia, supply adjustments for many products occur through imports. Thus, any rise in market price above underlying production costs would soon be removed as firms seize the profit opportunity and increase the amount of the product that they supply to the market.

In contrast, housing is non-transportable and the construction of new housing involves significant lead times and production lags. As a result, a rise in demand for housing may lead to a rise in the price of housing compared to underlying long-term construction costs, with this gap only diminishing relatively slowly over time as the housing stock expands. Thus, the nature of the housing market can create a short term problem of housing affordability.

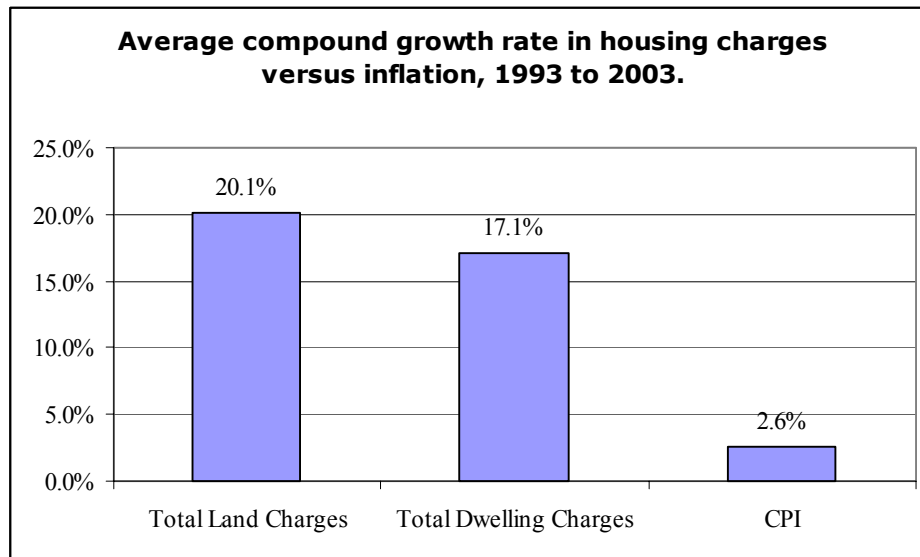
The potential for short term dislocation of the housing market may be exacerbated by government policy. For example, government planning policies can significantly increase the lead time for housing construction. While these policies may have significant benefits, and be designed to offset some of the externalities in the housing market, it must be recognised that they also have costs in terms of increasing any short-run adjustment costs in the housing market. Thus, these policies may intensify short-term problems of affordability created by a rise in housing demand.

Government taxes and charges may also impinge on the ability of the housing market to adjust to change. A change in demand for housing can be at least partially met by a reallocation of existing housing. For example, 'empty nest' households may choose to downsize their accommodation, freeing up a family dwelling if they perceive this to be in their economic interest. Transaction taxes, such as stamp duty on the sale of real estate, directly reduce the economic incentive for reallocation of housing stock. Such taxes create an artificial barrier to adjustment of the housing market and exacerbate any short-term dislocation in the housing market.

The following graph is based on analysis conducted by HIA in its submission based on figures provided, on a commercial-in-confidence basis by a major HIA member, of their actual housing and development on a typical 'green-fields' site in Sydney. It shows 32.4% of the cost of a typical house cost is from taxes, fees and charges to Government.



The following graph from HIA (2003) shows how charges on housing have changed over the past ten years. Where inflation has grown at a compound rate of just 2.55 percent per year, charges on dwellings have increased at 17.1 percent and charges on land have increased at 20.1 percent.⁷



⁷ Again these are based on commercial in confidence figures supplied by a major national developer to HIA.

On a national basis, these tax increases directly inflate the cost of a typical home by an average of around \$68,112.⁸

3.2.2 Land

As noted in section 2, housing is spatially immobile. The reason for this is simple. Housing involves a joint product of land and a dwelling. If the price of housing rises relative to the construction cost of a dwelling then this may be due to an increase in the price of the complementary asset, land.

If rising demand for housing leads to a rise in the price of land, then housing affordability will fall. In other markets, we would expect a rise in the price of a product to spur increased production. But such a response is constrained for land. At first glance this would appear to be due to the fixed nature of the supply of land. However, such an explanation is inadequate, because the supply of land available for housing is not ‘naturally’ fixed. Rather, the supply of land for housing can be increased in two ways. First, land that currently is not used for housing but is used for other purposes, such as agriculture or industry, can be moved into housing. Second, land that is currently used for housing can be used more efficiently. This can be through an increase in medium or high density housing development. Thus, if the rising price of land were a major factor in decreasing housing affordability, we would expect to see the supply of land for housing rise over time. As noted in 3.2.1, this adjustment may be slow. However, the supply of land is simply another short-term constraint on adjustments in the housing market. It is not a long-term immutable constraint.

If there is a long-term problem with the availability of land for housing, then this is likely to reflect government land-use policy.

3.2.2.1 Zoning and Town Planning

Because housing developments impose external effects on neighbours – including environmental, aesthetic and social – governments (in particular, state and local governments) impose constraints on new developments and redevelopments. Thus, if a developer senses that an increased demand for housing in a large city makes multiple dwelling structures more commercially attractive than existing single dwellings, that developer faces additional costs and even prohibitions

⁸ HIA (2003), referencing UDIA March 2002 “Landcost: The impact of land costs on housing affordability,” p.8

on these potential investments. This is not to say that this type of regulation is unwarranted; external effects are real and should be taken into account. However, one impact of these laws is to limit the ability of developers to respond changes in housing demand.

The concern is that these regulations might drive a significant part of the affordability problem, particularly in the longer term. If housing affordability is reduced when house prices rise faster than the underlying construction cost of new dwellings, this wedge between market price and supply cost could be the result of zoning laws.⁹

Professor Edward Glaeser (an advisor to this taskforce) and Joseph Gyourko have examined the effect of government land-use planning on housing affordability in the context of the United States. They found that there are three broad classes of urban areas in the United States. The vast majority fall into a class where the price of housing corresponds to construction costs. There are also some areas where the price of housing is less than the cost of new construction. These are areas that have been in steady urban decline as a result of economic migration away from those areas. Finally, there are a few cities where the price of housing substantially exceeds construction costs. Glaeser and Gyourko find that what distinguishes those areas from the others is the nature of zoning regulations; particularly, in terms of the costs of converting single to multiple dwelling properties. That is, there are pressures of population density on these areas and zoning laws are preventing supply adjusting to the limited land stock by increasing the number of dwellings per lot.

3.2.2.2 Public Infrastructure

While land-use laws may impinge on the supply of land for housing in existing urban areas, land can also be brought into housing by the expansion of an urban area. However, while ‘urban sprawl’ may improve housing affordability, it needs to be accompanied by the development of public infrastructure such as roads, sewerage, schools and public transport. If this public infrastructure does not accompany urban growth than any improvement in housing affordability for the poor may have little welfare gain. For example, while new urban development may allow low income households to gain improved access to housing, if this means that these communities are isolated

⁹ Some evidence for this is presented in HIA’s submission. They forecast demand for new dwellings in the Sydney region over the next 5 years to be just over 25,000 per year. This is contrasted with Planning NSW’s forecast a release of only 5,000 new lots annually. HIA predicts, on the basis of current programs, that actual production is more likely to deliver an average of just 1,400 lots a year .

from transport to areas of employment, then the community may face high unemployment and a poor overall standard of living.

Improving the transportation infrastructure of a city in a way that makes suburban commuting more attractive reduces pressure on inner and near inner neighbourhoods to house people. It opens up the land available for effective housing and hence, reduces pressures that drive house prices up.

The quality of the transportation infrastructure – most critically roads and rail – is the subject of governmental decision-making. What is important to recognise is that, like zoning laws, transportation infrastructure can alleviate or exacerbate differences between housing prices and construction costs and hence, impact on basic affordability.

3.2.3 Summary of Supply Factors

General housing affordability is reduced if a rise in demand for housing is met by a slow response in housing supply. In part, the speed of any supply-side response to a rise in housing prices reflects the indivisible nature of housing stock. But a significant factor in the speed of any market response, and the ability of the market to reverse any short-term decline in housing affordability, is the government laws and regulations that relate to housing development. These laws have a sensible economic basis, but it must be recognised that they also impinge on housing affordability. Further, governments play a key role in providing complementary infrastructure for housing development, particularly in new urban areas. Thus, a general problem of housing affordability can be at least partially addressed through government responses – the removal of transactions taxes on housing, the removal of unnecessary planning laws, the speeding up of approvals for new developments, the design and extension of government infrastructure services and the careful evaluation of planning constraints, particularly for high-density housing developments.

3.3 Filtering

The preceding discussion of supply side factors considered general housing affordability. It might be argued that such a general discussion does not relate to low-income housing. But this would be wrong for two reasons. First, many of the supply side factors identified above impinge as much or more on low income housing as

they do on other housing stock. For example, restrictions on high density developments, planning laws restricting the development of low cost land and inadequate outer urban public infrastructure all impinge on low income housing. Second, the argument is wrong because it ignores the linkages between housing submarkets. A change in government policy that increases supply in one housing submarket will also affect the affordability of housing in other submarkets. In particular, housing submarkets are linked through ‘filtering’.

The basic idea of filtering is that the housing stock depreciates over time in terms of quality. Often new housing stock is added in submarkets where consumers demand high quality. But this does not mean that there are no implications for other submarkets. Rather the addition of high quality housing stock has repercussions for the prices in other submarkets. In particular, new developments servicing high quality submarkets will tend to result in a reduction in prices for medium and lower quality submarkets. Over time this process might be such that households in those lower quality markets may find it worthwhile to purchase higher quality dwellings with the oldest stock abandoned or demolished. This process by which every household ‘moves up’ the quality index for housing is one way that the welfare of the lowest income households improves.

A simple example illustrates filtering. Houses in Australia are on average significantly larger than they were fifty years ago. But this increase in space has not been confined to the high end of the market. Rather, households in both low and middle income brackets have also benefited from an improvement in housing quality over this period due to the increase in dwelling size. This is not because these households are building new large luxury houses. Rather, it reflects that these households now have access to more spacious housing, through either rental or ownership, which was built in the last fifty years and has moved from the high-quality submarket to lower quality submarkets as it has depreciated.

In this sense, filtering has a parallel to notions of ‘trickle down’ effects that can be associated with economic growth. But filtering is not at all inevitable. Aging housing stock may not be passed down to lower income households. For one, the housing market constraints may be so extreme that households all lower their housing standards as the stock depreciates. Alternatively, the aged stock may be upgraded and become occupied by higher income households. In this situation, the low income households in the older and lower quality submarkets might be displaced by housing renewal.

The extent to which filtering operates to link housing submarkets is important for low income housing policy. If filtering is strong, then

policies targeted to low income households may be relatively ineffective, as the effects of the policy are diluted by adjustments in other housing submarkets. At the same time, if filtering is strong, then general policies to alleviate short-term problems of overall housing affordability may have significant benefits to low income families as well as the broader community.

3.4 Financial and Rental Market Imperfections

As we have already stressed, the housing market and financial markets are closely connected. Thus when we consider affordability of housing it is important to consider the operation of financial markets. Financial market imperfections may create or exacerbate affordability problems for housing.

In theory, financial markets should operate to provide finance to potential homeowners and investors who are likely to be able to make the relevant repayments. However, it is well understood that financial markets suffer from potential problems of asymmetric information that may lead to market failures and credit rationing.¹⁰

Information problems arise in financial markets because potential lenders may have difficulty distinguishing between individuals who would be able to make repayments and those who cannot. As a result, potential lenders may be reluctant to provide funds to customers who appear more risky; for example individuals with a lack of credit history or who are proposing more risky investments.

The underlying problem here is asymmetric information, not risk. After all, risk accompanies all lending and, in the absence of information asymmetries, would simply be reflected in higher interest rates to more risky borrowers. Rather, the problem is that the potential lender cannot adequately distinguish between high and low risk borrowers and so may be reluctant to lend any funds. Further, this problem cannot be solved by simply raising the interest rate on borrowed funds. Raising interest rates may simply act to dissuade the low risk borrowers leaving only the high risk borrowers. After all, the high risk borrowers, who know that there is a higher chance they might default on the loan, will be less influenced by interest rates. In this way, a simple interest rate charged equally to all potential borrowers, adversely selects for borrowers with a higher risk profile.

¹⁰ See, for example, Stiglitz and Weiss (1981).

To attempt to solve this problem a lender might try to ration credit; attempting to infer borrower risk through indirect means.

In financial markets that provide housing funds, a standard way to try and avoid adverse selection is through income history and income potential. This clearly has an undesirable effect on low income households, particularly those with a chequered history of employment. Such households will tend to be excluded from access to housing finance.

Another common solution to the adverse selection problem in the market for housing finance is to shift significant risk from the financier back on to the borrower. This is most easily achieved by requiring a large deposit on a house before funds are provided. This reduces the risk that the financier will be stuck with a house that is valued at less than outstanding debt if default occurs. But again, low income households will be most adversely affected by this solution, as they are least able to save for a significant housing deposit while at the same time paying for rental housing.

Overall, this means that credit rationing is likely to have the greatest adverse effect on low income households.

A similar adverse selection problem arises in rental markets. Investors are keen to rent properties to households or individuals who will be able to pay the relevant rent and who will not impact too heavily on the depreciation of the dwelling. But again, landlords cannot tell the exact risk associated with particular tenants and will try to infer this risk from other factors. Again, an obvious method used by investors to distinguish between tenants is their employment history and their current job and income. This discriminates against low income households who are viewed as having a higher risk by landlords.

Other common methods that have historically been used by landlords include the marital status of potential tenants, whether the household includes children and the number of adults in the household. While explicit use of these types of characteristics would violate current anti-discrimination laws in Australia, landlords will still be tempted to try and infer tenant risk from information they can gain about the tenant. This makes the rental prospects for low income households less certain than those for higher income households.

The use of economic discrimination in both financial and rental markets biases those markets against low income earners. This discrimination need not reflect any bias on the part of lenders or landlords. Rather it is simply a rational attempt by lenders and landlords to at least partially overcome information asymmetries in the market. However, the end result may be to ration many low

income families out of the private markets for housing. Put simply, the market imperfections can make housing unobtainable for low income households.

3.5 Income Risk and Affordability

Market imperfections in the financial and rental markets highlight the housing problems for low income households. Low income and factors that might be correlated with low income, such as being a single-parent household or having a chequered employment history, are used by lenders and landlords to infer risk that relates to these households. However, even if a low income household is able to gain appropriate housing, either as tenants or owner-occupiers, these households remain particularly vulnerable to future income risk.

Income risk is something that faces all households. It can arise through a number of sources. For example, unemployment is usually associated with a significant but temporary drop in income for individuals and households. Injury or significant illness can also lead to a sudden reduction in income.

An unforeseen drop in income can lead to a large but temporary reduction in housing affordability for the relevant household. For example, if the household is renting, then it may be impossible for the household to make its regular rental payments when it suffers a sudden reduction in income. In such circumstances, the tenants face eviction. Similarly, recurring mortgage payments may not be met due to a sudden income shock, leading to potential foreclosure.

Income risk, like any other form of risk, can be reduced by insurance. For example, income protection insurance is available to households. Similarly, both landlords and lenders may be willing to renegotiate agreements to overcome short-term income shocks. After all, finding new tenants or foreclosing on a mortgage and selling a property are both expensive activities. Both landlords and lenders have incentives to take actions to avoid incurring these expenses. Finally, households may self-insure against income risk, for example by keeping ahead of mortgage payments or by keeping a readily accessible pool of savings.

These solutions to reduce the cost of income risk, however, are less likely to be available to low income households. For a household with a history of unemployment, income protection insurance is likely to be either unavailable or prohibitively expensive. The moral hazard problem facing the insurer makes such insurance unviable. Self-insurance through discretionary saving is difficult, if not impossible,

for low income earners. And renegotiation to avoid foreclosure or eviction is less likely to occur for higher risk, marginal households.

Consequently, low income families are likely to face significant residual income risk that creates short-term housing crises for these families.

Income risk falls into different categories. First there is individual idiosyncratic risk. Households may suffer income shocks that are not correlated with general economic activity but rather that reflect the outcome of chance events. Income loss due to a motor vehicle accident is an obvious example of this. Income risk may also be regional. For example, a particular geographic location may suffer increased unemployment if the major employers in that region lay off workers. Finally, income risk may be national, for example when there is an economy-wide recession.

Both individual and national income risk create shocks to housing affordability that do not require a housing market supply response. For example, if an individual household faces a loss in income due to temporary unemployment, then this shock does not require a supply-side housing response. The short-term inability to meet financial commitments leads to a temporary dislocation in the housing market. But this dislocation is temporary and will be resolved when the relevant individual finds new employment.

Similarly, a national recession can create significant housing distress, but this does not require the creation of new housing stock. Rather, it requires macroeconomic policies to move the economy back to positive growth and increased employment.

In contrast, regional risk, particularly if it leads to a long-term downturn in a region, is likely to lead to longer term emigration from the relevant region to other parts of Australia. This has implications that feed into the supply of housing.

3.6 Summary

Low income households may find housing unaffordable. They may also find adequate food and clothing unaffordable. For low income households who are in poverty, even the basic goods and services that most Australians consider essential will be unaffordable. These households require general poverty programs to provide them with adequate resources to gain these essentials. But the focus of this report is on government policies to help low income households who

find housing *in particular* to be unaffordable. Our focus is not on general alleviation of poverty but on the idiosyncrasies that relate to housing.

In this section we have reviewed the concept of housing affordability, the impediments to a market-based response to a reduction in housing affordability, and the particular features of housing affordability that impact disproportionately on low income families. At a general level, an affordability problem simply reflects a temporary misalignment in housing markets. Housing stock cannot be rapidly adjusted. However, in the absence of government intervention we would expect private markets to respond to the profit opportunities created by a fall in housing affordability. New houses will be built, housing density will increase, and non-residential land will be brought into use for housing. While this takes time, it is not clear that there is a general role for activist government policy. However, governments can improve the ability of private markets to resolve housing affordability, by removing overly restrictive planning laws, building regulations, land-use constraints, transaction taxes and a developing appropriate public infrastructure.

Problems with housing affordability, however, may arise for low income households even if housing is affordable for the general population. These problems arise due to asymmetric information in financial and rental markets which lead lenders and landlords to rationally discriminate against low income households. From the lenders' and landlords' perspective, these low income households appear too risky. Similarly, temporary income loss can create a short-term crisis in housing affordability for low income households. These households will not have access to the risk protection available to more affluent households. As a result, short-term fluctuations in income can create significant short-term housing dislocation.

Government policy that relates to income and risk can be used to overcome these temporary income shocks. However, as we discuss below, most standard housing policies do not focus on income risk but on income support. In other words, while these policies may provide some elements of income insurance, they are not designed as insurance policies and do not necessarily differentiate adequately between short-term income risk and long-term poverty.

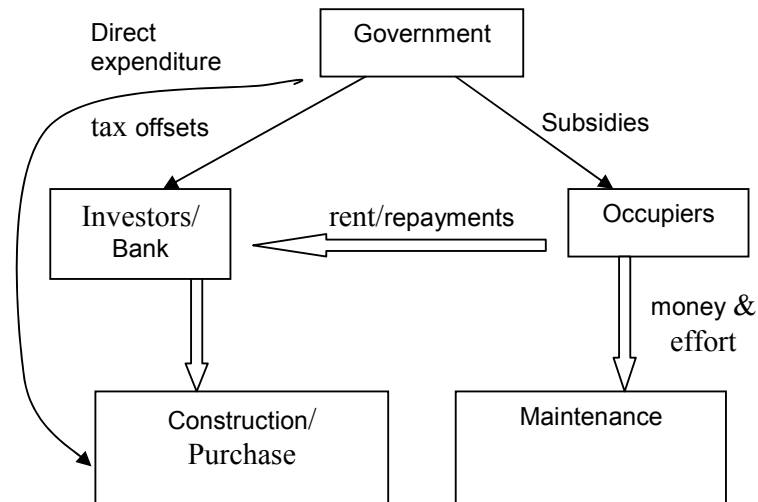
4 Dimensions of Low Income Housing Policy

We now turn to outline the dimensions that characterise government policy for low income housing. As was noted earlier, there are hundreds of potential policies, many of which have been suggested to us through submissions to the task force. But significant numbers of these potential policies overlap and involve similar characteristics. For this reason, it is important to isolate some of those key characteristics to allow for a sensible categorisation of policies and to allow for comparison between policies.

4.1 Paying for Housing

A critical dimension of housing policy is who pays for the housing services. Figure 4.1 provides a simple schematic representation of some of the alternatives.

Figure 4.1: Flow of Payments



Notice that there are several paths by which government money may flow to housing services. These include direct expenditures by government on construction or purchase of dwellings (e.g., public housing), subsidies to occupiers (e.g., rent assistance) or tax offsets

(e.g., interest deductibility). Of course, while the figure concentrates on the flow of government funds, the actual flows of funds in Australian housing markets are dominated by private transactions – between private owners and private lenders and between private tenants and private investors.

4.1.1 Public versus Private Funds

A first dimension of housing policy is the proportion of payments for housing that come from the government. Such payments feed into the outcomes of the housing market in two ways. From a ‘static’ perspective, government payments for housing, regardless of the exact way that those payments feed into housing expenditure, have a redistributive effect. Government housing expenditure will tend to alter the distribution of current housing across society. If the expenditures are targeted at low income households, then they make those households better off. In particular, the government expenditures will tend to increase the quality of housing services available to low income households. The government expenditures may also lead to substitution effects by freeing up part of the households’ expenditure for other private purchases.¹¹ As such, direct government expenditure channelled to low income housing has a redistributive effect. It makes low income households better off, although the tax revenue required to fund this government expenditure makes other tax paying households worse off.¹²

The redistributive effects of government housing expenditure will depend on the exact design of the relevant policy and careful design is needed to avoid potentially perverse effects. For example, subsidies to

¹¹ Technically, government expenditure tied to housing has an income and a substitution effect. The expenditure raises the real income of the recipient, allowing them to consume a bundle of products (including housing) that they would not be able to afford in the absence of the government expenditure. But the expenditure also ‘frees up’ some of the household’s income that previously would have been used to privately finance housing. This allows the household to substitute some of its own income away from housing and to other goods and services. Note that the substitution effect remains even if the government expenditure is tied to housing, because it relates to the private income of the household. If the government wished to avoid this effect then it would not only need to tie its expenditure to housing, but also make the government expenditure contingent on certain private expenditure from the relevant household.

¹² Broadly speaking, the government can fund increased low income housing expenditure from current taxation revenues or future taxation revenues. In the latter case, the government would run a deficit on current expenditure and issue bonds to pay for the deficit. These bonds are a liability to future tax payers. A full analysis of government fiscal policy is beyond the scope of this paper.

low income households can increase demand for housing by these households and, in the short run, can lead to a rise in the price of lower quality housing. Due to linkages between housing submarkets, this can lead to a rise in the price (both purchase price and rental price) of low to medium quality housing. This can have an adverse effect on those households who 'just miss out' on being eligible for government assistance. These relatively poor households do not receive the government housing assistance but face rising housing prices due to that assistance flowing to other households. The consequent redistribution can be from relatively poor households to the poorest households, rather than from the richest to the poorest households.

Government expenditure on housing can also have a 'dynamic' effect, altering the level of investment in housing and, over time, altering the size and composition of the housing stock.

Poorly designed government expenditure programs can have an adverse effect on the housing stock. For example, suppose that the government targeted subsidies to households living in dwellings with no more than two bedrooms. These dwellings would effectively be government subsidised and, over time, we would expect to see the housing market respond by increasing the relative number of one and two bedroom dwellings available.¹³

Well designed government policies can stimulate private housing investment. For example, a targeted government payment that is tied to corresponding private investments can stimulate the total level of investment. This is the case with the first home owners grant. This government payment is targeted on a specific consumer type (first home buyers), tied to other investments (only payable if a house is bought or constructed) and potentially temporary (has not been committed to as a permanent measure). The result is a short-run increase in house prices and a potential increase in the housing stock in the longer-run. The difference between the long and short run in this case is made less extreme by the potentially temporary nature of the policy.

Thus, the evaluation of the use of government funds for housing rests on two criteria:

¹³ While such a government policy, and the related market reaction, might seem 'far fetched,' there are historic precedents. For example, in the seventeenth century, the English government levied taxes on buildings according to the number of windows. This led to the boarding up and removal of windows from buildings in order to avoid the tax.

- *To what extent is the expenditure assisting in any redistributive goals the government may have?*
- *To what extent is the expenditure encouraging private investment on low income housing?*

We will take these criteria into account when assessing specific policies below.

4.1.2 Encouraging Single versus Dispersed Ownership

Government housing policy also impacts on the way in which private funds flow into housing. For example, housing policy can tilt the housing market towards owner-occupied dwellings and away from rental properties, or the reverse. Policies can encourage direct ownership, such as tax deductibility of mortgage interest payments on a household's own home. Alternatively, policies may encourage private funds to flow into investment rental properties, for example where such investments receive favourable tax treatment.

Similarly, government housing policy may encourage either single ownership or dispersed ownership. Single ownership refers to the situation where dwellings are directly owned by single individuals or households; regardless of whether they are occupied by their owners or not. Dispersed ownership refers to the situation where individual dwellings are effectively owned by a wider group of individuals. For example, if a financial institution purchases rental housing stock then the ownership of the dwellings is dispersed across the investors that belong to the institution. Similarly, direct public ownership of dwellings is a form of dispersed ownership, where dwellings are effectively owned by the population as a whole.

As Caplin and Joye (2002) argue, when an individual investor or household owns 100 percent of a dwelling, it is rarely the case that the investor or household is holding a portfolio that is optimally diversified against local and regional geographic risks. There is also an idiosyncratic risk to any individual property that arises because of the condition of the dwelling itself and the nature of surrounding dwellings. Modern finance theory informs us that it would be more appropriate to diversify portfolios from idiosyncratic and local geographic risks to asset value. For short holding periods Englund, Hwang and Quigley (2002) have shown that the efficient portfolio contains essentially no housing while, for longer periods, low risk portfolios contain 15 to 50 per cent housing. It suggests that markets are currently under-providing financial instruments to encourage dispersed ownership.

To the extent that housing policy involves the government absorbing some of the risks associated with housing investment it is also, by implication, a move towards dispersed ownership. As such, housing policy can improve the allocation of property risk in society and thereby improve welfare. For this reason, we will also consider the *achievement of dispersed ownership* (and consequent improved societal risk pooling) as a criterion for evaluating different housing policies.

4.2 Ownership

Housing policies also differ in the extent to which they encourage ownership by occupants. Increasing the level of home ownership is often the cornerstone of many debates regarding housing policy.

Homeownership gives people a stake in society and induces them to care about their neighborhoods and towns. By subsidizing property ownership, the deduction induces people to invest and then to have a stake in our democracy. Ownership makes people vote for long run investments instead of short run transfers. Moreover, home ownership, and perhaps housing consumption itself, seems to be good for the outcomes of children. (Glaeser and Shapiro, 2002, p.2)

In addition, there are purported externalities associated with home ownership.

There are three main externalities that might come from housing consumption. First, sufficiently poor housing could spread disease and fire. Indeed, throughout most of history, government intervention in the housing market has been motivated mainly by a desire to impose minimum standards on housing so as to stem the flow of infectious diseases and to reduce the threat of widespread urban fires. Second, better housing might create aesthetic amenities which bring pleasure to neighbors and passersby. Third, housing might benefit children. If the government, in general, cares more about children relative to parents, than parents care about children relative to themselves, then there is a case for subsidizing commodities that specifically benefit children. (Glaeser and Shapiro, 2002, p.14)

Although as with many externalities, establishing their actual magnitude is difficult.¹⁴

There appears to be a general consensus that ownership by occupiers is a desirable social outcome. From a purely economic perspective, the case for owner-occupiers comes from incentives. Ownership gives individuals control over how housing is used, upgraded, modified to individual preferences and generally maintained. This incentive comes from the fact that the occupiers receive the main impact in terms of private benefits from these decisions and, therefore, control over these decisions allows those benefits to be realised. In addition, owner-occupiers face a market-test on their actions given by the fact that any poor decisions or failure to undertake appropriate actions (e.g., maintenance) will be reflected in the price that housing will receive in the marketplace. Thus, key decisions are more likely to reflect an appropriate balance of private interests and asset value when these decisions are made by owner-occupiers than when these decisions are the joint outcomes of the actions of separate occupiers and owners.

Both the economic and social reasons discussed above suggest that an important criterion for evaluating housing policies must be the extent to which it *encourages ownership by occupiers*. More generally, however, policies must be evaluated to the extent that they provide appropriate incentives for all relevant parties to undertake desirable activities that affect the ongoing quality of the housing assets. These actions relate to both the specific dwelling and to any external effects that relate to housing.

In this regard, public ownership, ownership by absentee landlords and even partial ownership through equity sharing may reduce the incentives for parties to take desirable actions. Further, for individuals and households that face income risk, adverse incentive effects will be exacerbated. This is obvious in the case of rental properties. If income risk lowers the probability of continued tenancy, tenants will have less incentive to invest in either physical or social capital relating to their current dwelling. The income risk means that the household

¹⁴ “Causal inference is tricky, but homeownership is strongly correlated with political activism and social connection. Homeownership appears to increase home maintenance and gardening. Most tellingly, people seem to be willing to pay more to live around homeowners. Controlling for metropolitan area and for the observable human capital of neighbors, we find that a ten percent increase in the local homeownership rate increases local housing prices by 1.5 percent. While omitted unobservable variables might explain this correlation, the overall body of research seems to confirm positive externalities from homeownership.” (Glaeser and Shapiro, 2002, p.3)

will be less likely to reap the benefits of such investments. For the same reason, income risk can also reduce the attractiveness of owner-occupied dwellings where the property is mortgaged and future foreclosure is possible. Thus, a policy that reduces income risk for low income households may also improve incentives for these households to undertake desirable activities that improve the amenity of their dwelling and neighborhood.

4.3 Allocation

The mechanism by which dwellings are allocated can be substantially influenced by housing policy. In the absence of government intervention, the allocation of dwellings is driven by ‘market forces.’ That is, it is the outcome of the interactions of buyers and sellers each with their own private interests at heart. Market allocations have the benefit of not requiring anyone to presume what might drive the private interests of households in their housing decisions. In other words, if households decide that they want houses that are of a particular size, that have certain features or are in certain locations, the market will tend to respond to these preferences through prices in the short term and through altered housing development in the longer term.

Market allocations of housing however may not lead to equitable outcomes. An unfettered market for housing may mean that some households end up with a dwelling whose quality is below acceptable social standards.

There is sometimes a presumption, made both by people who are for and against government intervention in housing markets, that moving towards a goal of universal access to minimum standard housing requires the complete removal of the benefits of private choice in housing allocation. In other words, there is a presumption that those households who are not adequately served by an unfettered private housing market must be removed completely from this market. Such a presumption leads to a policy where public housing is financed, owned and managed by government.

The fallacy of the above presumption, that any failure of the private housing market must lead to a policy that replaces private provision with public provision, is summed up by the great urban activist Jane Jacobs:

Our cities contain people too poor to pay for the quality of shelter that our public conscience (quite rightly, I think) tells us they should have.

Furthermore, in many cities the sheer supply of dwellings is too small to accommodate the population without overcrowding, and the quantity of additional dwellings needed does not necessarily match up with the direct ability of the people concerned to pay for them. Because of these reasons, we need subsidies for at least some portion of city dwellings.

These seem like simple and straightforward reasons for dwelling subsidies. They also have a large leeway as to how subsidies might be applied, both financially and physically.

But let us see how involuted and rigid these reasons can become – have become – by giving another seemingly simple but slightly different answer to the question: What is the reason for subsidized dwellings in cities?

The answer we long ago accepted went like this: The reason we need dwelling subsidies is to provide for that part of the population which cannot be housed by private enterprise.

And, the answer went on, so long as this is necessary anyway, the subsidized dwellings should embody and demonstrate the principles of good housing and planning.

This is a terrible answer, with terrible consequences. A twist of semantics suddenly presents us with people who cannot be housed by private enterprise, and hence must presumably be housed by someone else. Yet in real life, these are people whose housing needs are not in themselves peculiar and thus outside the ordinary province and capability of private enterprise, like the housing needs of prisoners, sailors at sea or the insane. Perfectly ordinary housing needs can be provided for almost anybody by private enterprise. What is peculiar about these people is merely that *they cannot pay for it*. (Jacobs, 1961, pp.323-324; italics in original)

Inadequate private provision and allocation of housing does not necessitate public provision and allocation of housing. Further, public provision and allocation of housing necessarily ignores significant aspects of individual tastes and preferences. In other words, public housing, while attempting to solve a failure of the private market, also neglects the benefits of housing allocation associated with the private market. It replaces individual and household choice with some form of bureaucratic decision making.

A key element for evaluating low income housing policy is the degree to which it improves the allocation of housing *while respecting the individual tastes and preferences of low income households*. Good housing policy will allow individual and household choice to be respected while increasing access by low income households to acceptable housing stock.

4.3.1 Micro-Management versus Entitlements

One area where the issue of individual choice manifests itself is in the broad policy distinction between micro-management of housing developments versus entitlements available to all households falling within a given classification.

This comparison is best understood by simple illustration. Some housing policies involve governments financing particular developments. The housing in those developments is then made available to households at attractively low rents. Not surprisingly, there is usually excess demand for this type of housing. As the goal is not to use an increase in price (namely rents) to allocate that housing, some other form of allocation mechanism is required. Even with eligibility criteria (e.g., income level, number of children, etc.), some judgment has to be made as to who is allocated a dwelling and who is not. Judgment is also required as to the length of tenure, whether there is a waiting list and if so how the waiting list is formed. In addition, the development itself is formulated on assumptions about household need rather than the individual and household choice associated with market development and construction. This type of policy is a good example of one that requires heavy micro-management.¹⁵

In contrast, consider the first home owners grants given out by the federal government. The requirement here is that these grants be given to households making their first home purchase. There are no eligibility criteria; it is simply an entitlement. In this respect, it is a clear subsidy to a particular class of household (those considering their first home purchase) but otherwise does not presume to second-guess particular housing preferences. The configuration of housing supply is still left to the market even though it is stimulated overall by the policy. This is an excellent example of an entitlement.

The costs of micro-managed allocation mechanisms when compared to entitlements and market-based allocation are clear. Micro-managed

¹⁵ Olsen (2001) makes a strong case for the rejection of project-based housing policies.

allocation requires the government to make a variety of assumptions about housing requirements.¹⁶ In a private market, this same information is elicited through the price mechanism. If a developer builds housing that does not satisfy buyers' needs, then the developer will go bankrupt. Conversely, developers who correctly predict changing housing requirements can build stock to match those requirements and make a considerable profit. As other developers copy these innovations, the desired housing stock becomes widespread and 'standard'.

Put simply, there is little reason to believe that micro-managed government housing developments will best meet the changing needs of low income households.

At the same time, there are benefits to the government from micro-managed developments. Such developments make government financial and budgetary planning much easier. Fixed expenditures can be allocated and agreed upon within and between governments. This can be done over many years into the future. In contrast, entitlements are inherently more uncertain in terms of their impact on government budgets. By their nature, the level of expenditure is determined by the demands of individual recipients. Thus, planning is more difficult.

This said, the government can take actions to reduce the budgetary uncertainty associated with entitlement schemes. This can be achieved through careful forecasting and, where relevant, the use of private financial markets to hedge government exposures. For this reason, we believe that *favouring allocation mechanisms that do not presume knowledge of individual household circumstance and preferences is desirable*. When resources are allocated in a more decentralised manner, it is likely to generate greater welfare and satisfaction than an equivalent government expenditure using a micro-managed policy.

4.3.2 Selection Criterion and Income-Based Instruments

Many housing policies that focus on low income households involve benefits that are income 'means tested'. The focus of the policy is on low income households so that if household income rises, the size of

¹⁶ Government practices also contribute to higher construction costs for equivalent buildings. This is due to requirements to use pre-qualified architects and builders (which are more expensive as they come from a smaller pool and pre-qualifying itself has costs) combined with a high level of specification in tender and other documentation. See "Affordable housing in the Australian Capital Territory: Strategies for action," 2002, Report of the Ministerial Taskforce on Affordable Housing.

the benefit is reduced. If household income exceeds a specific level then the benefit is removed completely.

Income based means testing of government assistance is common in Australia. It not only applies to housing policy (e.g., rent assistance) but also to unemployment benefits, health policies (e.g., the health care card), and public transport assistance. Further, income based means testing forms a common element in government assistance programs in many overseas countries.

Housing policies do not need to discriminate on the basis of income, but can discriminate on other factors. For example, the first home owners grant does not have an income test and instead supplants it with a criterion – the subsidy is for a first home – that biases towards younger households. In the United States interest payments on home mortgages are tax deductible and in Australia capital gains on owner-occupied homes are not subject to capital gains tax. These policies do not have an income criterion but tend to favour higher income households for whom interest repayments and capital gains, in dollar terms, tend to be higher.

Selection criteria are necessary for both micro-managed policies and for entitlements. For a subsidised housing development, the government needs to determine who gains access to the housing. For an entitlement, the government needs to determine which households are eligible for the entitlement.

At first glance, it might appear that a selection criterion based on income would be desirable, particularly for low income housing policy. For example, consider a policy that involves government rent assistance. The government might offer builders who construct dwellings a guarantee of interest payments on finance or of rent payments if those dwellings house low income households. A rent guarantee would require the government to pay for the difference between the guaranteed rent and the level of rent the low income household could afford. But how would the rental subsidy adjust if the relevant household's income rose? An early advocate of such plans, Jane Jacobs, outlined what could happen in these circumstances:

If a household's income improved, its proportion of the rent would go up, and the proportion by the subsidy would go down. If and when a household reached the point of paying a full economic rent, it would thereafter ... be of no concern... Such a household or individual could stay on in the dwelling forever, paying the economic rent. (Jacobs, 1961, pp.327-328)

The problems of these types of income-based selection criteria are well-known. Because the selection criterion effectively punishes households who earn greater income, these policies reduce the incentive of the household to undertake actions that will raise their income. For example, suppose that the cut-out rate for the rent subsidy was 50 per cent. In other words, for every increase in household income of \$1, the rent subsidy falls by 50 cents. Then, even in the absence of any income or other taxes, the income-based means testing has imposed an effective marginal tax rate on the low income household of 50 per cent. It effectively loses half of its increased earned income due to the decrease in the rent subsidy. The household faces a marginal tax rate above the maximum marginal income tax rate currently faced by Australia's highest income earners.

In Australia, the cumulative effect of means tested programs for the poor mean that some households effectively face marginal taxation rates of close to or even above 100 per cent. In other words, for every extra \$1 that the household earns, it loses more than \$1 in government entitlements and benefits. The household literally loses money by working harder.

The use of means tested selection criteria can create a poverty trap – a situation where low income individuals and households effectively face excessive marginal taxation rates on earned income, reducing their incentive to take opportunities that might increase their income.

While poorly designed income based selection criteria may create poverty traps, other selection criteria may also create socially undesirable incentives. There has been an ongoing and highly controversial debate as to whether selection criteria based on family size create incentives for welfare recipients to 'have more children'. Selection criteria based on marital status can lead couples to enter 'marriages of convenience'.

An important characteristic of low income housing policy is the selection criteria. Care must be taken as to how selection criteria are formulated and what this might mean for the incentives and behaviour of households themselves. Thus, a key characteristic for the evaluation of low income housing policy is *the extent to which they avoid implicit incentive traps*.

4.3.3 Level of Government

Key decisions regarding both the formulation and implementation of housing policy are made at different levels of government. Funding relating to housing policy is generally provided by the federal government in Australia, although the relevant funds may be

distributed to state and territory governments. Both decisions relating to the specific use of funds for low income housing and to the general design of policies relating to housing design are made at a state level. But these policies are usually implemented at a local level and local governments have significant discretion on the implementation of many of these rules (albeit subject to administrative appeal).

The division of decision making across different levels of government is sensible. Local governments are in the best position to judge issues relating to local zoning and the relevant urban environment. However, state governments are in a better position to judge wider trends in land use and housing. The federal government is in the best position to act to ensure equity and consistency across states.

This report is directed towards policies that would be implemented primarily by the federal government. These policies, however, necessarily have implications for other levels of government. In our evaluation of policies we have not drawn any demarcation between the relevant levels of government. Rather, we evaluate policies on the basis of their economic merit. Questions relating to the specific level of government relevant for policy implementation are beyond the scope of this report.

4.4 Summary: Criteria for Policy Evaluation

The overarching goal of low income housing policy is to ensure that low income households are able to obtain and achieve adequate and stable housing outcomes. To achieve this goal, policy must address the affordability problems associated with low income housing discussed in section 3, while respecting the idiosyncratic features of housing markets that were discussed in section 2. However, there are still a variety of alternative policies that can meet this overarching goal. To separate between these alternative policies, we need to consider the specific aspects of good policy design. In this section, we have reviewed criteria that should be observed for effective housing policy. To summarise, those criteria are:

- *Does the net expenditure associated with a policy assist in any redistributive goals the government may have?*
- *Does the net expenditure associated with a policy encourage private investment on low income housing?*
- *Does the policy encourage efficient portfolio management by home owners?*

- *Does the policy encourage ownership by occupiers?*
- *Does the policy respect the individual tastes and preferences of low income households? Alternatively, does the policy require the government or the bureaucracy to make assumptions about these tastes and preference and to micro-manage housing allocation?*
- *Does the policy avoid implicit incentive traps?*

These questions will guide us as we evaluate particular policies below.

5 Housing Policies

We now turn to review some broad housing policies that have been used to improve outcomes for low income households. Our goal here is to provide an overview of such policies and not to examine their detail nor evaluate them at anything but the broadest level.

We classify policies as to whether they aim at the supply-side or demand-side of the housing market. Supply-side policies aim to directly influence the supply of low income housing while demand-side policies aim to influence this supply indirectly, by increasing the ability of low income households to afford housing. Thus demand side policies aim to improve low income access to housing in the short run and increase the supply of low income housing as the market reacts to the changed demand in the longer term.

5.1 The Basic Constraint on Housing Prices

The basic issue behind low income housing is simple. Given their circumstances low income households are unable to afford adequate private housing at existing prices.¹⁷ As we noted at the beginning of this report, while housing markets have certain idiosyncrasies, they are still driven by underlying demand and supply. If the price of housing to low income households is too high, then that price can be driven lower by increasing the supply of relevant housing stock. Increased supply of housing stock in general and housing stock at the lower end of the quality index (above some minimum standard) will lead to lower housing prices.

Supply-side policies directly attack the supply constraint by increasing the stock of housing. In contrast, demand-side policies try to increase the ability of low income households to pay for housing. The rise in low income housing demand will tend to induce a rise in housing prices (hopefully to a degree that leaves housing no less affordable for

¹⁷ It needs to be remembered that this report is considering low income households, rather than temporary housing for the homeless, crisis housing and other housing measures aiming at the least fortunate in society. In other words, we consider stable housing units who have a relevant source of income over time but who cannot afford adequate housing.

those low income households than before such policies are imposed). In the long-run the rise in demand, particularly at the low-end of the housing market, will feed into relatively higher returns for investors in housing stock to service those households, and will lead to an increase in the construction of low income housing stock..

At a basic level, supply and demand policies are direct substitutes. For example, a supply-side policy could involve a subsidy to developers of new low income housing. Such a subsidy will increase the supply of low income housing over time, reducing the effective price of such housing to low income households. Alternatively, a demand-side policy might directly subsidise low income households when they rent or purchase housing. This subsidy will increase the demand for low income housing, tending to raise the market price of housing, but reduce the effective (i.e. subsidised) price of housing to low income families. The rise in effective price to providers of low income housing will make it profitable for them to increase the supply of such housing over time.

Because demand-side policies appear more 'indirect' than supply-side policies, it might be assumed that they are slower in their effect. This assumption is incorrect. Both demand and supply-side policies channel resources into housing development and such developments take time. New housing projects take time to be approved and to be constructed. Thus, the constraints and bottlenecks on housing development mean that there is no presumption that either demand-side or supply-side policies will be 'faster' to increase housing stock. This said, different demand and supply policies will have different effects over time and these effects need to be evaluated when judging alternative policies. For example, a general demand-side policy (such as the first home owner scheme) will have very different outcomes to a micro-managed supply-side policy (such as the development of a specific low income housing estate).

5.2 What types of households?

Both demand-side and supply-side policies need to establish criteria in order to determine which households will be eligible for assistance. Proponents of housing policies usually argue that low income households need to be targeted for assistance when they are spending too great a proportion of their income on housing and too little on other goods. However, given differing tastes and preferences between households, such a criterion for eligibility might simply target those low income households who most value housing rather than those

most at need.¹⁸ We discussed this issue when considering housing affordability above.

If eligibility criteria are based on the actual fraction of income spent on housing, then this would only seem reasonable if it is assumed that housing expenditure is indivisible. However, this does not seem to be the case, particularly for rental accommodation where a wide range of accommodation at different rental rates is available. If eligibility is to be determined by the fraction of income spent on housing then it may be better to use a 'standard' measure of housing expenditure rather than actual expenditure. This standard measure could vary between geographic regions.

Income based eligibility criteria can be based on real or nominal income. For example, the cost of housing and other goods differ between geographic regions so that an income that is adequate to gain reasonable housing in one area might not be adequate in another area. As already noted, housing involves spatial immobility, so it seems reasonable that eligibility criteria for housing policy takes geographic location into account.

Income based eligibility can also relate to current or to lifetime income. Households often face predictable income fluctuations over the lifetimes of family members. For example, a household involving a couple and a single child, where the couple are in full time education, are very likely to be a low income household in terms of current income. But if the couple are currently completing professional tertiary training then the household's lifetime income may be quite high. The problem facing this household is one of a temporary lack of income. They would expect their income to rise substantially in the future.

Lifetime income attempts to take into account not only the current income of the household but also the household's future earning prospects. After all, households with both a low current and lifetime income are likely to require very different housing support to a household with a low current income but a higher lifetime income. To treat these households as identical would lead to misguided housing policy.

Eligibility criteria may be adjusted for household size and age composition. A single person household has very different housing requirements to a household with six members. And a family of six

¹⁸ Edgar Olsen (2001) wonders if this means that proponents are suggesting that such low income households undervalue those other goods. In this situation, the appropriate expenditure to subsidise would be expenditures on those other goods.

with five members under the age of 6 years has very different requirements and needs when compared to a household of six where all members are over eighteen years of age.

As already discussed above, eligibility criteria feed into incentives. In particular, poorly designed eligibility criteria can result in ‘poverty traps’, where low income households face high effective marginal taxation rates.

Eligibility criteria also need to consider the exact goal of government low income housing policy. As already noted, such policies can have a redistributive element. Is the aim of the policy to make low income households ‘better off’ or to ensure better housing solutions for low income families? These goals are not identical and both the actual policy implemented and the eligibility criteria used need to keep the relevant goal in mind. Similarly, is the aim of the policy to encourage improved low income housing, or increased low income home ownership? Again, these are different goals and should lead to different policies and different eligibility criteria.

5.3 Supply-side policies

We begin with supply-side policies. How can the government impact on the supply of low income housing?

5.3.1 What type of Housing Investment?

Increasing the stock of decent housing available to low income households can be achieved by two routes. First, existing substandard dwellings can be rehabilitated and upgraded to an acceptable standard. Second, new construction of housing stock can be undertaken.

5.3.1.1 Rehabilitation

Rehabilitation can be achieved by subsidising landlords directly to pay for improvements that would otherwise be uneconomic. In principle, this can reduce the rents in the housing submarkets that are targeted. Thus, even though the dwellings are in fact of higher quality and would in fact receive a higher rent, all other things being equal, those dwellings add to the total supply in the relevant submarkets leading to lower long-run rents. The extent of the improvement to renters’ well-being depends on the potentially higher maintenance costs of upgraded dwellings, interrelationships with upgrade decisions in other

submarkets and low income households actually receiving access to such upgraded dwellings (Rothenberg et.al., 1991).

Rehabilitation subsidies that target home owners may have greater effect than those targeted at landlords. This is because the home owners receive the benefits of the (subsidised) improvements both in the short-term and the long-term when the property is sold. Thus owner-occupiers may have greater incentive to undertake relevant rehabilitation. However, such a policy would have little impact on many low income households. These households often do not own any existing housing stock but are tenants. As such, they would not gain from an owner-occupier rehabilitation subsidy.

5.3.1.2 New Construction

Incentives for new building construction can clearly increase the supply of housing. But what quality of housing should be targeted by such a policy? Any attempt to target low quality housing ignores the fact that a significant aspect of quality is the age and state of maintenance of the relevant dwelling. By definition, new housing stock will be of higher quality than equivalent existing housing stock. So policies that aim at increasing the supply of new dwellings will necessarily involve a quality bias.

This quality bias is not a problem in itself. However, it does mean that new housing construction might be attractive to middle income families as well as low income families. In such a situation there are two alternatives. Either the policy involves incentives that only apply if the new dwelling is sold or leased to low income families. Alternatively, the policy can rely on filtering to aid low income families. Both of these approaches have limitations.

If policies try to implement incentives that only apply to low income families, then they will involve difficult selection criteria and may be open to abuse. This most obviously applies to dwellings sold to low income households. Unless resale is prevented, such households may find it desirable to resell their dwelling onto other households who are not classified as low income. It would be difficult to stop such resale. After all, there will always be legitimate reasons why such resale might be valuable, such as changed employment location. An attempt to block such abuse of the system is likely to lead to more micro-managed development.

Filtering may also lead to problems, although this is an area that requires further empirical study. To what degree would a construction policy that increases, say, the supply of middle income housing, lead to a flow-on effect to low income housing? The answer to this

question depends on the exact nature of the links between various housing submarkets.

Unless filtering is both strong and relatively rapid, targeted policies towards housing investment are likely to be more effective for low income households than general incentives. Targeted incentives are also likely to involve lower government expenditure. However, selection criteria need to be carefully formulated to avoid poverty traps. Also, some 'leakage' of new construction 'up the income chain' is inevitable. Attempts to completely foreclose such leakage are likely to be intrusive and have little chance of long-term success.

On-going policies aimed at new construction might also have an adverse effect on the existing housing stock. The rate of deterioration of existing housing depends on the level of maintenance. But this depends on the incentives that face both owner-occupiers and landlords. For example, if there are significant benefits available to investors who construct new dwellings and lease these dwellings to low income households, but there are not equivalent benefits to investors who upgrade dwellings that are currently leased to low income households, then incentives will be biased towards new construction rather than maintenance. This may lead to the neglect of existing housing stock. This accelerated quality deterioration will tend to reduce the benefits of any construction incentives targeted at low income families. As such, any policy directed towards new housing construction may need to be tied with a policy aimed at the maintenance or rehabilitation of existing dwellings.

5.3.2 Policy Instruments

There are several different types of policy instruments that can be used to improve outcomes for low income housing by changing housing supply. We briefly review each of these in turn.

5.3.2.1 Public Subsidies and Tax Breaks

Payments from government or relief from taxation can flow through investors to housing development (Figure 4.1). Some of these subsidies or tax breaks may be tied to specific housing construction. Some of these require micro-management to assess eligibility for the subsidy (who the tenants are or where housing is located) while others take an entitlement form; including, for example, the ability to negatively gear rental properties. In some situations, these subsidies may be a guarantee of a rate of return to investors and hence, may take the form of implicit 'insurance'.

5.3.2.2 Public Provision and Management

In contrast, governments may directly stimulate housing development by contracting for specific projects and owning and managing the developments themselves. This is the thrust of public housing and is a direct means of managing rents to low income tenants. However, it is necessarily project-based and also creates incentive problems associated with non-owner occupation as well as potential administrative and other costs associated with assessing a tenant household's eligibility.

5.3.2.3 Reducing Construction Costs

As discussed in section 3, government regulations and taxes can create significant constraints on the construction of new dwellings. Some of these constraints relate directly to the cost of constructing new dwellings and of rehabilitating older dwellings. Relaxing or removing these constraints, particularly where they impinge on low income housing development, may provide significant benefits at relatively low cost to the government. For example, state and local governments could allow for 'fast track' planning approval for developments aimed at medium to high density housing that is more likely to be attractive to low-income households.

Reducing relevant fees and charges would also assist housing supply. Reducing or removing transaction taxes on existing dwellings, such as state stamp duties, would also aid low income households. These taxes create incentives for high and middle income households to renovate existing dwellings rather than to purchase new dwellings. Removal of these taxes would increase the flow of transactions in the housing market and would lead to greater movement of housing stock down the quality/income chain. Similarly, removing transactions taxes would reduce the lock-in effects associated with home ownership. This would reduce the risk of home ownership for low income families (and for their financiers). The following table, provided in the REIA submission to the Home Ownership Task Force, summarises the state-by-state transaction taxes on 'average' homes.

Duties Payable on Median House Prices and Average Home Loans - March Quarter 2002

City	Median House Price ¹ \$	Stamp Duty Payable \$	Stamp Duty as Percent Of Median House Price %	Average Home Loan ² \$	Mortgage Stamp Duty Payable \$	Mortgage Stamp Duty as Percent of Average Loan %
Sydney	372,000	12,230	3.29	192,608	711	0.37
Melbourne	316,500	14,650	4.63	163,868	619	0.38
Brisbane	220,000	6,250	2.84	142,389	570	0.40
Adelaide	168,500	5,570	3.30	119,835	409	0.34
Perth	180,100	5,094	2.83	140,023	668	0.48
Canberra	225,000	6,390	2.84	159,745	Nil	Nil
Hobart	136,000	3,505	2.58	88,917	301	0.34
Darwin	195,000	6,567	3.37	109,831	Nil	Nil

- Market Facts, March quarter 2002 edition, Real Estate Institute of Australia.
- Home Loan Affordability Report, March quarter 2002, revised edition, AMP Banking/ Real Estate Institute of Australia

5.3.2.4 Zoning Laws and Increasing Land Availability

The other area of government intervention discussed in section 3 related to zoning laws and impediments to the development of new land for housing. A change in the zoning laws to encourage higher density development would lead to increased housing construction and this would flow through to low income housing prices. Similarly, government infrastructure developments can aid the development of outer urban developments, and improve the services for low income families that live in these areas.

As noted in section 3, zoning and planning laws have an important function in urban planning. However, these laws also have a cost and that cost is likely to be borne most heavily by low income households. This cost needs to be recognised by relevant governments and the cost-benefit trade off in these laws needs to be made explicit.

5.3.3 Current Policy Approaches

Supply-side policies around the world typically comprise a variety of public housing projects and developments.

In Australia, the bulk of public funds for housing development come through the Commonwealth-State Housing Agreement. This agreement involves capital grants to State Housing Authorities who in turn provide public housing and direct aid to community housing organisations for social housing. These payments also fund crisis

accommodation, and loans and grants to private investors to offset initial costs.

In the past, United States housing policies have had a similar thrust. In recent years, however, there has been a move away from supply-side to demand-side policies (Quigley, 2000).

In Britain, there is a long tradition of state provided public housing; usually managed by local councils. This policy has undergone a revolution in the last two decades with strong moves towards owner-occupier solutions and private sector ownership. This has been achieved primarily by substitution of government funds for demand-side policies.

In the Netherlands, a significant level of housing stock remains in public hands with management provided by housing associations in a largely decentralised manner.

5.4 Demand-Side Policies

Demand-side policies target specific types of households and assist those households in gaining suitable housing through the private housing market. Unlike many supply-side policy, that require strict government micro-management, demand-side policies usually make few presumptions regarding the housing preferences of the households in need of assistance. Rather, demand-side policies assist households while allowing them to retain significant discretion over the types of dwellings they would choose to occupy. This type of empowerment has been a substantive reason for shifts towards demand-side housing policies in many countries.

Here we review the broad demand-side policies that might be applied and their potential costs and benefits.

5.4.1 Instruments

There is a myriad of instruments that impact on the demand-side of housing markets. We review some broad classes of these here.

5.4.1.1 Rent subsidies

A widely used form of housing assistance for low income households is rent assistance. This type of policy has many forms, including subsidies paid directly to low income private tenants and direct payments to landlords to ‘compensate’ for the provision of housing

to low income households. The calculation of the relevant subsidies, eligibility criteria, specificity of the payments and mode of payment differ widely between jurisdictions.

In the United States, part of the Section 8 voucher program provides subsidies for low income households who choose to live in a certain minimum standard of accommodation. The subsidy covers the difference between 30 percent of the household's income and a defined 'fair market rent.' The scheme is administered through a local public housing authority which determines the 'fair rent' for the unit. The relevant household, once they rise to the top of a waiting list, can search for any dwelling that satisfies the programs requirements.¹⁹ The public housing authority then pays the subsidy directly to the landlord on behalf of the tenants. The tenants pay the difference between the subsidy and the actual rent of the dwelling. Eligibility for the program is geographically based, with relevant families having less than 50 per cent of the median income for the relevant area.

So long as the 'fair market rent' truly reflects (or exceeds) the opportunity costs faced by landlords, this type of policy has the effect of encouraging the development of rental units that satisfy the minimum standards, particularly over the long term. The policy allows low income households to move up the housing quality spectrum. However, in the short run, the policy may also have the undesirable effect of squeezing those households who were previously serviced by 'minimum standard' accommodation but who are ineligible for the rental subsidy. From the perspective of these households, demand for housing in their relevant submarket will increase, leading to higher rents.

In Australia, a similar type of rental assistance is available, for example to individuals who receive a government pension or to households with dependent children who satisfy relevant criteria under the family tax benefit scheme. Payments are made to households who rent a dwelling from a private landlord and the payment is made to the household in addition to the other benefit payments being received by the household.²⁰ Rent assistance is calculated at three quarters of the rent being paid by the household above a minimum threshold, up to a maximum payment. For example, for a family with a single adult and one or two dependent children, the maximum payment is currently \$109.48 per fortnight.

¹⁹ Demand for the program significantly exceeds the available funds, leading to waiting lists of applicants.

²⁰ In other words, rent assistance is a supplemental benefit that is only paid to households who are receiving a primary benefit from the Australian government.

Rent assistance only applies if your rental bill is at least \$109.06 per fortnight and the maximum rent (to receive the maximum payment) is \$255.03 per fortnight. The payments do not vary across cities or regions. For this reason, it targets low nominal income rather than low real income households.

Rental assistance schemes need careful design. Because they tend to be based on current rather than lifetime income, they can easily lead to poverty traps for low income households. As noted above, eligibility criteria also mean that such programs risk harming those who ‘just miss out’ on eligibility. These programs may be viewed by governments as a drain on funds, and as the US experience shows, they may involve funding that only covers some and not all low income families. Depending on the form of payment and the dwelling criteria, these schemes may distort dwelling choice. For example, the Australian scheme which has an *ad valorem* subsidy effectively reduces the marginal price of housing to low income families once rent is above the minimum threshold and until it reaches the maximum. Such a subsidy will tend to push rental demand towards the maximum thresholds. This can involve households choosing ‘too high’ a level of housing relative to other inputs of equal or greater importance to family welfare (e.g. clothing, food, education, child care, etc). It can also lead to ‘bunching’ in the rental market, where much rental accommodation is offered near the maximum cut off with a reduction in more moderate housing.

5.4.1.2 Ownership subsidies

Governments may also assist low income households to purchase housing rather than rent housing. Again, there are many ways in which such a scheme could be implemented, including once-off or continuing payments, payments set at fixed amounts or payments based on interest rates, payments directly to the household or to the selling or lending bodies, and different eligibility criteria.

The first home owner scheme in Australia represents an ownership subsidy scheme. It only applies to first home owners and has very broad eligibility criteria. In this sense, it does not focus on low income households, although such households also enjoy the benefits of the scheme.

The U.S. section 8 program also includes vouchers for first home owners. Like the rental vouchers program, it is administered through public housing authorities and has minimum quality requirements for the dwelling. The scheme has minimum and maximum income criteria and also an employment criterion. It is generally only available to first home owners. This said, there is no separate funding for this

home ownership scheme. Public housing authorities who participate in the scheme must draw funding from other voucher arrangements and authorities do not have to participate in the scheme.

5.4.1.3 Tax breaks

Governments also use the tax system to implement demand-side housing policies. In the United States, the deductibility of home mortgage interest represents the largest housing expenditure by that government. It serves to raise incentives for home ownership as opposed to landlord-tenant relationships. But, as it is a tax deduction in an otherwise progressive taxation system, it disproportionately favours higher income households.

In Australia, rental properties obtain an interest rate deduction through negative gearing but this favours more expensive rental properties that are likely to be owned by investors with incomes on the top marginal tax rate.

An important issue is whether the United States policy removes or creates a distortion toward home ownership. Rents will have any after-tax financing costs built into them. In this sense, in Australia, rental properties involve lower after-tax financing costs than home ownership. This is not the case for the United States and it could be argued that the Australian tax system distorts the housing market towards rental properties and away from ownership.²¹

On the other hand, under the US system, home mortgages attract lower after-tax financing costs than other purchases (including cars, education and other durable goods) where interest payments are not tax deductible. Thus, the US scheme will tend to distort household decisions towards housing and away from other consumer durables. US households will tend to over-consume housing relative to other goods pushing up house prices and rents in dense urban areas.

As such, there are distortions in both systems in that after-tax financing costs are different between different expenditure types.

Neither the Australian nor the US tax rules for interest deductibility are directed towards low income housing per se. In the US, the Low-Income Housing Tax Credit programme provides tax relief for investors in long-term low income housing. There is certainly scope, therefore, for governments to use tax relief to encourage investment

²¹ Although, to the degree that such a distortion exists, it is not reflected in simple home ownership figures. However, many factors affect total home ownership, including issues relating to culture and mobility.

in housing for particular types of households. However, the scope for tax relief to low income households themselves is limited by the fact that those households usually do not incur significant levels of tax relative to housing costs.

5.4.1.4 Loan guarantees

The above instruments essentially amount to direct payments to improve outcomes for low income households. An alternative is for the government to take measures to share risk that arises from the provision of housing to low income households.

One source of risk concerns the households themselves and their future ability to pay rent or to meet mortgage interest payments. This type of risk sometimes means that there is poor access to financing (e.g., bank lending) for low income housing; whether it be for home ownership or rental properties.

The government can absorb some of this risk by guaranteeing some portion of loans that are made to investors providing accommodation for low income tenants or to low income households themselves. Such guarantees can improve access to debt financing at market rates of interest.

5.4.1.5 Shared equity

Another source of risk arises from the future value of the housing provided to low income households. That future value is uncertain because of changes in land value as well as idiosyncratic impacts on particular neighbourhoods.

The government could potentially share in some of this type of risk by taking an equity stake in properties. This would mean a capital outlay for the government but the government would also share in potential returns from the investment. This is essentially a public version of the proposal for shared equity financing instruments by Caplin and Joye (2002).

5.5 Policy Evaluation

This section has reviewed some of the common demand-side and supply-side housing policies. How do these policies fare when subjected to the criteria outlined in earlier sections of this report? These criteria can be summarised as follows:

1. Does the policy provide adequate housing solutions for low income families?
2. Does the policy deal with the basic affordability problem facing low income households in particular and more generally affecting many households?
3. Does the policy achieve the government's redistributive aims, if any?
4. Does the policy ensure that the flow of government funds is transparent and accountable?
5. Does the policy lead to an appropriate mix of public and private funding for low income housing?
6. Does the policy provide appropriate incentives for increased public or private investment in low income housing, either through maintenance, refurbishment, new construction or the movement of existing dwellings to low income households?
7. Does the policy respect the choice and preferences of low income households, or does it involve a high degree of micro-management and government presumption about low income households' needs?
8. Does the policy address issues of spatial immobility and provide flexible housing opportunities and outcomes for low income households?
9. Does the policy adequately deal with both short run and long run changes to the housing market?
10. Does the policy deal with basic market imperfections in the rental and mortgage markets?
11. Does the policy protect low income households from various sources of income risk?
12. Does the policy allow for evaluation of household needs on the basis of life time income or only on the basis of current (often transitory) income?
13. Does the policy allow for geographic differences and differences in real housing prices between geographic regions?
14. Does the policy deal with the underlying supply constraints facing the housing market, particularly land constraints which may be exacerbated by government laws and regulations?

15. Does the policy create appropriate incentives for low income households? In particular, does the policy avoid creating a poverty trap?
16. Does the policy avoid creating undesirable side-effects for households that, while not classified as low income, may compete with low income households for housing solutions in private markets?
17. Does the policy deal appropriately with the externalities that exist between neighbouring dwellings and within geographic areas?
18. Does the policy take adequate account of filtering in the housing stock and, where relevant, use filtering to the advantage of low income households?
19. Does the policy encourage owner-occupiers?
20. Does the policy allow for adequate portfolio management by low income home owners?

Clearly, no one policy will be able to adequately address all of these criteria. However, the success of any policy (or group of policies) for low income housing will depend on how successfully it addresses these criteria.

Individual policies, of course, will differ and require individual analysis, particularly regarding eligibility criteria and the incentives created by the policy. Broadly, however, direct housing provision by government through housing estates clearly fails a number of criteria. Such estates are often purpose built and do not take advantage of filtering in the housing stock. Government built housing is micro-managed and does not respect individual household choice. Estates are often highly (if not wholly) reliant on government funds so such a policy fails to bring private capital participation. It often tends to aggravate spatial immobility, particularly if managed on a regional basis so that a household choosing to move to another location is forced to go 'back to the bottom' of a waiting list. Estates tend to be long-term solutions with little benefit in the short-term. Purpose built low income housing estates often place little emphasis on the externalities that exist between dwellings in the housing market. Eligibility criteria are often based on current income and may create poverty traps. There is little emphasis on owner-occupation in many public housing estates, and tenants may have few incentives to contribute to upkeep and maintenance. Finally, public housing estates are inflexible and are unable to adapt to changing household circumstances in the short term.

Given these failures, it is unsurprising that many governments have moved away from state-based policies. Many of these same failures also apply to more geographically dispersed solutions, for example, where government-owned, low income housing is located throughout residential suburbs. Thus, while some direct government ownership of housing stock might form part of a total package of low income housing policy, it is clear that such direct ownership is unlikely to be the central plank in a successful low income housing policy.

Private subsidies and tax concessions for private investors who move property into low income housing are more likely to provide appropriate solutions than direct government ownership. Such policies better facilitate the use of private as well as public funds. As such, these policies can potentially lead to better housing for those on low income for any given level of government expenditure. Micro-management may still be a problem with such policies as they often rely on the classification of housing in advance as suitable for low income households.

Thus, at a broad level, policies that emphasise the supply side of the market are likely to have limited success. But this does not mean that the supply side should be ignored. In fact, there are important supply-side elements that need to be addressed in low income housing policy. The careful consideration and (where relevant) alteration of zoning laws, housing density regulations, and stamp duties on housing transactions clearly focus on only a few of the above criteria. However, they address the underlying constraint of supply on overall housing affordability. The evaluation of these laws and regulations, together with the careful development of public infrastructure to allow an increased supply of urban land, are likely to be key planks in any successful low income housing policy.

Demand-side policies allow for greater flexibility for low income households, so long as they do not deteriorate into micro-managed schemes due to bureaucratic implementation. They also create incentives for private funds to flow into low income housing. Rent subsidies and mortgage assistance can also remove some of the risk from the relevant housing markets. However, standard rent subsidies, for example, tend to focus only on current income and, in Australia, do not allow for geographic differences. The eligibility criteria also tend to create poverty traps, hurting low income households in the longer term. At the same time, the policies are inflexible and it may be difficult for these programs to provide short-term relief where a household has temporary need. Such policies may also impact adversely on those who just miss out on eligibility through competition for a limited stock of dwellings in the short-term.

Loan guarantees and shared equity arrangements both deal with demand-side factors effecting home ownership opportunities for low income families. Shared equity arrangements allow for improved utilisation of a low-income household's own funds, while removing some of the risk of home ownership from these families. Loan guarantees help overcome risk factors in the mortgage market and help protect low income households from income risk. We consider two variants of these policies below.

6 Policy Options for Investigation

In this section we consider some innovative proposals that, in our opinion, are worthy of closer government investigation as to their merits and costs. These proposals are ones we have distilled from the myriad proposals and policies implemented for low income housing around the world. The analysis presented here is not meant to be a full evaluation. Rather, we compare these policies to the criteria for good low income housing policy and provide a preliminary assessment. A full assessment of these proposals will involve work beyond the scope of this report.

The driving motivation behind considering these proposals is the limited success associated with many existing policies. The problem is not that governments have failed to address low income housing. In fact, the converse is the case, with many developed countries having low income housing policies. But these policies have only met with limited success. This does not mean that existing policies need to be scrapped completely (although this is an option that needs to be evaluated on its merits). At a minimum, however, existing policies need to be supplemented (and possibly replaced) with better designed, innovative housing policies.

We have already emphasised the potential for governments to improve general housing affordability by simply re-evaluating and changing laws and regulations relating to transactions taxes, zoning and housing density. We do not restate these issues here. In our opinion, any successful policy needs to include a re-evaluation of existing government interventions in the housing market. To use a sporting metaphor, such changes are a fee kick for governments that will help them achieve low income housing goals.

6.1 Supply Elastification

While we have pointed out the limitations associated with many supply-side policies, it is worthwhile considering in more detail a proposal that has been presented to make the housing market more responsive to the needs of low income households.

6.1.1 Affordable Housing Consortium

The Affordable Housing National Research Consortium (AHNRC) is a national committee with representatives from the housing, building and development industries, trade unions and not-for-profit organisations. These include the Housing Industry Association, Australian Council of Social Services, Real Estate Institute of Australia, Australian Council of Trade Unions, National Community Housing Forum, Urban Development Institute of Australia, Property Council of Australia, Royal Australian Institute of Architects, Master Builders Australia, and the Royal Planning Institute. This consortium commissioned the Australian Housing and Urban Research Institute (AHURI) and the Allen Consulting Group to undertake an extensive study into the nature of the affordable housing problem and the options for public policy in this regard.

Their report, released in 2001, advocated and costed a preferred policy outcome amongst the many options that they evaluated. Their preferred policy has the following elements:

- *Public debt raising:* that the state and territory governments raise debt through a long-term bond issue at market prices to private investors. Institutional investors were seen as potential purchasers of these bonds in the current environment of low public debt in Australia.
- *State government acquisition of new and existing dwellings:* housing authorities in each state (or SHAs) would use the funds to acquire dwellings.
- *Federal government subsidised rent:* those dwellings would be let out at low rents to eligible tenants. This will mean that the returns on the government dwellings will be insufficient to cover the bond financing costs (as these are at market rates) and operating costs on the dwellings. The gap would need to be covered by the Federal government for the life of the program.
- *Progressive sale:* the dwellings would not remain in public hands indefinitely but would be progressively sold off when they fell vacant. The sale would be used to repay debt.
- *Sunset:* those dwellings still in government hands at the end of 20 years would be sold and the remaining debt would be retired. Sitting tenants at that time would have to be relocated. Of course, it is also possible that an SHA may decide to retain

this stock in public hands. In this case, state governments would be required to bear subsidy costs.

The main motive behind this proposal is to make certain and clear the burden that would fall on the Federal government from this scheme. State governments issue bonds and so long as the dwellings' value appreciates at a rate less than the interest payments on those bonds, it should be neutral for them.

The Consortium argues that this program is cost effective for the Federal government because for each dollar in subsidy, \$4.50 in housing can be acquired – that is, \$3.50 comes from private investors. This is compared to the alternative where all \$4.50 comes directly from the Federal government.

It is argued that the consortium approach involves a public-private partnership and brings new private funds into public housing. Such a claim, however, is simply an illusion of accounting. Government expenditures on housing can and always have been met by a combination of taxation and government debt. The Consortium is arguing for an increase in debt rather than taxation to fund public housing. They compare this to the alternative where public housing is funded totally out of taxation revenues. Taxation is often considered undesirable because it can distort economic outcomes as well as reduce macroeconomic stimulation. Debt finance is potentially better although, from taxpayers' perspective, debt involves a deferred tax liability.

It might be argued that debt is beneficial compared to taxation for public housing because the proposed housing investments are sound investments; expected to earn an acceptable return. However, this means that they would be a good investment regardless and would be undertaken by private investors without the need to issue State debt.²² On such an argument the only reason that the public housing investments would need to be undertaken and managed by SHAs is because (i) state government debt costs are lower than private sector

²² A proposal put forward by Brendan Crotty, CEO of Australand, envisaged an alternative funding approach to new low-income housing construction that would have it fully provided for by the private sector with an explicit rent subsidy paid for by the Federal government to ensure a sufficient rental yield for those investors. While this has similarities to rent assistance schemes, it has the advantage of tying those schemes to new housing construction (in a similar manner to the Consortium project). Interestingly, a second aspect of that scheme is when housing is eventually sold, residents may be able to appropriate some of the capital returns if they satisfy certain standards of continual rental payment and property maintenance. Thus, some of the advantages of home ownership would come to play in a similar manner to the shared equity proposals of Caplin and Joye.

finance costs; and/or (ii) the SHAs are superior managers of these dwellings as compared to private investors.

If the goal of the proposed program is to manage the Federal subsidy to low-income rents, there is no reason why it has to be tied to a particular policy of State public housing and borrowing. As Berry (2002, p.9) notes: “the Consortium model reinvents public borrowing for social housing.”

The Federal government subsidy that is part of the Consortium proposal could alternatively go to *any* provider of a dwelling who rents that dwelling to an eligible tenant. This could include public housing financed by State borrowing or any private investor. The total subsidy payments could be capped and the allocation of subsidy payments among the states could be fixed as well. This would make the proposal similar to the Section 8 Voucher program in the United States.

The Federal government currently has a program of rent assistance that operates through supplemental payments to recipients of other government benefits. In our opinion, it is worth considering whether this program should be broadened. Such an enhanced rent assistance program might be based on increased federal government borrowing. However, we believe that the use of government funds for low income housing and the financing of any federal government deficit are really two separate issues and there is no need to tie low income housing to an expansion in public debt. Similarly, an expanded low income rent assistance scheme may be targeted more at dwellings than at households. However, for the reasons discussed above, it is likely that a policy aimed at low income households rather than specific dwellings will better serve social goals. It offers greater flexibility and avoids spatial immobility. There would only be a need to target specific housing developments if the private market for housing was unable to provide appropriate housing. However, there appears to be no evidence of a market failure that would limit any private response to increased demand for low income housing that would flow from an increased government subsidy.

6.1.2 Caplin-Glaeser-Joye Proposal

The Caplin-Glaeser-Joye proposal deals with government planning laws. This proposal has been presented in detail in a separate paper for the Home Ownership Task Force. In brief, the proposal considers innovative ways to accelerate the approval and land release process so as to promote private sector investment in the production of affordable housing. Such accelerated processes could include binding targets or quotas for local authorities where the targets are adjusted to

reflect regional differences in housing markets. Enforcement would involve tying some of council funding to them satisfactorily meeting their targets.

6.1.3 Wood Proposal

Gavin Wood (2001) has formulated a proposal that is similar to the US's low-income housing tax credit. He proposes two reforms to the tax system to achieve this:

1. *Income tax credit*: investors with dwellings that have rents below a certain threshold (Wood considers \$100 per week), would receive tax credits.
2. *Capital gains tax reform*: there would be relief from capital gains tax on the first \$10,000 of capital gain for these dwellings.

This policy would be an entitlement to any investor at the lower end of rental accommodation. As such it avoids some of the micro-management aspects of proposals aimed at particular dwellings.

While it might appear that this policy avoids the need for government funding, the federal government still funds this scheme 'through the back door' via capital gains tax relief. Thus the policy involves the provision of government funds but in a non-transparent fashion. There are also issues of accountability relating to length of low income tenancy, the legitimacy of tenants and the nature of the dwelling. The policy may lead to the inappropriate downgrading and degradation of some housing stock, in order to meet the program requirements.²³ Such a scheme would need to be carefully designed to prevent gaming by investors.

It is also far from clear that this scheme would ultimately target low income households. As we have discussed, an issue for low income households is the risk that they face in the rental market. This risk means that low income households may be viewed as high risk. Because this scheme is open to any investor who rents a dwelling below the rental threshold, there is a potential for gains from trade between investors and more-secure, middle income households. Such

²³ As a simple example, an investor seeking to gain the benefits of the scheme could take a single dwelling, rented at \$200 per week, and divide it into two dwellings, each rented at \$100 per week. At one extreme, this may simply be done as an accounting trick – without even a change in tenants. At the other extreme, where each dwelling requires specific individual features, the division may involve costly (and possibly inappropriate) modifications to the dwelling that reduces its utility for housing.

households are more secure tenants, in that they carry less risk of failure to meet future rental obligations. An investor may prefer to offer the dwelling to such 'secure' tenants rather than to a low income household. The middle income household, at the same time, may be willing to take the low rent, even at the cost of some reduction in housing quality.

One benefit of this proposal is that, unlike negative gearing, tax relief would only be possible if the dwelling is actually rented. Thus, landlords would have an incentive to fill vacant dwellings with low income households. However, the proposal fails to meet many of the criteria identified in this report, and we doubt that it provides significant benefits compared to alternative proposals.

6.2 Demand Elastification

As already discussed, demand side policies offer some benefits compared to policies that target specific dwellings. We now consider some innovative demand side policies that are worthy of further government attention.

6.2.1 Housing Lifeline

Perhaps the main problem for low income households relates to the *risk* that they face and the affect of this risk on their prospects of success in either the rental or the mortgage markets. Sudden loss of income, due to the loss of employment, illness or other short-term changes in circumstances, will adversely affect any household. But for low income households, who have little, if any, savings, such a loss of income can have disastrous repercussions for housing. Unable to meet rental or mortgage payments, households faced with short-term distress can face the loss of appropriate housing. Current assistance programs, however, are not well equipped to deal with short-term distress. For example, Federal government rental assistance in Australia only becomes relevant once a household becomes eligible for other forms of benefits. In the US, Section 8 voucher programs often involve waiting lists, meaning that they are unable to meet the needs of low income families facing short term distress.

As we have already noted, the risks associated with low income households mean that landlords and lenders will rationally discriminate against low income households in the housing market. Landlords and lenders will be reluctant to provide relevant services to low income households. Thus, the risk of short-term income

fluctuations can lead to a long-term housing problem for low income families. In the extreme, appropriate housing solutions may be unavailable to these households at any price.

Standard approaches to low income housing often pay scant regard to this short-term income risk. The programs are designed for households that not only have low income today, but are destined to remain on low incomes forever. Further, as we have noted, the eligibility criteria for these programs often create poverty traps that exacerbate the plight of low income families over the longer term.

Rental and interest guarantees provide one way to help overcome market failures for low income households. These types of programs help to remove the risk from lenders and landlords. However, these programs often lack flexibility and cannot address income shocks when they arise.

An alternative approach would involve governments addressing the income risk associated with low income households directly. In particular, the government could provide a form of income insurance to low income families, to ensure that short term income fluctuations do not create long term housing problems. For example, the government might allow a household that has suffered a short-term drop in income, due to say unemployment or temporary lay off, to draw down a payment (say up to an eventual maximum of \$5,000 - \$10,000) towards rental or mortgage costs.

The obvious question is how would such insurance work? After all, if an individual is unemployed, they can (after the relevant waiting period) receive unemployment benefits and rental assistance. Isn't this already a form of government income insurance? Yes. But it is a form of benefit that is not designed as insurance but as a form of long-term assistance. In addition, housing stress can arise for income shocks not necessarily the result of unemployment (e.g., sickness or profit reductions for small business owners). From the perspective of providing income insurance for low income households, existing rent assistance does not address short-term income fluctuations, requires low income households to draw down (possibly non-existent) savings while waiting for eligibility, fails to offer security to lenders and landlords, and creates undesirable incentives for the low income household as it tries to overcome the temporary setback.

In this subsection, we consider an alternative approach that we call a 'housing lifeline.' This is essentially a government provided insurance product. It has a number of similarities to the Higher Education Contribution Scheme (HECS) in that it is based on lifetime income rather than current income, it limits the impost of government funds while providing short-term relief for relevant households and it is a

product where benefits are determined by the needs and requirements of the low income household themselves.²⁴

6.2.1.1 The basic concept of a housing lifeline

Suppose that a household suddenly finds itself facing a crisis where they are likely to be unable to meet short-term commitments for housing payments. A housing lifeline would mean that the household would be able to draw down a payment from the federal government to tide it over the short-term crisis. This payment would be a loan to the household, but the loan would be automatic. In other words, the household would need only to prove relevant need and satisfy simple liquid asset tests in the short-term. However, the household would incur a future tax liability associated with this loan. The payment of this liability would be tied to future income, like the HECS. Further, the liability may or may not have a reduced interest rate associated with it, depending on government policy.²⁵

Payments to a household would be capped. The housing lifeline is designed to provide short-term relief, not to provide a permanent source of support for those families who will not have the means to adequately fund housing in the medium to long-term. Thus, the lifeline *does not replace* other long-term poverty programs but supplements these programs providing more appropriate assistance to low income households facing temporary crisis. The payments may be capped on both a weekly and a total basis. For example, it might be possible to 'borrow' up to \$200 per week under the cap up to a total of \$10,000. Thus, the scheme would provide up to 50 weeks (or more if less than \$200 was drawn upon) support for a relevant household.²⁶

²⁴ In many ways, the housing lifeline aims to overcome exactly the same type of market failures that HECS is designed to overcome. Tertiary students are often unable to borrow against their future income, and so may be unable to afford the cost of tertiary education. The credit market fails for these students. Similarly, low income households face income risk that prevents relevant credit markets that relate to housing from working for these households. Further, the low income households are generally unable to purchase private insurance at reasonable premiums due to their risk.

²⁵ One obvious way to limit government exposure to long term risk would be to set the lifeline interest rate equal to the long-term government bond rate. This is likely to be substantially below equivalent interest rates available to low income families.

²⁶ Even low income households who face a crisis due to unemployment usually find new work within six months. Thus, any household who remained in crisis after twelve months should probably be moved to a more permanent program.

We envisage that the payments under a housing lifeline would be tied to housing.²⁷ Thus, funds would be paid directly to a (registered) landlord or lender specified by the relevant household. This would require a contractual agreement that ensures that the funds do reduce the household's liability to landlords and lenders directly. At present, Medicare payments operate in this manner.

Drawing down the lifeline would be a choice made by the relevant household. But because this access to an instant 'line of credit' removes a substantial amount of the risk that would otherwise face lenders and landlords who provide housing solutions to low income families, the lifeline directly addresses the problems embedded in the rental and mortgage markets.

The risk, of course, does not disappear, but it is both reduced and it is passed onto the government. The risk is reduced because the government takes on a portfolio of 'loans' to low income households. Unlike an investor with only one or two properties, the government can pool the risk of income loss for low income households, reducing the idiosyncratic variability of that risk.

It is recognised that there are significant differences from the government's perspective in the positions of people who are in housing stress because they cannot meet their mortgage payments and those who cannot pay their rent. The housing lifeline proffered to a struggling mortgagor can readily be constituted as a second (or third) mortgage ensuring that the government has some real security for its advance over and above the promise of the borrower to repay. Advances to a struggling tenant are supported only by the obligation of the borrower to repay and that of course being contingent on earning sufficient income in the future to enable him or her to do so.

It is for that reason that government may consider this housing lifeline is best first tested with those in the process of buying homes.

While the government takes on board the risk associated with low income households, through the housing lifeline insurance, the government is also in a good position to deal with that risk. The government has the substantial advantage of ensuring appropriate repayment of any lifeline loan through the taxation system. A low income household can use the lifeline in periods of crisis and then would repay the loan when their circumstances improved. This may

²⁷ Alternatively, the payment could be made to the household who would then choose how they divided up the funds. As our emphasis in this report is on low income housing, we will only consider how the lifeline applies to housing, not a more general scheme to aid households in crisis.

be in the short-term or in the longer term, depending on the relevant household's circumstances. For example, modest repayments to the government may begin when household income approaches a set level above poverty-line income.

This illustrates the basic concept of the housing lifeline. However, a myriad of practical issues present themselves. In what follows we provide some answers to natural questions that arise.

6.2.1.2 How would the lifeline be funded?

In principle, the housing lifeline could be self-funding. So long as the interest rate charged by the government is above the long-term bond rate on government funds and accumulated debt is eventually repaid, the government will be operating on the same funding principles as any lender.

In practice, however, full repayment from every household will not be possible. Some households will move from temporary to long-term crisis and will be unlikely to ever gain a lifetime income that would allow repayment. In such a situation, the household can be transferred onto appropriate long-term benefits after the lifeline expires or when the long-term nature of the crisis becomes evident. Further, to the extent that the government subsidises the lifeline interest rate (especially in situations where the crisis is protracted), the repayments will be less than the financial cost of the associated funds.

At the same time, because the lifeline aids households in temporary crisis and provides appropriate short-term assistance to these households, it can help these households avoid becoming reliant on more long-term government assistance. For example, a low income household suddenly faced with an income crisis may face eviction or foreclosure. This may force them to move to alternative housing in the short-term and may force them to move onto government benefits. In the medium-term, the crisis will harm the household's credit standing so that it may be harder for the household to gain appropriate housing in the future. Thus, the temporary income crisis may lead to a long-term housing crisis for the household. The timely and temporary intervention allowed by the lifeline can avoid these long-term problems (with the associated long-term government payment of benefits).

6.2.1.3 Who is eligible for the lifeline?

We envisage that the housing lifeline be available to households with insufficient financial assets (as defined by a means test) to utilise to overcome short-term housing crises. The financial assets would

include equity in properties (other than the family home), shares and other financial assets but not superannuation (which is currently illiquid).

The idea of basing eligibility on an asset rather than income test goes to the heart of the lifeline concept. An income test is inappropriate because (1) it is income that is fluctuating and generating the need for a lifeline (so it is unclear what the appropriate measure of income would be); and (2) income-based eligibility tests have the potential to create poverty traps. On the other hand, assets are a measure of lifetime income and wealth accumulation. Thus, for the same reason that these are used for eligibility to old-age pensions, they are an appropriate sorting mechanism for who should be entitled to a housing lifeline.²⁸

6.2.1.4 What maximum debt should be allowed?

The basic idea of the housing lifeline is to insure households against loss of housing during short-term fluctuations in income. The level of debt allowed will be related to the period of time the household is in crisis as well as the level of liabilities in terms of rent and loan repayments they face. Evaluating this would require more information regarding the length of time and level of payments that could see an average low income household through a crisis.

Suppose it was determined that typical housing stress can take 12 to 18 months to overcome and required payments of \$100 to \$200 per week. This suggests that a maximum debt of between \$10,000 and \$15,000 would be sufficient to cover this period. Nonetheless, the exact amount available would really require a careful examination of the reality of housing stress.

²⁸ An alternative would be to make the lifeline an entitlement; being available to everyone. This, of course, raises an issue that every household may choose to take out the maximum possible loan if the interest rate on the lifeline is less than current market lending rates. Short-term interest penalties could be used to ensure that higher income households do not have an incentive to take out the lifeline. The advantage of this is that it would require no government screening process for eligibility; saving time and money. There is, however, an issue for those households that are currently in long-term crisis. Households currently receiving rent assistance or similar would have an incentive to take out the lifeline on the expectation that their incomes may never rise enough to have to pay it back. This suggests that there will have to be some limitations on the eligibility of households currently receiving other forms of government benefits. This could be achieved by restricting eligibility directly or alternatively by offsetting those benefits on the assumption that the lifeline will be used. Nonetheless, in either case, households with current long-term housing difficulties need not be penalised by the availability of a housing lifeline.

Adjustments would also have to be made for the number of people in the household (in particular, the number of dependents). This, however, is something that is currently dealt with through the social security and taxation system; principles of which could carry over to the housing lifeline.

6.2.1.5 What interest rate should be charged?

We envisage that debt accruing under a housing lifeline would be subject to interest that would compound over the life of the debt. To break-even, the scheme would have to charge an interest rate exceeding the rate on long-term government bonds to take into account the debt that is never repaid. However, it is possible that the interest rate in this situation may still be less than market rates on home and other lending.

In principle, the lifeline need only provide a ‘no questions asked’ access to normal market lending rates that might not otherwise be available to households in crisis. This would avoid any credit rationing that might otherwise occur. In this situation, the government may actually generate long-term revenue from the scheme.

It is also possible that the interest rate could be lower than market rates or even a break even rate. In this case, the scheme would play a role of providing a subsidy to low income households.

The level of interest rate ultimately depends upon whether the government wishes to use the lifeline as just pure insurance or something more. This is not a policy judgment that can be easily made here.

However, in terms of interest rates charged, there is an issue as to whether those rates will be fixed or variable. Again, this brings in issues of sound management of government debt as well as other macroeconomic considerations.

6.2.1.6 What happens if a household is still in crisis when their maximum debt is reached?

A household that remains in crisis for a longer period of time will exhaust their lifeline resources. In this situation, closer intervention will be required. This could be in the form of a review that extends their loan or it could be a shifting to other social security and housing plans designed to deal with households with long-term low income. It needs to be emphasised that the housing lifeline is designed to provide assistance to short-term loss of income and housing stress. Long-term issues need to be addressed through other means.

6.2.1.7 What will the lifeline do to household incentives?

An issue that commonly arises with housing assistance is that it can create a poverty trap. That is, if it is income based, when incomes rise, households may face very high marginal tax rates. This, in turn, reduces household incentives to find employment or otherwise restore income to their previous levels.

Because the lifeline repayment is based on a notion of lifetime income rather than current income, it is less likely to create a poverty trap for households. While repayments through the taxation system will create income zones where the household faces slightly higher taxation rates than otherwise, these changes are small compared to the effective marginal taxation rates under, for example, rent assistance schemes. Thus, a housing lifeline can retain incentives for households to take appropriate actions and risks to improve their standard of living.

The lifeline is based on a loan, not a gifted payment, so there are reduced incentives for higher income households to try and abuse the system. To gain a payment, a household only needs to provide a tax file number and appropriate identification. But repayment begins as soon as the household income exceeds a certain level. A household earning income above that level has little incentive to 'borrow' funds then immediately repay them through the taxation system.²⁹

6.2.1.8 What happens if households do not expect to return to their previous income?

An important practical issue arises because reductions in income to households are not necessarily purely random events but can occur because of retirement and related factors. A household where the primary income earners are nearing retirement and do not expect to have a large future taxable income may opt for the housing lifeline as they do not expect to have to pay it back.

While a difficult issue, it does not appear to us to be something that is insurmountable. First, the maximum allowable debt could be made partly age related (falling as the retirement age approaches). Second, repayments could be tied to the old-age pension or superannuation taxes. Again, this practical issue will require careful attention but does

²⁹ If such borrowing was sought by inappropriate households, due to say a discounted interest rate on the lifeline, then this can easily be prevented through a penalty payment if household income within twelve months after the borrowing occurs exceeds a particular level (e.g. lies in the top two quintiles of Australian household income). Thus, only truly low income households would find it desirable to use the lifeline.

not appear to be any more difficult than similar issues that arise in taxation or social security. Indeed, the old-age pension already includes an asset requirement suggesting overall compatibility with the lifeline concept.

6.2.1.9 Is the debt incurred by individuals or households?

Under the HECS scheme, debt is incurred by individuals. The taxation system is based on individual income. In the case of the housing lifeline, however, an individual based debt would raise some problems.

The most salient of these has to do with the possibility that only one member of a household earns income. If the housing lifeline were available to individuals, then households would face an incentive for one or more members not to earn income but to utilise the housing lifeline (without the need to ever repay the debt). For this reason, some household-based notion would seem appropriate.

This, in turn, raises other difficulties. For example, issues of liability in case of the break-up of the household need to be considered.³⁰ The accumulated household debt would need to be divided; although the same issue is faced by all home mortgage lenders.

In addition, a household based scheme would create an incentive for individual members to represent themselves as members of different households. We have no clear solution to this practical problem at this stage. Nonetheless, it should be noted that such problems arise for many social security payments and for the private health insurance rebate. Penalties may have to be imposed and enforced, a registration system may be needed and some means of recognising household-based income would be desired.

6.2.1.10 Isn't this something banks could (or should) do?

A natural question arises as to why banks and other lenders cannot provide temporary loans to households in crisis. In economics, the reason there is a market failure here is because banks cannot easily distinguish between households who face short and long-term housing crises. As they do not wish to manage the risks of loan default, they naturally shy away from lending to households precisely when they might need a loan most.

³⁰ It may be useful to treat household lifeline debt as any other household debt in the case of household separation.

The government, however, already bears the risk associated with long-term housing crises. Therefore, while it faces funding issues associated with managing its own debt, this is not related to the particular, unknowable status of a particular household. It also has the ability to use the tax system to monitor income and repayments. In this respect, the government is in a better position than private lenders to provide a ‘no questions asked’ lifeline to households in crisis. They can assist those households for which the crisis is short-lived while continuing to assist those with long-term needs.

6.2.1.11 Will the lifeline encourage home ownership?

The lifeline will encourage home ownership by reducing the risks associated with taking out a home mortgage. For households, they face a reduced risk of default because of a short-term inability to meet repayments. For lenders, this reduced risk of default will change the criterion upon which they can accept loans from low income households. In this respect, it will improve access to credit.

However, in its broad form, the lifeline does not explicitly encourage home ownership over renting. The lifeline payments will apply equally to owners and renters. Thus, landlords will face lower risks of non-paying tenants and hence, there will be improved access to rental properties for low income housing. The lifeline is designed to make housing more affordable regardless of whether housing is owner-occupied or not.

6.2.1.12 How will this be implemented?

At the first instance, it makes sense to provide the housing lifeline on a more limited basis. For example, it may initially only apply to home owners with mortgages. In this form the lifeline will in fact be a statutory second mortgage and could be managed by the government as such. This would make the lifeline virtually costless to implement in a budgetary sense. It would also provide a means of transitioning from the current (temporary) first home owners grant.

Once the lifeline has been established as workable on this dimension it could be extended to include the broader rental market – where much of the low income housing problems reside. Doing this, however, will likely require a review of existing government policies for rent assistance and the like to ensure compatibility with the lifeline. For this reason, we envisage that it will take longer to implement a broad lifeline than one applying only to mortgage holders.

6.2.1.13 Evaluation against policy criteria

The basic approach of the housing lifeline is to directly address an important problem that faces low income families in a way that is likely to be cost effective for government and that addresses the relevant problem without creating issues of welfare dependency and poverty traps.

The housing lifeline is not about providing new housing solutions for low income families but rather opening up housing opportunities through the private market for low income households and helping them to retain appropriate existing housing in the face of temporary setbacks. The policy is about housing insurance. Thus, it should help low income households gain adequate housing with almost no micro-management. It increases choice for low income households rather than decreasing choice, so it respects the preferences and wishes of individual households.

While the housing lifeline improves the availability of housing for low income families, and does so in a way that does not artificially separate the market on ‘eligibility’ grounds, it is not aimed at addressing broader housing affordability. The housing lifeline will make it more desirable for private investors to develop housing for low income families, but supply constraints on housing will still arise. For this reason, the housing lifeline should be considered in tandem with other policies that help improve general housing affordability, such as the re-evaluation and reform of transaction taxes and planning laws discussed above.

The housing lifeline helps to bring private funds to play in low income housing solutions. In particular, it brings the private funds of the low income households themselves into the market to provide appropriate housing. Unlike other policies, it does not view low income households as ‘victims’ to be ‘helped’ through benefits funded by others. Rather, it empowers the low income household and helps them to access their future income rather than just depending on their current low income.

The housing lifeline brings government funds into play, but it also provides a means for the government to recover at least some of these scarce funds.

The housing lifeline does not specifically address existing issues of spatial immobility, but also does not artificially increase constraints on mobility for low income households, unlike schemes that are tied to particular dwellings. The scheme, however, is highly flexible and the choice of how much or how little of the scheme to use at any point in time is largely up to the relevant household. Thus, while the scheme

does not explicitly allow for geographic differences, the household itself can adjust for those differences within the payment bounds set by the government. Further, because it is based on individual household needs, as seen by that household itself, it responds instantly to the changing circumstances of that household.

The scheme does not explicitly encourage owner-occupiers, but is neutral with regards to the household's own housing choice. Owner-occupation can be useful in addressing a variety of externalities that exist between dwellings and within geographic areas. But it also lacks flexibility and may exacerbate issues of spatial immobility. The housing lifeline allows the individual household to determine which source of housing; rental or owner-occupied; best suits that household's circumstances.

The scheme does not address the issue of portfolio management, but it is flexible enough to be used in conjunction with a scheme that does address portfolio issues.

Finally, the housing lifeline avoids creating poverty traps that harm low income households.

6.2.2 Land Value Risk

As noted earlier in this report, owner-occupied housing can have advantages to the community. But owning a dwelling rarely represents a well-balanced portfolio for a household. This asset ownership exposes households to significant risk that could be avoided through a more diversified asset portfolio. The Caplin-Joye (2002) proposal represents an approach to allow for improved portfolio management by households.

The Caplin-Joye proposal, however, is based on households gaining bank finance. As such, it may have limited benefits for low income households who cannot access sufficient funds to pay for even a limited equity in housing. Of course, a program such as the housing lifeline discussed above may improve the availability of mortgage funds for low income households. But can the government further improve the access by low income households to mortgage funds in a way that provides appropriate incentives and protects the government from open-ended funding risk?

One alternative would be for the government to participate in a variant of the Caplin-Joye proposal relating to the land associated with a dwelling. Roughly speaking, all dwellings gain value from two components: the land and the improved capital value of the dwelling itself. Much of the risk associated with a property purchase relates to

the land. Will the land value appreciate or depreciate in value? Despite recent urban house price booms, land values in many parts of Australia have fallen in real terms over the past decade. Some rural areas have been hit particularly hard by falling land values, although at the same time other rural areas have experienced increases in land prices that exceed some capital cities. Thus, when a household purchases a dwelling and the associated land, they expose themselves to the risk of land price variations.

In contrast, there is significantly less market risk associated with the physical dwelling although there is significant moral hazard. The condition and value of the dwelling usually depends on maintenance and care taken by the occupant. This creates a problem in the rental market. If a tenant does not appropriately look after a dwelling then any rental revenue can quickly be swallowed by maintenance expenses from the landlord's perspective. Thus, it is desirable for a household to have equity in their dwelling. This provides them with incentives to appropriately look after the dwelling.

The government can use the separation between land and dwelling to aid low income households through a shared equity scheme. Under such a scheme, the government would own the land associated with the relevant dwelling while the household would own the dwelling. The low income household would only need to gain the funds necessary to finance purchase of the dwelling, thus reducing the risk facing lenders. The government would fund the purchase of the land. For example, consider an apartment in outer Sydney that sells for \$150,000. The value of the dwelling may be half the total price, meaning that the low income household would need to fund only half of the total purchase price. The government would buy the land. When the apartment is resold, say five years later, for \$180,000, with the land value worth \$100,000 and the dwelling worth \$80,000, the revenue from the sale would be split between the government and household accordingly.

A scheme involving shared government equity through land has useful incentive properties. It removes uninsurable risk from the low income household but also eliminates the moral hazard problems associated with tenancy. The government would be exposed to land value risk, but again the government can pool this risk over a wide range of properties. The split between land and dwelling allows for relatively easy valuation. Land valuation at any point in time can be based on the sale of either land or houses in 'knock down' condition in the relevant region. There is a well developed profession of land valuation and such a valuation can be made at arms length to avoid dispute between the government and the dwelling owners. Sale of land would occur with the dwelling. So the dwelling owners would

choose the time of sale but the new purchaser would not face any issues relating to the previous ownership arrangement.

Clearly, a land-equity-sharing arrangement would require further investigation. However, such a proposal may allow low income households to share in the benefits of an equity sharing arrangement while limiting the government's long-term financial exposure.

6.3 Conclusion

In this section, we have reviewed some alternative demand-side and supply-side approaches to low income housing. In our opinion a number of these proposals, relating to government laws and regulations, a housing lifeline and a land-shared-equity scheme, should be investigated further by the government. Changing and where relevant removing government imposed barriers to more affordable housing seems a matter of common sense. The housing lifeline policy is innovative and builds on existing government experience with contingent loans. It also directly addresses many of the limitations and failings of existing low income housing schemes. The land-shared-equity proposal is more preliminary, but may help low income families gain access to housing ownership.

The policies presented here all involve some degree of government commitment. In our opinion, this is necessary. The government cannot leave low income housing solutions 'to the market'. The types of households who will benefit from the schemes outlined above are those who cannot access the market at present. It makes little sense to rely on market-based policies to assist individuals and households who have no access to the market. Thus, some government commitment, through funding and/or risk management is needed.

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