



# Tackling homelessness in Victoria

Submission to the Legislative Council inquiry into homelessness in Victoria

Brendan Coates, Tony Chen, and Jonathan Nolan

## 1 Summary

We welcome the opportunity to make a submission to the Legislative Council's inquiry into homelessness in Victoria. This submission summarises recent work by the Grattan Institute that is relevant to the inquiry, focusing specifically on the provision of secure long-term housing for those most in need.

Housing is of paramount importance. Yet a growing number of Victorians are homeless. Homelessness arises from a combination of personal, economic, and social factors. But poverty, scarce and increasingly costly housing, as well as reduced access to social housing, all play a part.

There is a powerful case for more government support to reduce homelessness and help house vulnerable Australians. But housing subsidies are expensive. Nor will all policies be equally effective. The Victorian Government should give priority to reforms that are well targeted to those most in need, and deliver the best bang for Victorian taxpayers' buck.

In particular, the Government should give priority to constructing new social housing for people at serious risk of homelessness, replicating the success of 'housing first' programs abroad. But boosting social housing will be expensive. Given its costs, social housing should be reserved for those most in need, and at significant risk of becoming homeless for the long term.

The Government should steer clear of schemes to build more affordable housing. The most recent major affordable housing initiative, the National Rental Affordability Scheme (NRAS) was deeply flawed. It was expensive, poorly-targeted, and it didn't materially increase housing supply. Future affordable housing schemes are likely to suffer from similar problems. Such schemes aren't well targeted at people at

high risk of homelessness. Inevitably, many more people will be eligible than there are places available, making such schemes a lottery that provide more assistance to some people than others – and generally not the most needy.

Boosting Commonwealth Rent Assistance by 40 per cent would be a fairer and more cost-effective way to help the much larger number of lower-income earners struggling with housing costs. Rents won't increase much, because only some of the extra income will be spent on housing, but it would substantially reduce financial stress and poverty among poorer renters.

Housing will become substantially more affordable for most low-income Australians only if we build more of it. The Victorian Government should fix planning rules that prevent more homes being built in inner and middle-ring suburbs of Melbourne. And Victoria should continue to push the Commonwealth Government to reform tax policies that inflate the demand for housing.

Housing vulnerable Australians poses substantial policy challenges. Past governments have refused to face up to the size of the problem because they feared doing so would fuel demands for massive new expenditures on housing. But the challenge is not insurmountable. Policy can make a difference, but only if we make the right choices.

## 2 Who is homeless in Victoria?

Housing is of paramount importance to almost all Australians. Housing fulfils many objectives, from basic shelter, to the emotional security of a refuge where a family can be nurtured. For these reasons, housing is considered a fundamental human right under the Universal Declaration on Human Rights.<sup>1</sup>

Yet a growing number of Victorians don't have safe and secure housing. About 42 in every 10,000 Victorians were homeless on Census night in 2016. Rough sleepers are the most visible homeless, but they account for only 5 per cent of Victoria's homeless.<sup>2</sup> More often, homeless people are living in homeless shelters or staying temporarily with friends or family. Almost 36 per cent of all Victorians classified as homeless by the Australian Bureau of Statistics are living in 'severely crowded' dwellings (places that would need to have four or more extra bedrooms to properly accommodate the people who usually live there).

While homelessness remains lower in Victoria than in NSW or Queensland, the rate of homelessness in Victoria still rose by almost 19 per cent between 2006 and 2016 (Figure 2.1). The largest increase came from a larger number of people living in severely crowded dwellings. The number of rough sleepers in Victoria also increased, by nearly 43 per cent, over this period.<sup>3</sup>

**Figure 2.1: Homelessness is increasing in Australia, especially in states with expensive housing**

Number of homeless per 10,000 of population, by state



Notes: For readability, the NT is excluded. The number of homeless in the NT per 10,000 of population was 791.7 in 2006, 723.3 in 2011, and 599.4 in 2016.

Source: ABS (2018).

1. United Nations (1948).

2. ABS (2018).

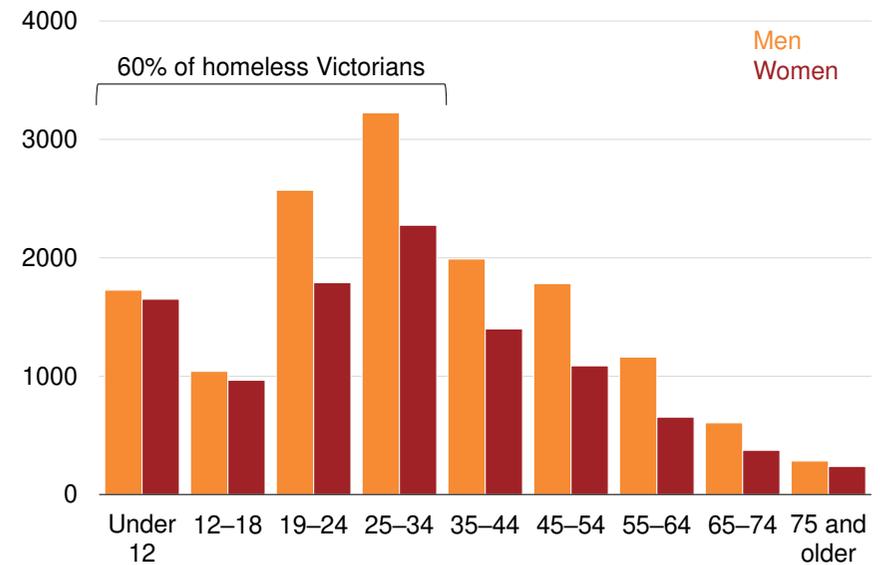
3. Ibid.

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There has been much attention on the emerging homelessness crisis among the elderly. But most homeless Victorians are young: about 60 per cent are younger than 35 (Figure 2.2). About 89 in every 10,000 Victorians aged 19-24 are homeless, falling to 27 in every 10,000 among Victorians aged 55-64. In fact people aged 19-34 account for 70 per cent of the increase in homelessness in Victoria over the five years to 2016, and men account for 68 per cent of the increase.<sup>4</sup>

In contrast, relatively few older women are homeless. But the risk is rising: nationally, rates of homelessness increased fastest over the five years to 2016 among single women entering retirement age.<sup>5</sup> Declining rates of home ownership among younger poorer Australians, together with the lower retirement savings of many women, increase the risks that more older women will suffer poverty and homelessness as they approach retirement.<sup>6</sup>

**Figure 2.2: Most homeless Victorians are young**  
 Number of homeless, by gender and age



*Note: The definition of homelessness includes people who are sleeping rough, and people in supported accommodation for the homeless, temporary accommodation, boarding houses, and 'severely overcrowded' dwellings.*

*Source: ABS (2018).*

4. Ibid.  
 5. The number of homeless women aged 65-74 increased by about 50 per cent in the five years to 2016. The number of homeless men in the same age group increased by nearly 30 per cent over the same period. Coates and Chivers (2019a).  
 6. Coates and Nolan (2020).

### 3 Why do Victorians become homeless?

#### 3.1 Homelessness arises from a combination of social and personal circumstances

A person who becomes homeless is likely to have faced a difficult combination of economic, social, and personal circumstances.<sup>7</sup>

People are vulnerable to homelessness if they suffer from health problems or violence in the home, or if they have a history of incarceration, substance abuse, or unemployment.<sup>8</sup> People on very low incomes are less likely to be able to respond to a shock to their employment or housing situation.<sup>9</sup> For example, Johnson et al (2018) estimate that the probability of an already-vulnerable person becoming homeless increases by 4 per cent if they've never been employed, and by a further 3.7 per cent if they have previously slept rough.

An absence of low-cost housing also increases the risk that vulnerable people will become homeless – a phenomenon O'Flaherty (2004) calls being the 'wrong person' in the 'wrong place'. Australian evidence shows that the risk of a disadvantaged person becoming homeless increases from 2 per cent in areas with plentiful cheap housing, to 17 per cent in areas with high rents.<sup>10</sup>

7. As described by Bramley and Fitzpatrick (2017), 'there is unlikely to be a straight either/or between structural and individual causes of homelessness, but rather a complex interplay between the two'.
8. Early (1998), Curtis et al (2013), McVicar et al (2015), Diette and Ribar (2018) and Moschion and Johnson (2019).
9. Johnson et al (2018).
10. Johnson et al (ibid). In areas where the 20th percentile of rents is \$100 per week, the probability of a disadvantaged person becoming homeless is 2.4 per cent. In areas where the 20th percentile of rents is \$550 per week, this rises to 17 per cent.

#### 3.2 Housing has become more expensive, especially for the poor

Housing costs are rising for Victorians, particularly for low-income earners. Households that were already doing it tough are now spending more of their money on rent, which is contributing to high rates of financial stress. Increased financial stress at the bottom of the income distribution is likely to have played a role in the recent growth in homelessness.

The bottom 20 per cent of Victorian households by income now spend 26.3 per cent of their income on housing on average, up from 21.5 per cent in 1995 (Figure 3.1). Many low-income Victorian renters are struggling: almost 44 per cent of them are suffering rental stress.<sup>11</sup> The share of low-income Victorian renters in rental stress has increased, up from 34.5 per cent in 2007-08 to 43.9 per cent in 2017-18.<sup>12</sup> Rates of financial stress are higher in Victorian than in all other states except NSW and Western Australia.<sup>13</sup>

These trends largely reflect higher housing costs, rather than slow growth in incomes. The rents paid by low-income earners have grown significantly faster than average rents.<sup>14</sup> Incomes for the poorest fifth of households increased by about 27 per cent between 2003-04 and

11. Rental stress is defined as spending more than 30 per cent of gross income on housing costs.
12. ABS (2019).
13. Daley et al (2018c, Table 5.1).
14. Rents for cheaper dwellings in capital cities have grown faster than rents for more expensive dwellings. Rents for cheaper (privately leased) units and apartments, often the cheapest option, increased in price by more than more expensive options. Daley et al (2018a, Figure 2.15).

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2015-16. But their incomes after housing costs increased by only about 16 per cent.<sup>15</sup>

Home ownership is also falling sharply among younger, poorer Australians.<sup>16</sup> If current trends continue, a greater proportion of low-income Australians will be renting – and more of them will depend on the private rental market rather than social and public housing.

### 3.3 Income support for vulnerable Australians is increasingly inadequate

People living in poverty are at particularly high risk of becoming homeless. The income support system plays an important role in alleviating financial stress and poverty for low-income Australians. Yet while the Age Pension, Parenting Payment, Carer Payment, and Disability Support Pension are indexed to wages, Newstart only increases with inflation.<sup>17</sup> Newstart has therefore become woefully inadequate as a safety net for unemployed Australians. Unlike wages or pensions, Newstart has not increased in real terms in more than 20 years.

This has ‘squeezed’ the living standards of people living on Newstart relative to the rest of the population. Households of working age receiving Newstart are under much more financial stress than households receiving other welfare payments.<sup>18</sup>

15. Incomes for the middle quintile grew by about 27 per cent, while after-housing incomes grew by 20 per cent. In contrast, incomes for the highest fifth of households increased by 36 per cent, and their after-housing incomes by 33 per cent. Coates and Chivers (2019b).

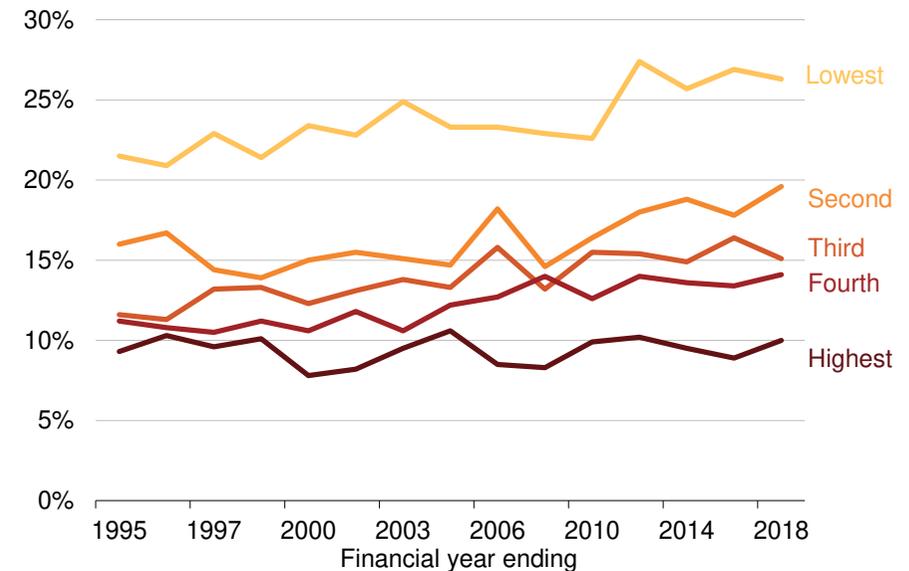
16. Daley et al (2018a, Figure 4.3).

17. Wages typically increase faster than prices. So the Age Pension has grown more rapidly than Newstart over the past two decades. And several one-off changes have increased the Age Pension even more (Daley et al (2013a, p. 20)).

18. Daley et al (2018b, p. 27); and Daley et al (2013b, p. 19).

**Figure 3.1: Low-income Victorians have increased their spending on housing the most**

Housing costs as a proportion of gross household income, by equivalised disposable household income quintile, for Victoria



Notes: Housing costs include rent, mortgage payments, and rates (general and water). Data interpolated for missing years.

Source: ABS (2019).

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Eligibility for the Parenting Payment and the Disability Support Pension has also been tightened in recent years. Changes in assessment rules for the Disability Support Pension in 2012 have especially hit Australians approaching retirement age who have musculoskeletal health problems. The changes coincide with an increase in the number of older people on Newstart.<sup>19</sup>

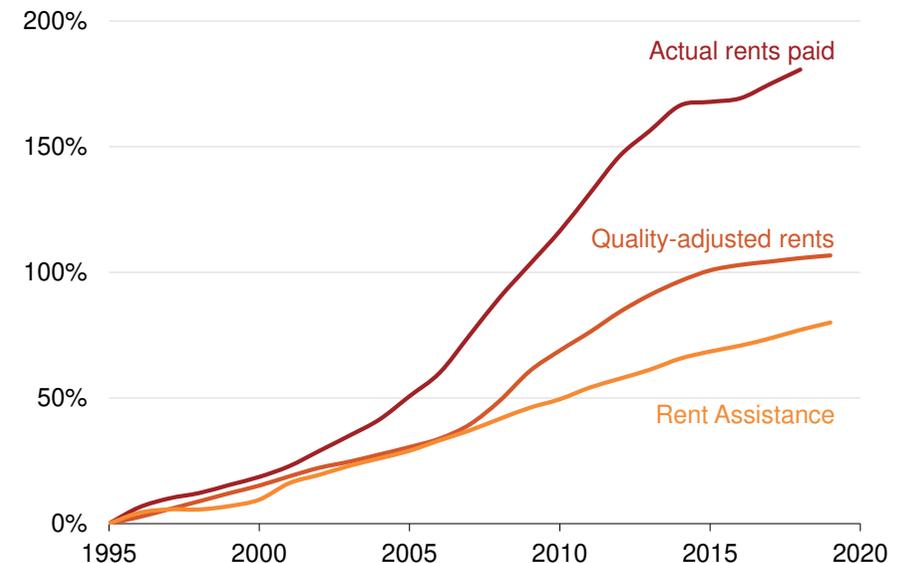
### 3.4 Rent Assistance has not kept up with rising housing costs

Similarly, Commonwealth Rent Assistance materially reduces housing stress among low-income Australians.<sup>20</sup> Rent Assistance is a non-taxable income supplement, payable fortnightly to income support recipients in the private rental market. Rent Assistance is paid at 75 cents for every dollar above a minimum rental threshold, until a maximum rate (or ceiling) is reached. The minimum threshold and maximum rates vary according to the household or family situation, including the number of children.

The maximum Rent Assistance payment is indexed in line with CPI, but rents have been growing faster than CPI over the long term. Between June 2003 and June 2019, CPI increased by about 46 per cent, while average (quality-adjusted) rents increased by about 65 per cent (Figure 3.2).<sup>21</sup> The actual rents paid by Australians, including improvements in the quality or quantity of housing, rose even faster.

19. The eligibility requirements for the Disability Support Pension were tightened in 2012. In 2009, about 12 per cent of 55-64 year-olds were on the Disability Support Pension. By 2017 that number had fallen to 9 per cent. Coates and Nolan (2020, p. 14)
20. In June 2016, 68 per cent of Rent Assistance recipients would have paid more than 30 per cent of their income on rent if Rent Assistance were not provided. With Rent Assistance provided, this proportion was reduced to 41 per cent (Daley et al (2018b, p. 76)).
21. Coates and Nolan (2020, Figure 2.6).

**Figure 3.2: Rents have risen faster than Rent Assistance**  
Increase in actual rents paid, quality-adjusted rents, and Rent Assistance since 1995



Notes: Actual rents paid refers to actual rents paid according to the Survey of Income and Housing. Quality-adjusted rents refers to the ABS's quality-consistent measure of rent increases.

Source: Coates and Nolan (2020, Figure 2.7).

### 3.5 Social housing has become less accessible

Social housing can make a big difference to the lives of vulnerable Victorians. People in social housing receive a much greater average level of assistance – at much greater cost to government – than private renters receive from Rent Assistance.<sup>22</sup> Yet growth in the stock of social housing has not kept pace with population.

The best Australian evidence shows that social housing substantially reduces tenants' risk of becoming homeless. Prentice and Scutella (2018) found that placing those at high-risk of homelessness in social housing reduced their risk of homelessness by 65 per cent.<sup>23</sup> Similarly, Johnson et al (2018) found that being in public housing lowers a tenant's risk of becoming homeless by 6 percentage points.<sup>24</sup> And while many landlords rent to low-income households, some may be prepared to leave their property vacant if the only person seeking tenancy has problems associated with homelessness.

Many homelessness programs now adopt a 'housing first' strategy, in which the priority is getting homeless people, or people at risk of homelessness, into social housing.<sup>25</sup> Once vulnerable people are housed, it's easier for community workers to help them with any other social issues.

Despite its importance to vulnerable Australians, Australian governments have invested little in social housing over the past two

decades. The number of social housing dwellings has barely grown over that period, while Australia's population has increased by 33 per cent (Figure 3.3).

Tenants generally take a long time to leave social housing: most have stayed for more than five years.<sup>26</sup> And when people do leave public housing, it is rarely by their own choice. In 2012, only 18 per cent of people leaving social housing voluntarily entered the private rental market or bought their own home.<sup>27</sup>

Victoria's experience is no different to the rest of Australia. Social housing made up 3.3 per cent of the Victorian housing stock in 2006, but this number fell to 2.8 per cent by 2016.<sup>28</sup> In fact Victoria had the *lowest* stock of social housing as a share of the total housing stock nationwide in 2016 (Figure 3.4). As a consequence, there is little 'flow' of social housing available for people whose lives take a big turn for the worse, and many people who are in greatest need are not assisted. The result is that fewer Victorians are living in social housing than in the past, and every year proportionally fewer social housing units become available for new tenants.

22. Productivity Commission (2018).

23. The authors use data from the Journeys Home survey, which is a longitudinal study of Australians who were identified in Centrelink data as being homeless or at risk of homelessness. The survey tracked people over a two-and-a-half year period, starting in 2011.

24. Other explanatory variables in the authors' model of homelessness entry include demographic variables, tenure history, and socio-economic factors.

25. For example, see Conroy et al (2014). Mares (2018) argues that Finland's Housing First strategy has all but eradicated homelessness through the provision of social and affordable housing to at-risk groups.

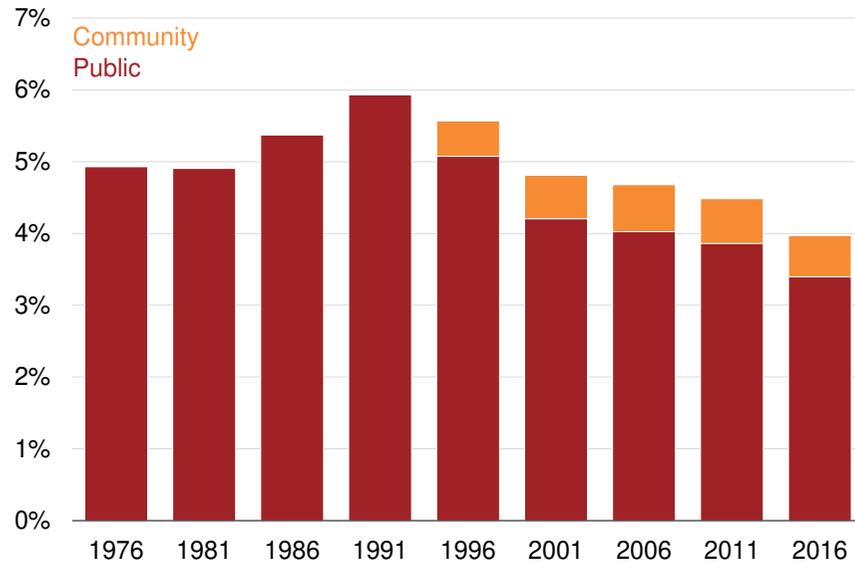
26. AIHW (2019).

27. Wiesel et al (2014).

28. ABS (2006) and ABS (2016). Housing stock is defined as total occupied private dwellings.

**Figure 3.3: Australia’s social housing stock has not kept pace with population growth since 1991**

Share of Australian households in public or community housing

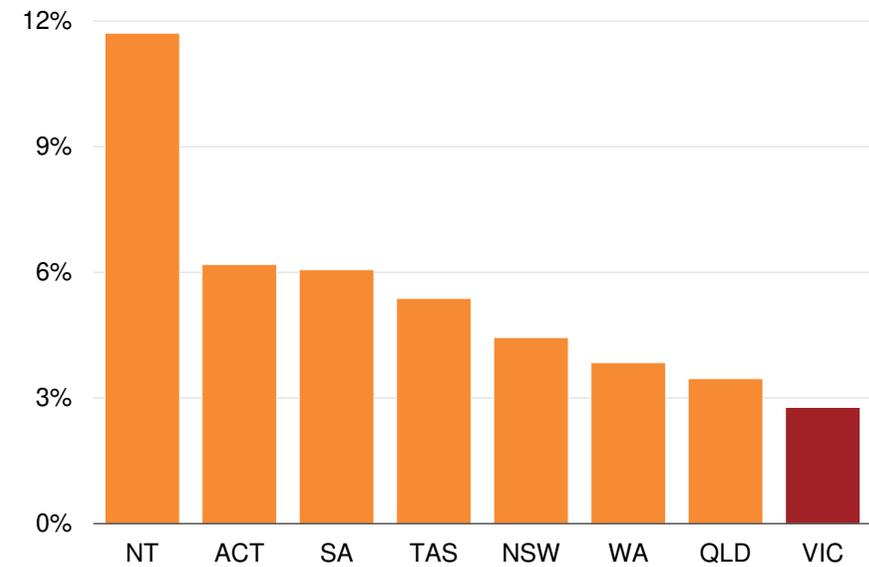


*Note: Before 1996 community housing was not recorded in the Census, but it is likely to have accounted for a small amount of the total social housing stock.*

*Sources: Grattan analysis of ABS (1978), ABS (1983), ABS (1988), ABS (1993), ABS (1997), ABS (2001), ABS (2006), ABS (2011) and ABS (2016).*

**Figure 3.4: Victoria’s social housing stock lags behind other states**

Social housing share of total housing stock, 2016



*Notes: Social housing dwellings are those dwellings rented from a ‘state or territory housing authority’ or a ‘housing co-operative, community or church group’. The total housing stock is defined as the number of occupied private dwellings.*

*Source: Grattan analysis of ABS (2016).*

## 4 How can we address homelessness in Victoria?

There is a powerful case for more government support to house the most needy Australians. But housing subsidies are expensive. Nor will all policies be equally effective.

Since government resources are finite, governments should prioritise to do the most-good with the funding they have. But prioritisation inevitably means hard choices: it involves choosing to help some groups first before others. Governments should therefore give priority to reforms that are well targeted to people most in need, and deliver the best bang for the taxpayers' buck.

### 4.1 The Victorian Government should boost the supply of public housing

The Victorian Government should increase funding for social housing. But boosting social housing will be expensive. At the national level, Grattan Institute has previously estimated that 100,000 new social housing dwellings would be required to return the total social housing stock to its historical share of the total housing stock. Developing such a large number of dwellings would require additional *ongoing* public funding of about \$900 million a year, or an upfront capital cost of \$10-to-\$15 billion.<sup>29</sup>

The Victorian Government should be wary of proposed schemes to provide private sector financing for social housing. No amount of innovative *financing* can paper over the need for extra *funding* to boost the supply of social housing. Social housing provides heavily discounted rents to tenants, to assist them with their housing costs. And therefore government funding will be required to make up the shortfall between what tenants can afford to pay and the cost of

29. Daley et al (2018c).

acquiring land, building housing, and maintaining it over the life of the asset.

Given its costs, social housing should be reserved for people most in need, and at significant risk of becoming homeless for the long term.<sup>30</sup> In the meantime, the existing social housing stock needs to be better managed: it could be better allocated to meet the needs of tenants;<sup>31</sup> it is often not well-suited to their needs;<sup>32</sup> and it is often of poor quality.<sup>33</sup>

While a substantial boost to the social housing stock – such as increasing its share by 2 per cent of all housing – would make a big difference to people who are homeless, if it were tightly targeted towards them, more than two thirds of low-income Australians would still remain in the private rental market.

Therefore, beyond ensuring a flow of additional social housing for people most at risk of long-term homelessness, further support for low-income housing should be focused on direct financial assistance for low-income renters, and improving housing affordability more broadly by increasing the number of homes constructed.

30. New allocations of social housing are better targeted to people most in need. Of all social housing allocations in 2018, almost 90 per cent went to 'greatest needs' applicants – that is, low-income households which at the time of allocation were either homeless, had their life or safety at risk in their current accommodation, had housing inappropriate to their needs, or had very high rental housing costs: Productivity Commission (2020).

31. Potter (2017).

32. Tenants have little choice over the home they are offered; the type of housing available can be incompatible with their needs. For example, the public housing stock is dominated by three-bedroom houses, yet most recipients are singles or couples without children.

33. In 2018 almost one-in-five Victorian social housing dwellings did not meet minimum acceptable standards (Productivity Commission 2020).

#### 4.2 The Victorian Government should push the Commonwealth to raise Rent Assistance

Beyond building more social housing for people at risk of homeless, support for low-income Victorians struggling with high housing costs should focus on lifting Commonwealth Rent Assistance. Rent Assistance materially reduces housing stress among low-income Australians. But as Section 3.4 showed, the value of Rent Assistance has not kept pace with rent increases.

Grattan's 2020 working paper, *Balancing Act*, recommended a 40 per cent increase in the maximum rate of Rent Assistance. This would cost about \$1.3 billion a year.<sup>34</sup> Rent Assistance would then provide the same level of assistance to low-income earners as it did 15 years ago, taking into account the rising cost of their rent. In future, Rent Assistance should be indexed to changes in rents typically paid by people receiving income support, so that its value is maintained, as recommended by the Henry Tax Review.<sup>35</sup> Increasing Rent Assistance would do more to alleviate poverty per government dollar spent than any other housing policy.

Some worry that boosting Rent Assistance would lead to higher rents, eroding much of the gains in living standards for low-income renters.<sup>36</sup> But an increase in Rent Assistance is unlikely to substantially increase rents. Households are unlikely to spend all of the extra income on housing. And only half of low-income renters actually receive Rent Assistance, since eligibility is linked to receiving an income support payment.<sup>37</sup>

34. Coates and Nolan (2020).

35. Henry (2009, p. 595). While the rental component of the CPI is a readily available and transparent measure, an index of rents paid by Rent Assistance recipients would provide a more accurate assessment of their rental costs.

36. Senate Economics References Committee (2015, chapter 22).

37. Daley et al (2018b, p. 77).

#### 4.3 The Victorian Government should steer clear of schemes to build more affordable housing

Several commentators have called for governments to fund the construction of more affordable housing to help those on low-to-moderate incomes.<sup>38</sup> Others have explicitly called for a repeat of the National Rental Affordability Scheme (NRAS),<sup>39</sup> a 2007 election promise from the Rudd Government which aimed to reduce rental costs for people on low-to-moderate incomes.

Yet past affordable housing schemes, such as NRAS, have not been effective.

Affordable housing, such as that constructed under NRAS, is typically not targeted at people most in need, including those at greatest risk of homelessness. Eligibility thresholds for NRAS were set far too high: \$50,000 for a single adult, or nearly \$70,000 for a couple – much higher than the equivalent eligibility thresholds for Commonwealth Rent Assistance.<sup>40</sup> As a result, a substantial proportion of people actually allocated NRAS housing were on moderate-to-higher incomes.<sup>41</sup>

NRAS was also expensive: the scheme offered investors a subsidy of \$8,000 a year (about \$11,000 in today's money) in exchange for providing new dwellings for rent for at least 20 per cent below market rents. The average private renter pays rent of \$19,240 a year.<sup>42</sup>

38. These calls are often made under the banner of supporting a specific 'build to rent' affordable housing sector in Australia. For example, see: Palm (2017), PwC (2017) and Pawson et al (2019).

39. Burke (2018) and Bleby (2018).

40. Department of Social Services (2018). For example, the income cut-off for a single receiving Newstart is \$27,959 a year (Services Australia 2020).

41. Department of Social Services (2016). Only one third of tenants had gross household incomes less than \$30,000, and one third had incomes greater than \$50,000 a year.

42. Median rents varied from \$22,412 a year in NSW to \$13,520 a year in Tasmania in 2017-18. Therefore the cost of providing a dwelling at 20 per cent below market

Providing a 20 per cent discount to market rents for the median private renter should therefore cost less than \$4,000 a year – much less than the \$11,000 subsidy offered per dwelling.<sup>43</sup> Any extra subsidy beyond the cost of providing affordable housing flowed to NRAS property developers.

The subsidies offered to developers through NRAS were not tied to the type and location of any new affordable dwelling constructed. As a result, the same subsidy was offered for a new one-bedroom apartment or a three-bedroom home in the same location, and for dwellings in central Sydney and rural NSW.<sup>44</sup>

Nor was NRAS an effective way to boost the *overall* supply of housing. New housing construction in Australian cities is relatively unresponsive to demand,<sup>45</sup> largely because land-use planning rules prevent greater density. Since even affordable homes are subject to those planning rules, many homes constructed under the scheme were likely to have been built anyway.<sup>46</sup>

Given these issues, the bulk of extra support for housing costs for low-income earners should be provided via Commonwealth Rent Assistance, along with funding for more social housing targeted at the

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rent will vary from \$4,500 a year in NSW to \$2,700 a year in Tasmania. ABS (Table 12.2 2019).

43. While the market rent on a new dwelling built under the scheme may be higher than the median, the rents paid by low-income earners are likely to be lower than the median since they have lower incomes.
44. Participants in NRAS receive a subsidy of \$8,000 per year for 10 years (indexed) for new dwellings that were rented out for 20 per cent below market value rent to eligible tenants. Department of Social Services (2018). Studios and one- and two-bedroom dwellings accounted for two-thirds of all homes constructed under NRAS (Department of Social Services (2019, p. 4)).
45. The best estimate of the 'price elasticity of supply' in Australia is that a 10 per cent increase in dwelling prices leads to an increase in the stock of new housing of between 3 per cent and 5 per cent. See: Daley et al (2018a, p. 46).
46. Senate Economics References Committee (2015, p. 362).

long-term homeless. If affordable housing schemes are pursued, they should be focused on providing pathways for people already in social housing to transition out of social housing.

#### 4.4 The Victorian Government should adopt reforms to improve housing affordability generally

The Victorian Government should also pursue reforms that will improve housing affordability more generally.

Grattan Institute's 2018 report *Housing affordability: re-imagining the Australian Dream* evaluated a wide range of potential measures to improve housing affordability. These are summarised in Figure 4.1.

Governments should focus on the policies in the top right of Figure 4.1: policies that will materially improve affordability without substantially dragging on the economy or the budget. Almost all of them are measures that would boost the supply of housing. They include planning changes to facilitate subdivision in the inner and middle rings of our largest cities; boosting density along major transport corridors; and increasing greenfield land supply.

A number of tax reforms to remove distortions in housing investment would have large budgetary and economic benefits, but more modest impacts on housing supply. These include reducing the 50 per cent capital gains tax discount, limiting negative gearing, including owner-occupied housing in state land taxes, and including more of the value of owner-occupied housing in the Age Pension assets test.

None of these reforms are politically easy. But housing won't become more affordable, including for many low-income Australians at risk of homelessness, unless Australian governments make tough choices.

#### 4.4.1 The Victorian Government should reform planning rules to boost housing supply

Housing affordability will only get a lot better if governments ensure more homes are built. This is primarily a problem for state governments: they set the overall framework for land and housing supply, and they govern the local councils that assess most development applications.

While housing construction has picked up in recent years, recent record rates of housing construction are the bare minimum needed to meet record levels of population growth driven by rapid migration; and the backlog of under-supply remains. The Victorian Government should reform land-use planning rules to allow more housing to be built close to the centres of our major cities. Planning systems play an important role in managing the growth of cities. Land-use planning rules set out how competing land uses should be managed to coordinate the provision of infrastructure and to minimise the costs that some land users impose on their neighbours – such as pollution, noise, congestion, or poor design.

Yet current rules and community opposition make it very difficult to create extra residences in the inner and middle-ring suburbs of the capital cities.<sup>47</sup> As a result, the density of Melbourne has barely changed in the inner- and middle-ring suburbs over the past 35 years.<sup>48</sup>

A new Small Redevelopment Housing Code could protect neighbours, reduce planning uncertainty, and improve the quality of new

47. Daley et al (2018a, pp. 56–58), Kendall and Tulip (2018) and Lees (2017). Shoory and Rosewall (2017) note evidence that the complexity of the planning system has made redevelopment in established areas less attractive compared to development on the fringes of major cities. For international evidence see Hilber and Vermeulen (2015), Gyourko and Molloy (2015) and Glaeser and Gyourko (2018)

48. Daley et al (2018a).

developments.<sup>49</sup> The Code should include the things that worry neighbours most, such as privacy, height, and overshadowing of their outdoor areas, and the appearance of new developments from the street.

State governments should also ensure that appropriate developments are allowed ‘as of right’ on major transport corridors and around train stations, within specified height limits.<sup>50</sup>

Making existing private housing cheaper overall will help low-income earners struggling with rising housing costs. New housing doesn’t need to be specifically targeted at lower price points to improve overall housing affordability. More housing supply – even at the top end – will ultimately free-up less expensive housing stock. The people who move into the newly constructed housing are either existing residents who move out of less expensive housing, or new residents who would otherwise have added to the demand for less expensive housing. Irrespective of its cost, each additional dwelling adds to total supply, which ultimately affects affordability for all home buyers.<sup>51</sup>

This is not merely theory: international evidence suggests that ‘filtering’ occurs in practice. Initially expensive homes gradually become cheaper as they age, and are sold or rented to people with more modest incomes, and this is a strong source of more affordable housing, especially in the private rental market.<sup>52</sup>

And by reducing the cost of housing overall, such steps would also reduce the size of the public subsidies needed to bridge the gap between the market cost of housing and what low-income earners can afford to pay.

49. Kelly et al (2011, pp. 26–27); and Daley et al (2018a, p. 115).

50. Daley et al (2018a, p. 118).

51. While gentrification can push up prices in a particular area, constructing more housing in total should lead to overall prices being lower than otherwise.

52. For a detailed discussion of ‘filtering’ see: Daley et al (2018a, pp. 64–66).

#### 4.4.2 Demand-side reforms would also help, but are largely Commonwealth responsibilities

Given the allocation of federal responsibilities, it is the Commonwealth Government, rather than Victoria, that can primarily intervene to reform policies that inflate housing demand.

As recommended in our 2018 report, *Housing affordability: re-imagining the Australian Dream*, the capital gains tax discount should be reduced from 50 per cent to 25 per cent, and negatively geared investors should no longer be allowed to deduct losses on their investments from labour income.<sup>53</sup> The effect on property prices would be modest – they would be roughly 2 per cent lower than otherwise – and the change would primarily advantage would-be home owners at the expense of investors. The dominant rationale for these reforms is their economic and budgetary benefits: they would boost the budget bottom line by about \$5 billion a year.

Including more of the value of owner-occupied housing in the Age Pension assets test would improve the allocation of housing assets a little, make pension arrangements fairer, and contribute up to \$7 billion a year to the budget. Under the current rules, only the first \$210,500 of home equity is counted in the Age Pension assets test, and the remainder is ignored. Inverting this so that all of the value of a home is counted above some threshold – such as \$500,000 – would be fairer, and contribute to budget repair.

Other tax and transfer settings that affect housing include the (non) taxation of imputed rent, the corresponding (non) deductibility of mortgage costs, and the (non) taxation of capital gains and imputed rents on owner-occupied housing. But the policy merits of changes to

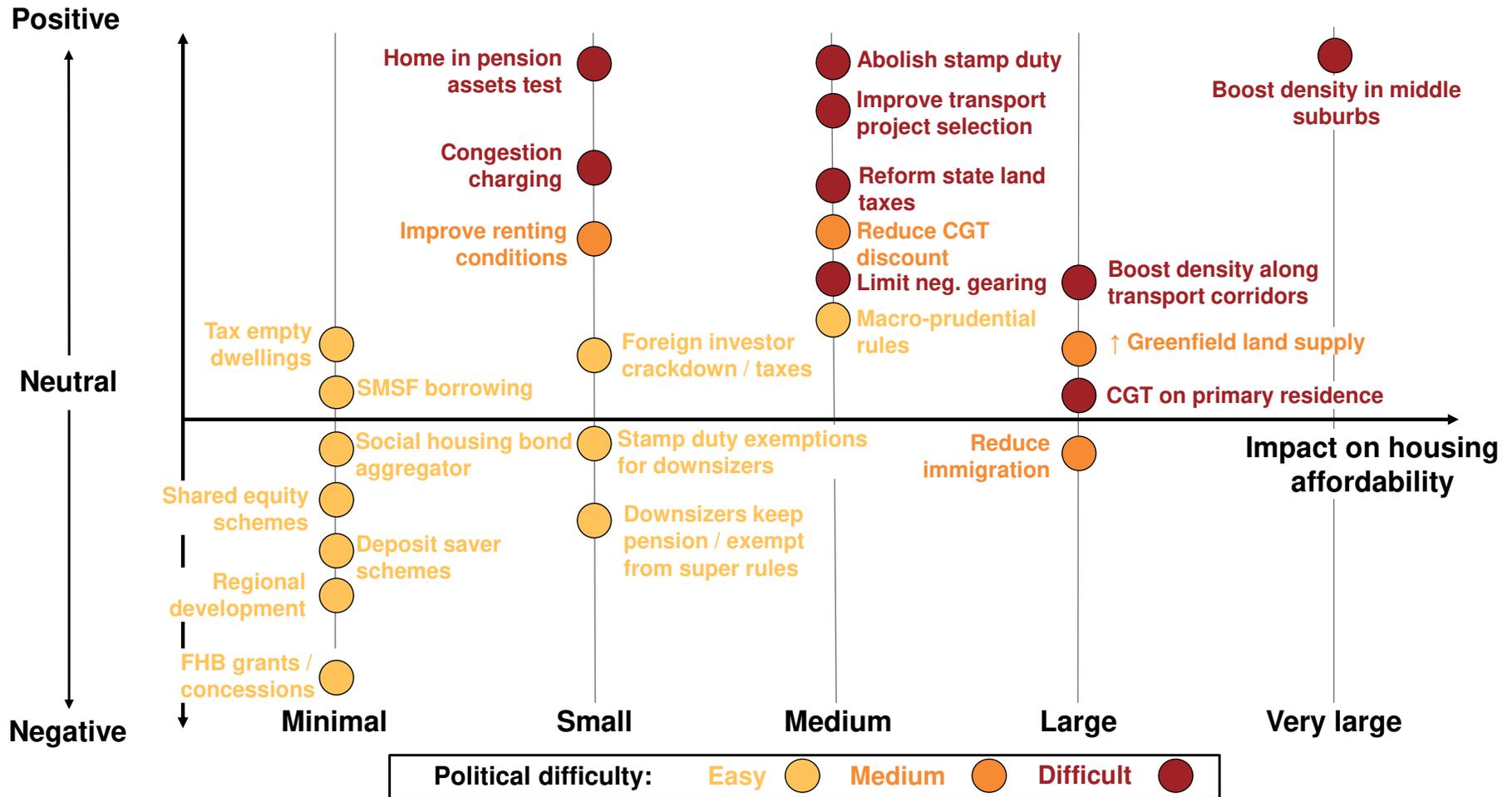
these settings are debatable, especially when the politics is likely to be intractable.<sup>54</sup>

53. Daley et al (2018a).

54. Investment would be less biased towards housing, where any capital gains and imputed rents – the value of owning the home that you live in – are untaxed, compared to investing in other more productive assets. But it would be difficult to resist calls to allow deduction of interest payments and the cost of any capital improvements made to the home such as renovations, which could wipe out most or all of the benefit to the budget. Taxing imputed rents in particular presents a number of practical policy design and implementation challenges, which is why only five OECD countries – the Netherlands, Iceland, Slovenia, Luxembourg, and Switzerland – tax imputed rents, and they often substantially under-estimate the rental value. Daley et al (ibid, pp. 101–102)

**Figure 4.1: Only some policies will actually improve housing affordability, and these are politically difficult**

Summary of economic, budgetary, and social impacts



Notes: FHB = first homebuyers. Prospective policies are evaluated on whether they would improve access to more-affordable housing for the community overall, assuming no other policy changes. Assessment of measures that boost households' purchasing power includes impact on overall house prices. Our estimates of the economic, budgetary, or social impacts should not be treated with spurious precision. Our assessments are generally directional and aim to foster a more informed discussion.

Source: Figure 5.2 from Daley et al (2018a).

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# How to make housing more affordable

Submission to the parliamentary inquiry into housing affordability and supply in  
Australia

Brendan Coates and Tom Crowley

## Summary

We welcome the opportunity to make a submission to the House of Representatives Standing Committee on Tax and Revenue on the contribution of tax and regulation to housing affordability and supply.

Within living memory, Australia was a place where housing costs were manageable, and people of all ages and incomes had a reasonable chance to own a home with good access to jobs. But Australian housing has become increasingly expensive, and public anxiety about housing affordability is rising.

Home ownership rates are falling, especially among the young and the poor. Without change, many more young Australians will be locked out of the housing market. Owning a home increasingly depends on who your parents are, a big change from 35 years ago. People on low incomes – increasingly renters – are spending more of their income on housing.

House prices have risen as interest rates have hit record lows, while tax and welfare settings and rapid migration fed demand. But housing costs would have risen less if more housing had been built.

We have not built enough housing to meet the needs of Australia's growing population. Australian cities are not delivering the best mix of housing location and density, given what people would prefer. Australia has among the least housing stock per adult in the developed world, and is one of only a handful of developed countries in which housing stock per capita has been stagnant over the past 20 years. The mismatch between supply and demand has created a 'zoning premium' for well-located housing that benefits existing property owners, but imposes additional costs on new purchasers and renters.

Given the allocation of federal responsibilities, the most direct way the Federal Government can improve affordability is by reforming tax and welfare policies that distort demand for housing. The Federal Government can improve housing affordability by reducing demand. It should reduce the capital gains tax discount from 50 per cent to 25 per cent; abolish negative gearing; and include owner-occupied housing in the Age Pension assets test.

Housing will also become more affordable if more homes are built. Building an extra 50,000 homes a year for a decade could result in Australian house prices and rents being up to 20 per cent lower than they would have been otherwise. Increasing housing supply will only restore housing affordability slowly. But without a concerted effort to boost housing supply in Australia, housing affordability will likely get worse. This is primarily a problem for state governments: they set the overall framework for land and housing supply, they govern the local councils that assess most development applications, and they set building regulations that affect building costs. But the Federal Government can encourage the states to reform land-use planning and zoning laws in ways that will boost supply.

It took neglectful governments more than two decades to create Australia's current housing affordability mess. They preferred the easy choices that merely appear to address the problem. The politics of reform are fraught because most voters own a home (and many own investment properties), and mistrust any change that might dent the price of their assets. But if governments keep pretending there are easy answers, housing affordability will only get worse.

## 1 Australian housing has become less affordable for many Australians

Australian housing has become increasingly expensive in recent decades, and public anxiety about housing affordability is rising.<sup>1</sup> House prices have grown much faster than incomes.<sup>2</sup> Interest rates have fallen, and so repaying a typical first home loan is *not* particularly difficult at the moment. But it is harder to save a deposit for a first home, a first home loan now entails more risk, borrowers live with that risk for longer, and inflation is unlikely to erode the cost of repayments as quickly as in the past. Rents have also risen relative to incomes over the longer term, particularly for low-income households in capital cities, although rental affordability has improved in recent years as housing construction has accelerated.

### 1.1 Australians are spending more of their incomes on housing

Australian dwelling prices have grown much faster than incomes, particularly since the mid-1990s. Prices have risen rapidly in all cities, and most regions. *Median* prices have increased from about 4 times *median* incomes in the 1980s and early-1990s, to more than 8 times today (and around 10 times in Sydney).<sup>3</sup>

1. Daley et al (2018a, Figure 1.1).  
 2. Ibid (p. 25).  
 3. Updated from Daley et al (ibid, p. 16).

#### Box 1: What does housing affordability mean?

‘Housing affordability’ is a catch-all term for a grab-bag of public concerns linked to rising house prices. But confusion over core concepts around housing markets complicates discussion of problems, their causes and potential solutions.

Housing is both something we live in and an asset we can own.

**Rents** are the actual cost of consuming housing services in the housing market. Changes reflect shifts in the balance of demand and supply of the housing *stock*.<sup>a</sup> Financial factors, such as interest rates, only affect rents indirectly by affecting the amount of housing that gets built.

**House prices** are the costs of acquiring a house, and reflect the discounted net present value of future rental income from owning a house, plus any expected capital gains in future.<sup>b</sup> Since home purchases are typically financed by debt, interest rates and the availability of mortgage credit have an enormous impact on house prices, especially in the short term. The tax treatment of housing also affects house prices.

Many people also think of housing affordability as the **mortgage burden** – the share of household income required to pay the typical mortgage. This approach more closely reflects the cash-flow costs of housing.

- a. Housing lasts a long time, but it depreciates, while new dwelling construction only adds 1-2 per cent to the housing stock in any given year.
- b. In practice home buyers can either rent their house out – earning a rental income – or live in it, avoiding the need to pay rent. Economists refer to the amount a household would pay to rent the house they own as ‘imputed rent’.

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Of course, not all Australians own their own homes – nearly one in three Australian households rent privately.<sup>4</sup> Rents have grown more slowly than house prices, and over the long term they have more or less tracked wages. But rents have fallen since the onset of the COVID-19 pandemic, as migration has come to a standstill.<sup>5</sup>

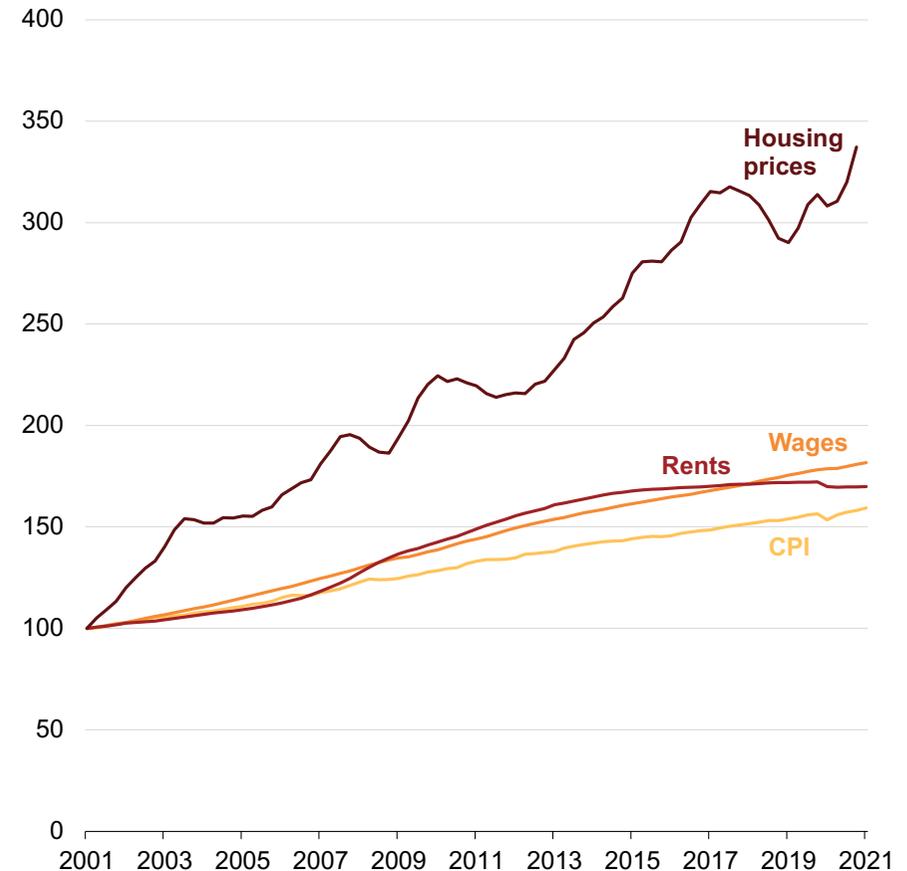
Rising housing costs in recent years mean Australians now pay 23.3 per cent of median incomes on housing costs, higher than all other comparator countries except the Netherlands (23.9 per cent).<sup>6</sup> Among the OECD countries with comparable data, Australians have the 16<sup>th</sup> highest median spending on housing out of 43 countries.<sup>7</sup>

Lower-income Australian households in particular are spending more of their income on housing.<sup>8</sup> More than half of low-income Australians in the private rental market suffer rental stress, especially those in the capital cities.<sup>9</sup> One in five working-aged households who rent are in

4. Over recent years the proportion of households renting has steadily increased from about 27 per cent of households in 1991 to 32 per cent in 2016. Daley et al (2018a).
5. Quality-adjusted rents reported by the ABS have fallen by 1.3 per cent across Australia since the March quarter of 2020: ABS (2021a). However other indices which track recently rented properties point to a rapid turnaround in rents in recent months: Chau (2021).
6. Median housing costs are defined as mortgage burden (principal repayment and interest payments) or rent burden (private market and subsidised rent) as a share of disposable income. See: Daley et al (2019)
7. To some extent this may reflect an Australian preference to spend more resources on better housing. New Australian homes (houses and apartments) are the second largest by floorspace among 18 countries, second only to the US. In 2017-18, the average size of a new house built in Australia was 230.8 square metres, down from a record high of 247.7 square metres in 2008-09. James and Felsman (2018, p. 3).
8. Daley et al (2018a, p. 15).
9. Daley et al (Figure 2.14 2018a) and ABS (2019). Rental stress for low-income households is defined as the bottom 40 per cent of households with respect to equalised disposable household income (excluding Commonwealth Rent Assistance), spending more than 30 per cent of gross income on rent.

**Figure 1.1: House prices have increased much faster than rents and income**

Nominal, index 2001 = 100



Notes: Nominal house price growth from Bank for International Settlements; Wages from Wage Price Index (excluding bonuses; private and public). Rents in the CPI are stratified according to location, type, and size.

Source: BIS (2021, H1), ABS (2021a, Tables 1, 7) and ABS (2021b, Table 1).

financial stress, defined as skipping a meal, accessing charity, pawning something or not heating the home.

## 1.2 It is getting harder to save for a deposit

There are typically three hurdles to home ownership in Australia: savings for the deposit; affording mortgage repayments; and the level of risk that first home-buyers take on.

The challenge of saving an initial deposit is now typically a bigger barrier to home-ownership than the initial burden of mortgage repayments, and so younger households increasingly rely on contributions from the 'bank of mum and dad'.<sup>10</sup>

In the early 1990s it took about six years to save a 20 per cent deposit for a typical dwelling for an average household. It now takes more than 10 years.<sup>11</sup> Although banks no longer insist on a 20 per cent deposit, most people still try to save this much before purchasing a dwelling.<sup>12</sup> In addition, many young households are finding it harder to save for a deposit because they face larger higher education debts and are now forced to save more of their income into superannuation than their parents did 25 years ago.

In contrast, borrowers' ability to afford repayments on the mortgage has improved as house prices have fallen. This 'mortgage burden' is often defined as the proportion of household income spent on repaying a mortgage. Depending on the household income measure used, the mortgage burden on a newly purchased first home, assuming a person

borrowes 80 per cent of the value of the home, is currently lower than it was during much of the past 20 years.<sup>13</sup>

Yet a first home loan now entails more risk, since purchasers are borrowing a larger share of their lifetime incomes to purchase a home, and borrowers live with much of that risk for longer. Homebuyers repay their mortgages over periods as long as 30 years. The mortgage burden over the life of the loan depends on how fast nominal incomes (that is, taking account of inflation) grow, and what happens to interest rates. Most people who bought 20-to-30 years ago now use only a relatively small share of their income to pay the mortgage. Nominal interest rates fell while nominal wages rose rapidly for most of the 1990s. In contrast, a new homebuyer today is likely to continue to spend a large proportion of their income on the mortgage for many years, unless wages start to grow faster than in the past few years.

## 1.3 Home ownership is falling, especially among the young and the poor

Between 1981 and 2016, home-ownership rates among 25-34 year-olds fell from more than 60 per cent to 45 per cent. Home ownership has also fallen for middle-age households, suggesting that most of the fall is due to higher dwelling prices rather than changing preferences for home-ownership among the young. Consequently, without intervention, home-ownership rates are unlikely to bounce back over time. For 35-44 year-olds, home-ownership has fallen fast – from 74 per cent in 1991 to about 62 per cent today – and home-ownership is also declining for 45-54 year-olds.

Home-ownership rates are falling particularly fast among younger, poorer Australians. Thirty-five years ago, most low-income younger households owned their own home. Today, only about 1 in 5 do (Figure 1.2). Owning a home increasingly depends on who your

10. Daley et al (2018a, Chapter 2).

11. Based on households saving 15 per cent of their gross annual income.

12. The typical leverage of a first home buyer has remained remarkably constant, at about 83 per cent between 2001 and 2014, even though banks loosened lending requirements and became more prepared to provide high-leverage loans.

13. See: Daley et al (2018a, p. 21). Interest rates have since fallen further.

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parents are, a big change from 35 years ago when home-ownership rates were high for all levels of income. Younger people on low incomes no longer have a real choice between home-ownership and renting.

### 1.4 Housing costs has contributed to growing inequality in Australia

With low-income earners spending a larger proportion of their income on housing, inequality is rising. While income inequality is not getting much worse in Australia, incomes *after housing costs* have risen much faster for high-income than low-income households (Figure 1.3). Housing is also a leading reason that wealth has increased faster for those who were already wealthy.<sup>14</sup>

Rising housing costs also contribute to increased homelessness.<sup>15</sup> Almost 50 of every 10,000 Australians were homeless in 2016.<sup>16</sup> Australia's rate of homelessness has increased in the past five years.

More than 116,000 people were homeless in Australia on Census night in 2016 – up from 105,000 in the 2011 Census and 90,000 in the 2006 Census. Over the same period, the number of people sleeping rough— on the streets, in improvised dwellings, or tents – grew by about 950 people, to 8,200. The number of people who are not homeless but living in crowded dwellings rose 33 per cent from 61,000 in 2011 to 81,000 in 2016.<sup>17</sup>

Among countries with similar definitions of homelessness, Australia ranks better than New Zealand, which has almost 90 homeless per

14. Daley et al (2018b, Figure 5.1).

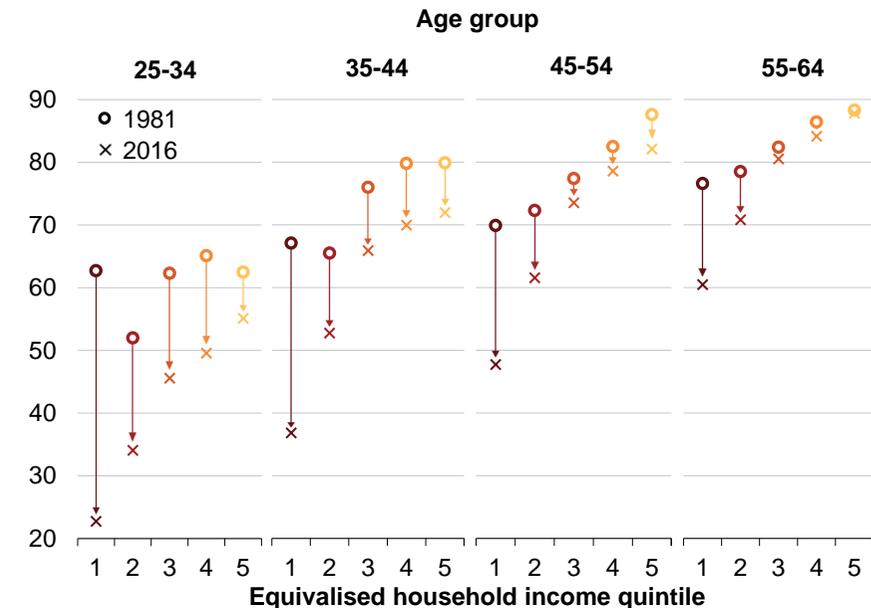
15. Johnson et al (2018).

16. Daley et al (2018c, p. 51).

17. The ABS categorises people in houses that need three extra bedrooms not as homeless, but 'marginally housed'.

**Figure 1.2: Home-ownership is falling particularly fast for low-income earners**

Home-ownership rates by age and income, 1981 and 2016, percentage



Notes: Household incomes based on Census data are approximate, and so small changes in ownership rates may not be significant. Excludes households with tenancy not stated (for 2016) and incomes not stated.

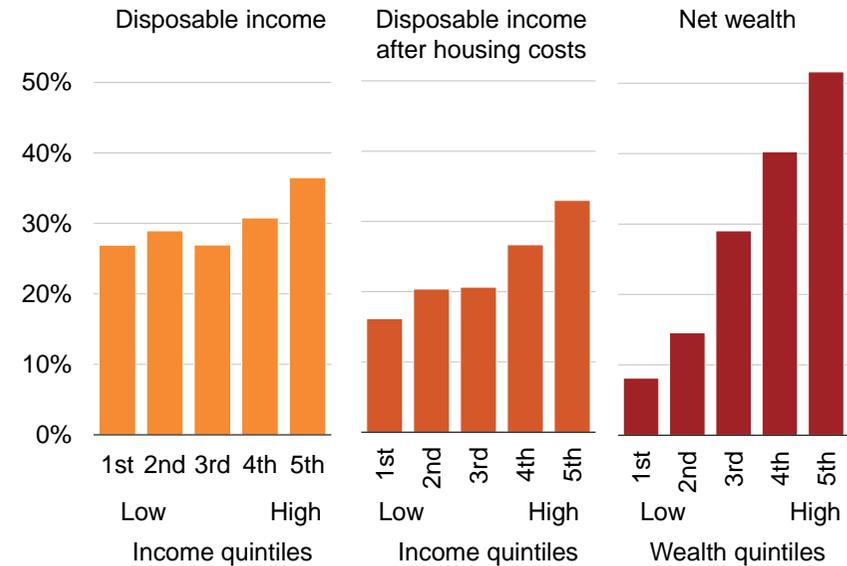
Source: Daley et al (2018a, Figure 4.3).

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10,000 people, but worse than the UK, which has about 25 homeless per 10,000.<sup>18</sup>

**Figure 1.3: Housing costs and wealth are key causes of increasing inequality**

Change in real equivalised household disposable income including and excluding housing costs growth, 2003-04 to 2015-16, per cent



*Notes: Housing costs include rents for renters and repayments on loans for owners with mortgages. Growth in income excluding housing costs calculated by subtracting growth in housing costs from growth in disposable income. Income quintiles are calculated using household disposable income, equivalised by family size. Bottom two income percentiles are removed due to low reliability.*

*Source: Daley et al (2018a, Figure 4.1).*

18. The definition of homelessness varies significantly across countries. The Australian definition includes: people living in improvised dwellings, tents, or sleeping out; people in supported accommodation for the homeless; people staying temporarily with other households; people living in boarding houses; people in other temporary lodgings; and people living in 'severely' crowded dwellings. See: Daley et al (2018c, p. 109).

## 2 Australia hasn't built enough housing to meet rising demand

Australian housing has become increasingly expensive – to rent or buy – for many reasons. Incomes rose, while tax and welfare settings and rapid migration fed demand. However record low interest rates have been the strongest driver of rising prices in recent years.<sup>19</sup> But housing costs – especially rents – would have risen less if there had been more housing.<sup>20</sup>

### 2.1 Australian cities have not built enough housing

Australian cities have not built enough housing to meet the needs of Australia's growing population. Australia has just over 400 dwellings per 1,000 people, which is among the least housing stock per adult in the developed world. Australia has experienced the second greatest decline in housing stock relative to the adult population over the past 20 years (Figure 2.1 on the following page). All states and territories except the ACT had less housing per adult in 2016 than in 2011.<sup>21</sup> Some argue that there is no undersupply and possibly even an oversupply of homes in Australia. But these estimates typically ignore how rising prices and worsening affordability pushed people into larger households than they otherwise would have chosen.<sup>22</sup>

Housing construction had accelerated in the years leading into the COVID pandemic.<sup>23</sup> Most of the additional approvals were for apartments in buildings with four or more storeys, with some pick-up in semi-detached townhouses.<sup>24</sup> But even record rates of housing construction in Sydney and Melbourne have only just been sufficient to accommodate the population increases seen prior to the pandemic.<sup>25</sup>

The closure of Australia's international borders due to COVID-19 saw Australia's population growth slow to a near stand-still in the year to March 2021.<sup>26</sup> Over the same period, 189,000 dwellings commenced construction.<sup>27</sup> As a result, new housing supply is temporarily exceeding new demand.<sup>28</sup> This shorter-term period where new supply exceeds new demand can be seen as partial catch-up for much longer more protracted periods of undersupply. Yet COVID has also seen an increase in housing demand from existing residents, especially an increase in demand for more space per person, offsetting some of the decline in housing demand from the drop in migration. If Australia's population growth returns to pre-COVID trends, future rates of construction will need to be even higher than recent elevated levels.

19. For instance, RBA researchers recently concluded that a temporary 1 per cent decline in interest rates would be expected to lead to house prices rising by 8 per cent over the following two years. But if such a rate cut was seen as being permanent, house prices would instead rise by 28 per cent over the next two years. Tulip and Saunders (2019). House price rises since the onset of COVID are consistent with these estimates.

20. In the past, additional supply over the long run has successfully limited price growth, even when demand grew rapidly. See: Daley et al (2018a, p. 111).

21. Daley et al (2018c, Table 5.1).

22. The average number of people living in each dwelling fell from 3.5 to 2.6 between 1966 and 1996 due to couples having fewer children, the ageing of the population, shifting lifestyle preferences, more family breakdowns leading to smaller households, and older people living in their home for longer. However,

household size has remained roughly constant since the late-1990s. Therefore, these estimates underplay the number of dwellings needed to accommodate Australia's growing population. Daley et al (2018a).

23. Daley et al (ibid, p. 50).

24. The NSW, Victorian, and Queensland governments have all changed planning rules and processes over the past five years or so, which has helped new building to catch up with additional demand. Daley et al (2018c, p. 52).

25. Daley et al (2019).

26. Australia's population grew by just over 0.1 per cent (35,700 people) to 25.7 million. ABS (2021c).

27. ABS (2021d).

28. For example, Corporation (2020) expects new demand for housing fall by 286,000 dwellings between 2020 and 2025, compared with the pre-crisis outlook.

## 2.2 Restrictive planning rules have constrained supply

The historical shortage of housing in Australia is largely a failure of housing policy, rather than housing markets.

Australia's land-use planning rules are highly prescriptive and complex. Current rules and community opposition make it very difficult to create extra residences in the inner city and middle-ring suburbs of our capital cities.<sup>29</sup> And so new housing construction in Australian cities is relatively unresponsive to demand,<sup>30</sup> and the density of Australian cities has barely changed in the past 35 years.<sup>31</sup>

Reserve Bank researchers estimated that restrictive land-use planning rules added up to 40 per cent to the price of houses in Sydney and Melbourne, up sharply from 15 years ago.<sup>32</sup> More recent research suggests that planning rules have added substantially to the cost of apartments, where building height limits in and around the urban cores of our major cities prevent more construction.<sup>33</sup> These findings are consistent with a growing international literature highlighting how land use planning rules – including zoning, other regulations, and lengthy development approval processes – have reduced the ability of many housing markets to respond to growing demand, adding to both rent and house price growth in a number of countries.<sup>34</sup>

29. See Daley et al (pp. 56-58 2018a) on how regulations affect housing supply.

30. The best available estimates of the 'price elasticity of supply' in Australia is that a 10 per cent increase in dwelling prices leads to an increase in the stock of new housing of between 3 and 5 per cent. See: Daley et al (p. 46 *ibid*).

31. Daley et al (*ibid*).

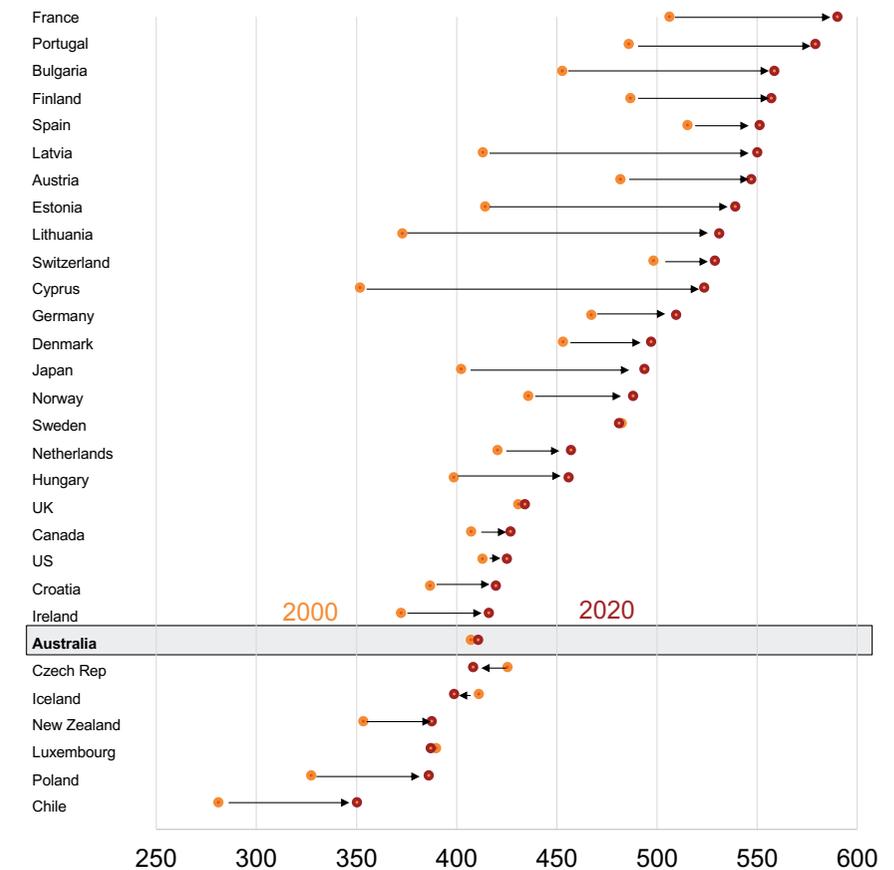
32. As demand for housing has increased, the zoning effect as a share of the price of housing has increased. Kendall and Tulip (2018).

33. Jenner and Tulip (2020) estimate that home buyers will pay an average of \$873,000 for a new apartment in Sydney though it only costs \$519,000 to supply, a gap of \$355,000 (68 per cent of costs). There are smaller gaps of \$97,000 (20 per cent of costs) in Melbourne and \$10,000 (2 per cent of costs) in Brisbane.

34. Daley et al (Box 4 2018a).

**Figure 2.1: Australia's growth in housing stock in the past two decades has been among the lowest for developed countries**

Dwellings per 1,000 people, 2000 and 2020 or latest



Notes: Figures are for total occupied and unoccupied private dwellings. Data for 2020 series refer to: 2020 for Austria, Denmark, Estonia, Finland, France, Ireland, Lithuania, Luxembourg, Netherlands, Norway, Poland, Portugal, Romania, Sweden, UK, and US; and 2018 for all others. Data for 2000 series refer to: 1998 for Italy; 2001 for Australia, Austria, Bulgaria, Canada, Croatia, Czech Republic, Hungary, Luxembourg, New Zealand, Norway, Portugal, and Spain; 2002 for Chile and Latvia; 2005 for Malta.

Source: OECD (2017).

## How to make housing more affordable

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Of course, land-use planning rules benefit other land users by, for example, preserving the views of existing residents or preventing increased congestion. But studies generally conclude that the benefits of restricting development are much less than the costs imposed.<sup>35</sup>

Planning rules that constrain development in Australian cities have also led to a shortage of medium- and high-density housing compared to what Australians actually want. After accounting for trade-offs in price, location, and size, many people would prefer a townhouse, semi-detached dwelling, or apartment in a middle- or outer-suburb, rather than a house on the city fringe. For example, semi-detached dwellings, townhouses, units, and apartments made up 44 per cent of Sydney's and 33 per cent of Melbourne's dwelling stock in 2016, up from about 38 per cent and 28 per cent respectively in 2006. But this is still well short of the 59 per cent and 52 per cent respectively that residents say they want (table 2.1).<sup>36</sup>

In recent years, planning controls have been significantly relaxed for high-rise in Brisbane and for medium-high density dwellings in Sydney.<sup>37</sup> But Australian cities still have relatively little medium density development in their extensive middle rings. Many local governments restrict medium- and high-density developments to appease local residents' concerns about road congestion, parking problems, and damage to neighbourhood character.

Since the onset of the pandemic, population growth into Australia has slowed. International borders are expected to be reopened in the coming months, but rates of inbound migration may take some time to fully return to pre-COVID levels. Wherever people decide

35. Ibid, p. 57. For example, in a review of the literature, Gyourko and Molloy (2015) conclude that while the benefits of land-use planning rules are difficult to quantify, 'recent studies suggest that the overall efficiency losses from binding constraints on residential development could be quite large'.

36. Daley et al (Table 3.2 2018a).

37. Daley et al (pp. 58-59 ibid).

to live after the pandemic subsides, the planning system should be flexible enough to ensure that they can. Changing land-use on urban fringes has already created some conflicts as housing developments encroach onto land previously used for farming.<sup>38</sup> Allowing Australians to choose where they want to live by relaxing planning rules to allow more housing to be built in a variety of places is the best approach.

### 2.3 Strict land-use planning rules reflect the politics of planning

Planning regulations have not changed much, despite the pressure of increasing population, because of the politics of planning. Most people in the established middle suburbs already own their house. Most of them don't like new developments in their neighbourhoods.

The structure of government doesn't make the politics of increasing density any easier. The voting bases of councils, the basis on which they collect rates, and the blurring of responsibilities between the Commonwealth and the states all reduce the political incentives for any level of government to do better.

The benefits of population growth accrue to society as a whole, whereas decisions about development approvals largely sit with local councils. Existing residents usually prefer their suburb to stay the same. Restricting development effectively increases the scarcity value of their property. And they worry that increased population will reduce the value to each of them of the current publicly provided infrastructure in their area such as roads and other amenities: existing residents are typically concerned that there will be more traffic congestion, more crowding on public transport, more noise, and less 'street appeal'.<sup>39</sup>

Meanwhile, prospective residents who don't already live in middle-ring suburbs cannot vote in council elections, and their interests are largely unrepresented.

38. Select Committee on Agricultural and Related Industries (Chapter 2 2010).

39. Daley et al (2018a)

**Table 2.1: The housing stock in Sydney and Melbourne is still some way from what people would prefer**

	Sydney				Melbourne				
	Detached	Semi-detached or townhouse	Apartment building up to 3 storeys	Apartment buildings 4+ storeys	Detached	Semi-detached or townhouse	Apartment building up to 3 storeys	Apartment buildings 4+ storeys	
<b>% housing stock in 2016</b>									
Inner	5	4	6	7	Inner	10	6	6	6
Middle	13	3	5	4	Middle	18	6	2	1
Outer	18	4	4	2	Outer	25	4	1	0
Fringe	21	3	1	0	Fringe	14	1	0	0
<b>Total</b>	<b>55</b>	<b>14</b>	<b>16</b>	<b>14</b>	<b>Total</b>	<b>67</b>	<b>17</b>	<b>10</b>	<b>7</b>
<b>Preferred housing stock, % of respondents</b>									
Inner	9	4	2	5	Inner	8	6	3	5
Middle	9	7	4	5	Middle	14	9	4	4
Outer	12	7	4	6	Outer	14	6	3	3
Fringe	10	6	5	4	Fringe	12	6	2	2
<b>Total</b>	<b>41</b>	<b>25</b>	<b>15</b>	<b>20</b>	<b>Total</b>	<b>48</b>	<b>26</b>	<b>12</b>	<b>14</b>
<b>Housing stock mismatch (housing stock in 2016 minus preferred housing stock), percentage points</b>									
Inner	-4	0	4	2	Inner	2	0	3	1
Middle	4	-4	1	-1	Middle	4	-3	-2	-3
Outer	6	-3	0	-4	Outer	11	-2	-2	-3
Fringe	11	-3	-4	-4	Fringe	2	-5	-2	-2
<b>Total</b>	<b>15</b>	<b>-11</b>	<b>1</b>	<b>-6</b>	<b>Total</b>	<b>19</b>	<b>-9</b>	<b>-2</b>	<b>-7</b>

*Notes: Preferred stock is from the trade-off survey in Kelly et al (2011). Excludes dwellings listed as 'Not stated' and 'Other dwellings'. Semi-detached/townhouses includes townhouses, terrace houses, row houses, courtyard houses, and villa units. Regions are at statistical local area level, sorted according to land price in 2011, and approximately match distance to the CBD. Data may not sum due to rounding.*

*Source: Daley et al (Table 3.2 2018a).*

### 3 What the Federal Government can do

The remainder of the submission identifies federal government policies that might improve housing affordability. Grattan Institute's 2018 report, *Housing affordability: re-imagining the Australian dream*, showed what would work. The report evaluated a wide range of housing policy options on whether they would make a material difference to affordability without substantially dragging on the economy or the budget. It concluded that many of them would boost the supply of housing, while a number of tax reforms to remove distortions in housing investment would have large budgetary and economic benefits, but more modest impacts on housing demand. These options are summarised in Figure 3.1.

Given the allocation of federal responsibilities, the most direct way the Federal Government can improve affordability is by reforming tax and welfare policies that distort demand for housing. The Federal Government can improve housing affordability somewhat – and immediately – by reducing demand. It should reduce the capital gains tax discount from 50 per cent to 25 per cent; abolish negative gearing; and include owner-occupied housing in the Age Pension assets test.

But affordability – both to buy and to rent – would also improve if governments permit more homes to be built. Building an extra 50,000 homes a year for a decade could reduce Australian house prices by up to 20 per cent compared to where they would have been otherwise.<sup>40</sup> This is primarily a problem for state governments: they set the overall framework for land and housing supply, they govern the local councils that assess most development applications, and they set building regulations that affect building costs. But the Federal Government can

encourage the states to reform land-use planning and zoning laws and release greenfield land, which would boost supply.

The Federal Government should also provide extra support for the worst-off. But not all such policies would be equally effective. Any boost to social housing will be expensive, and therefore should be reserved for people at greatest risk of long-term homelessness. And any further support for those on low incomes should be focused on direct financial assistance for low-income renters rather than building more social housing.

#### 3.1 Reform tax and welfare rules to reduce demand for housing

Housing demand would be reduced a little if the Federal Government reduced the capital gains tax discount and abolished negative gearing – and there would be substantial economic and budgetary benefits.<sup>41</sup> The effect on property prices would be modest – they would be roughly 2 per cent lower than otherwise – and would-be homeowners would win at the expense of investors. House prices at the bottom would probably fall by more, since these tax breaks have channelled investors into low-value homes that are lightly taxed under states' progressive land taxes and tax-free thresholds.<sup>42</sup>

The dominant rationale for these reforms is their economic and budgetary benefits. The current tax arrangements distort investment decisions and make housing markets more volatile. Our proposed reforms would boost the budget bottom line by about \$5 billion a

40. Daley et al (2018a). Saunders and Tulip (2018) estimate this would reduce the cost of housing by 11 per cent.

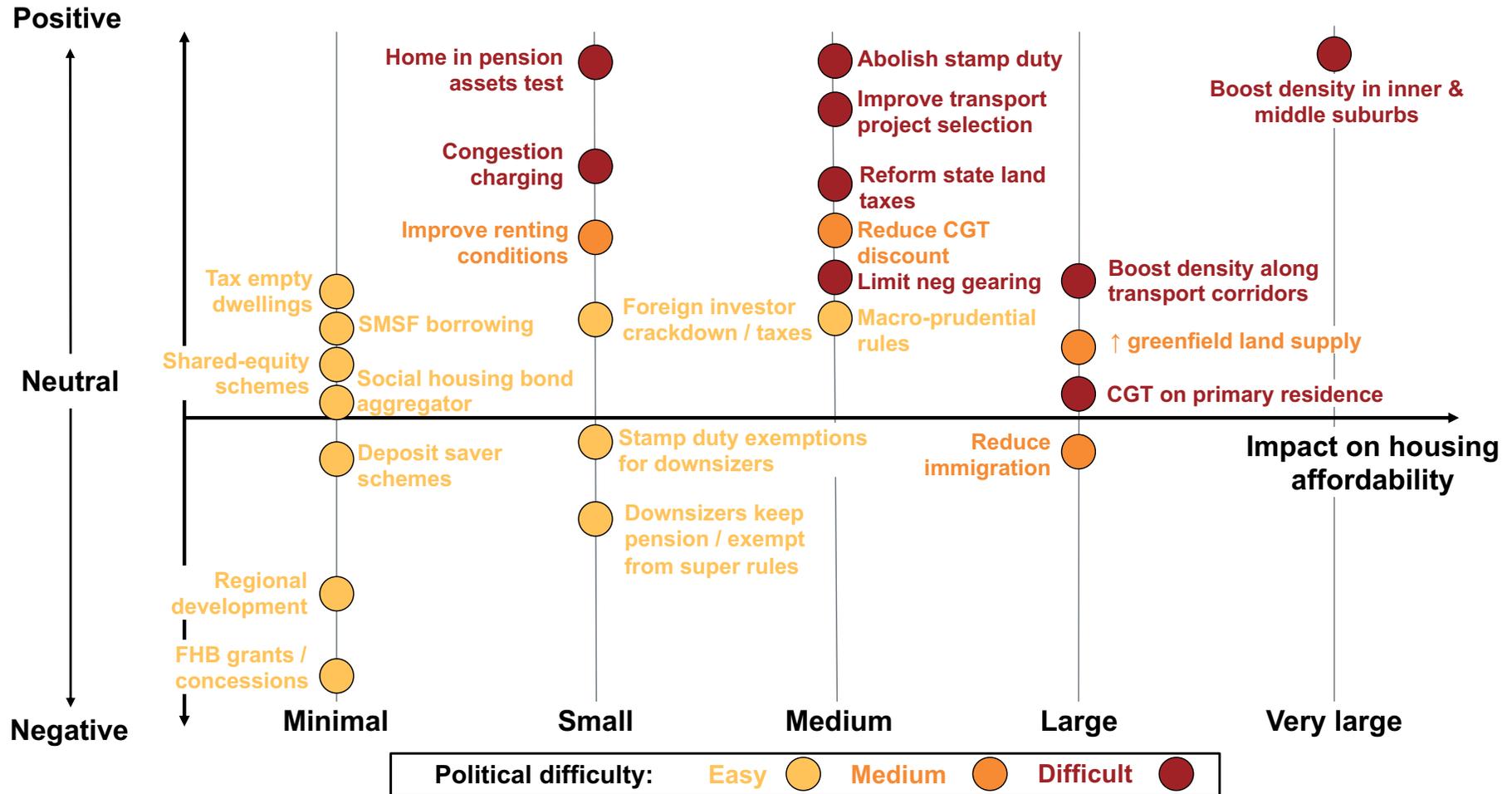
41. Daley et al (2016).

42. Daley et al (2018a, pp. 97–98).

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**Figure 3.1: Only some policies will actually improve housing affordability, and these are politically difficult**

Summary of economic, budgetary, and social impacts



Notes: Prospective policies are evaluated on whether they would improve access to more-affordable housing for the community overall, assuming no other policy changes. Assessment of measures that boost households' purchasing power includes impact on overall house prices. Our estimates of the economic, budgetary, or social impacts should not be treated with spurious precision. For many of these effects there is no common metric, and their relative importance depends on the weighting of different political values. Consequently our assessments are generally directional and aim to foster a more informed discussion. SMSF = self-managed superannuation fund. FHB = first home buyer. CGT = capital gains tax.

Source: Daley et al (2018a, Figure 5.2).

year.<sup>43</sup> Contrary to urban myth, rents wouldn't change much, nor would housing markets collapse.<sup>44</sup>

Including more of the value of the family home in the pension assets test would also marginally reduce housing demand. Under current rules only the first \$216,500 of home equity is counted in the pension assets test; the remainder is ignored. Inverting this so that all of the value of a home is counted above some threshold – such as \$500,000 – would be fairer, and contribute to the budget. Again the dominant rationale for this reform is the budgetary benefit, rather than housing affordability. Many Age Pension payments are made to households that have substantial property assets. Half of the government's spending on the Age Pension goes to people with more than \$500,000 in assets.<sup>45</sup>

This reform would also encourage a few more senior Australians to downsize to more appropriate housing, although the effect would be limited given that research shows downsizing is primarily motivated by lifestyle preferences and relationship changes.<sup>46</sup>

Other tax and transfer settings that affect housing include the (non) taxation of imputed rent, the corresponding (non) deductibility of mortgage costs, and the (non) taxation of capital gains and imputed

rents on owner-occupied housing. While the policy merits of taxing owner-occupied housing are sound, the politics is likely to be particularly intractable.<sup>47</sup>

### 3.2 The Federal Government should sharpen states' incentives to boost housing supply

The Federal Government should provide incentives to state and local governments to increase the supply of housing in good locations.<sup>48</sup> Coordinating action by the states is worthwhile because improved housing supply in one state spills over into lower prices in other states.<sup>49</sup> The Federal Government can help solve this coordination problem. And the Commonwealth tax base is more likely than the state tax base to capture the increased revenues that flow from higher economic growth as a result of better housing supply.

43. Daley et al (2016).

44. Analysis of daily house price data compiled by Corelogic after the 2019 federal election showed that APRA's post-election decision to loosen the lending restrictions it imposes on the banks, rather than the election result, spurred the recovery of Australian house prices. See: Coates and Cowgill (2019)

45. Daley et al (2018b, p. 98). Excludes impact of changes to the Age Pension assets test that took effect from 1 January 2017, reducing the pension entitlements of 326,000 pensioners. But these changes would have reduced overall pension payments to part-rate pensioners by only about \$1 billion in 2017-18, which is unlikely to substantially change the distribution of pension payments by net wealth, given total pensions spending of \$45 billion in 2017-18 (Morrison (2015) and Treasury (2017)).

46. Daley et al (2018b, p. 38); Productivity Commission (2015); and Valenzuela (2017).

47. Investment would be less biased towards housing, where any capital gains and imputed rents – the value of owning the home that you live in – are untaxed, compared to investing in other more productive assets. But it would be difficult to resist calls to allow deduction of interest payments and the cost of any capital improvements made to the home such as renovations, which could wipe out most or all of the benefit to the budget. Taxing imputed rents in particular presents a number of practical policy design and implementation challenges, which is why only five OECD countries – the Netherlands, Iceland, Slovenia, Luxembourg, and Switzerland – tax imputed rents, and they often substantially under-estimate the rental value (Daley et al (2018a, pp. 101–102)).

48. Daley et al (ibid, pp. 128–130). See also Deloitte Access Economics (2016).

49. Australia's housing markets are interconnected. If, for example, only the Victorian Government substantially boosts housing supply, any improvement in affordability will be dispersed across Australia as residents of other Australian cities move to Melbourne, attracted by lower house prices relative to other major Australian cities. But because Australia's migration intake is largely determined by the Federal Government, independently of state planning policies, affordability would improve in other states, even though they would have avoided the political costs of increasing housing supply. See: Daley et al (2018a, p. 129), Abelson (2016) and Aura and S. Davidoff (2008).

## How to make housing more affordable

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The principle of federal financial support for state-level reform is well-established. From 1997-98 to 2005-06 the National Competition Policy involved payments averaging about \$600 million a year to the states and territories for regulatory and competition reform.<sup>50</sup> The Productivity Commission's 2005 review of the National Competition Policy found that it had delivered substantial benefits to the Australian community which, overall, greatly outweighed the costs of these payments to the Commonwealth.<sup>51</sup>

The Federal Government had sought to use the most recent intergovernmental housing agreement to encourage state and local governments to boost housing supply.<sup>52</sup> But the Commonwealth did not put enough money on the table to get states to make the politically difficult decisions on planning reform.<sup>53</sup>

The Federal Government should also increase the pressure on states to make good planning decisions. The Commonwealth should shift housing research functions from the National Housing Finance and Investment Corporation to an independent statutory body, Housing Australia, with a mandate to collect nationally consistent data on issues related to housing supply and demand, including on the operation of state and local government land-use planning systems, infrastructure charges, and migration. This more independent body could be used to

50. Productivity Commission (2005).

51. Ibid.

52. The National Affordable Housing Agreement specifies national performance indicators including the total number of dwellings relative to the population, and increases in the number of dwellings permitted by zoning in major cities. But no funding is attached to achieving these milestones: (Treasury (2018) and Milligan (2018)).

53. The Commonwealth's City Deals could be used for this purpose, but so far they have focused not on housing affordability but on the broader objectives of increasing economic growth and stimulating urban renewal: see Department of Infrastructure, Regional Development and Cities (2019).

hold the states to account on any government promise to boost housing supply and reform land-use planning rules.<sup>54</sup>

Of course, boosting housing supply will improve affordability only slowly. Even at current record rates, new housing construction increases the stock of dwellings by only about 2 per cent each year. According to available estimates, adding an extra 50,000 dwellings to Australia's housing stock – an increase of about 25 per cent on current levels of construction nationally, or roughly 0.5 per cent of the national housing stock – would lead to national house prices being only 1-to-2 per cent lower than otherwise.<sup>55</sup>

But these estimates also imply that a sustained increase in housing supply would have a big impact on house prices. For example, if an extra 50,000 homes were built each year for the next decade, national house prices and rents could be between 10 and 20 per cent lower than they would be otherwise. While these effects are insufficient to offset the impact of record low interest rates on house prices, they could make housing substantially cheaper in Australia than would otherwise be the case.

### 3.3 Boosting housing supply would especially help low-income earners

A 10 per cent fall in private market rents would reduce the number of low-income households in housing stress by 8 per cent, and a 20 per cent fall in private market rents would reduce that number by 18 per cent.<sup>56</sup>

54. Daley et al (2018a, p. 129).

55. Daley et al (ibid, p. 111). A more recent estimate from Tulip and Saunders (2019) suggests that each 1 per cent increase in the stock of dwellings lowers the cost of housing by 2.5 per cent.

56. Grattan analysis of Wong et al (2016).

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Private housing helps people on low incomes by lowering the rents they pay. Rents have increased more slowly over the past decade in Victorian suburbs in which more housing has been constructed.<sup>57</sup> Increasing the supply of housing as we recommend would, over a decade, be sufficient to reduce the number of low-income households suffering housing stress by up to one-third, or about 170,000 households.<sup>58</sup> And all low-income households would be paying less for their housing.

Claims that direct investment in affordable housing is the only way to boost the stock of homes available to low-income earners are based on misleading research.<sup>59</sup> More housing supply will ultimately free-up less expensive housing stock, making rents cheaper for low-income earners.<sup>60</sup> International evidence suggests that this 'filtering' does occur in practice. For example, US estimates suggest that 45 per cent of homes that were affordable to very low-income earners in the US in 2013 had filtered down from owner-occupier or higher-rent categories

57. Each 1-percentage-point increase in the amount of new housing constructed in a local government area resulted in rents growing 3.7 per cent slower over the decade (Grattan analysis of ABS (2017a) and Victorian Department of Health and Human Services (2019)).

58. Grattan analysis of ABS (2017b). Based on a 20 per cent fall in rents.

59. For example, Ong et al (2017) claim that most of the additional dwellings built over the past decade were substantially more expensive than the existing housing stock. But this study is flawed because it groups price deciles by the number of local government areas, rather than by the number of dwellings. Grattan Institute's new analysis of the data, updated to 2016-17, shows that two-thirds of new houses have been built in the cheapest half of all suburbs, and most new units and apartments have been built in Sydney and Melbourne, where median prices are higher (Coates and Wiltshire (2018)).

60. See: Daley et al (2018a, p. 64). The people who move into newly constructed, more expensive housing are either existing residents who move out of less expensive housing, or new residents who would otherwise have added to the demand and pushed up the price of existing housing. Irrespective of its cost, each additional dwelling adds to total supply, which ultimately improves affordability for all homebuyers.

in 1985.<sup>61</sup> And higher rents increase the risk of homelessness for those who are already vulnerable.<sup>62</sup>

Decreasing rents provides the kind of support to households which subsidies on their own will never be able to feasibly achieve. Decreasing rents by 20 per cent would boost the post-housing incomes of low-income private renters by more than \$3 billion a year, equivalent to more than an increase of more than 80 per cent in the maximum rate of Commonwealth Rent Assistance.

Making housing cheaper would also make existing government subsidies more effective, since Rent Assistance would go further towards reducing financial stress among low-income private renters.

### 3.4 Reducing immigration would improve housing affordability but probably leave Australians worse off

Australia's migration policy is its de-facto population policy. The population is growing by about 350,000 a year. More than half of this is due to immigration. Some have called for fewer migrants to be allowed into Australia, to improve housing affordability and reduce congestion in our biggest cities.<sup>63</sup>

Lower migration would make housing somewhat more affordable, but only in the long term.<sup>64</sup> We estimate that curbing net overseas

61. Weicher et al (2016).

62. For example, Johnson et al (2018) find that a \$100 increase in 20<sup>th</sup> percentile weekly rents raised an individual's risk of becoming homeless by almost 3 per cent among a sample of welfare recipients who had been flagged by Centrelink as being at risk of housing insecurity. In fact, increasing rents actually had a greater impact on the risk of homelessness than frequent illicit drug use, experiencing physical or sexual violence in the past six months, or a history of being in state care.

63. For example, NSW Premier Gladys Berejiklian has previously called for the state's migrant intake to be halved (McGowan and Evershed (2018)).

64. Daley et al (2018a).

migration by 30,000 a year would result in house prices and rents about 3-to-4 per cent lower after a decade.<sup>65</sup> Researchers at the Reserve Bank recently estimated that the post-2005 increase in migration led to rents (and house prices) being around 9 per cent higher than they otherwise would have been.<sup>66</sup>

But lower migration would probably leave Australians worse off. Slowing migration, especially skilled migration, would probably reduce Australians' per-capita incomes.<sup>67</sup> Cutting migration would also hit the Commonwealth Budget in the short term.<sup>68</sup> Most migrants are of working age and are liable to pay personal income tax. And many temporary migrants, such as 457 visa holders, can't draw on a range of government services and benefits, including welfare and Medicare.

More importantly, cutting back on younger, skilled migrants is likely to hurt the budget and the economy in the long term. New migrants are younger than many previous waves of migrants when they arrived. And they are much younger than the incumbent Australia population.<sup>69</sup>

Consequently, they provide a 'demographic dividend' over the medium run by increasing the proportion of Australians in the workforce, thus smoothing the negative economic and budgetary impacts of an ageing population over a longer period.<sup>70</sup> While immigration does not eliminate the costs of population ageing, since migrants themselves also age, it has smoothed out the baby-boom 'bump' that created a cohort much larger than the age group born in the years before or after.<sup>71</sup>

65. Coates (2016) estimated that a 50,000-a-year cut to the migrant intake would reduce house prices by 6-to-7 per cent after a decade.

66. Tulip and Saunders (2019).

67. Daley et al (2018a, pp. 105–106).

68. Belot (2018). Then Treasurer Scott Morrison warned that reducing Australia's permanent migration cap by 80,000 people a year would cost the budget between \$4 billion and \$5 billion over four years.

69. Productivity Commission (2016, p. 125); and Daley et al (2018a, p. 34).

70. Daley et al (2018a, p. 105).

71. Daley et al (Figure 3.4 2018a); and Norton and Tanner (2017).

Consequently any decision to reduce net overseas migration would need much more careful thought, and would require changes to the rules around temporary visas, which typically involve difficult trade-offs.

### 3.5 Boost Commonwealth Rent Assistance

Rent Assistance materially reduces housing stress among low-income Australians.<sup>72</sup> But the value of Rent Assistance has not kept pace with rent increases. The maximum Rent Assistance payment is indexed in line with CPI, but rents have been growing faster than CPI for a long time.<sup>73</sup>

Boosting the rate of Commonwealth Rent Assistance would help low-income earners with their housing costs, and reduce poverty more generally. A 40 per cent increase in the maximum rate of Rent Assistance – worth about \$1,400 a year for singles – would cost \$1.3 billion a year.<sup>74</sup> Commonwealth Rent Assistance would then provide the same real level of assistance to low-income earners as it did 15 years ago, taking into account the rising cost of their rent. In future, Rent Assistance should be indexed to changes in rents typically paid by people receiving income support, so that its value is maintained, as recommended by the Henry Tax Review.<sup>75</sup>

A common concern is that boosting Rent Assistance would lead to higher rents, eroding much of the gains in living standards for low-income earners.<sup>76</sup> But an increase in Rent Assistance is unlikely

72. In June 2016, 68 per cent of Rent Assistance recipients would have paid more than 30 per cent of their income on rent if Rent Assistance were not provided. With Rent Assistance provided, this proportion was reduced to 41 per cent (Daley et al (2018b, p. 76)).

73. Ibid (p. 76).

74. Coates and Nolan (2020, p. 66).

75. Treasury (2009, p. 595). While the rental component of the CPI is a readily available and transparent measure, an index of rents paid by Rent Assistance recipients would provide a more accurate assessment of their rental costs.

76. Senate Economics References Committee (2015, Chapter 22).

## How to make housing more affordable

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to substantially increase rents.<sup>77</sup> Households are unlikely to spend all of the extra income on housing.<sup>78</sup> Households receiving Rent Assistance are only a small proportion of low-income renting households. And only half of low-income renters actually receive Rent Assistance, since eligibility is linked to receiving an income support payment.

But boosting Rent Assistance would not solve all the issues around housing affordability. Boosting Rent Assistance by 40 per cent would only modestly reduce the proportion of low-income earners in housing poverty. Many low-income Australians are spending up to 50 per cent of their incomes on housing.<sup>79</sup> And private rental is likely to be inappropriate for people at severe risk of long-term homelessness.

### 3.6 The Federal Government should help boost the supply of social housing to reduce homelessness

The Federal Government should increase funding through the National Affordable Housing Agreement<sup>80</sup> for social housing, provided that the money is tightly targeted to help Australians at serious risk of homelessness.

The best Australian evidence shows that social housing substantially reduces tenants' risk of homelessness.<sup>81</sup> Social housing can make a big difference to the lives of the worst off. While lots of landlords rent to low-income households, many are prepared to leave their property

77. Daley et al (2018b, pp. 77–79).

78. Each dollar of additional Rent Assistance should lead to an increase in spending on housing of only between 9 cents and 15 cents (Daley et al (ibid, p. 78)).

79. Ibid (p. 77).

80. Treasury (2018).

81. Prentice and Scutella (2018) studied the benefits of social housing, comparing the outcomes of people who entered social housing to similar individuals in the private rental market. They found that social housing tends to be effective at reducing homelessness rates. Only 7 per cent of residents placed in social housing subsequently become homeless, compared to 20 per cent of similar renters in the private market.

vacant if the only person seeking tenancy faces the many issues typical for those who are at severe risk of, or already suffering, homelessness. These issues include living with a disability, domestic violence, poor mental health, drug and alcohol misuse, a history of state care, or long-term disadvantage.<sup>82</sup>

The stock of social housing – currently about 400,000 dwellings – has barely grown in 20 years, while the population has increased by 33 per cent.<sup>83</sup> As a consequence, there is little 'flow' of social housing available for people whose lives take a big turn for the worse,<sup>84</sup> and many people who are in greatest need are not assisted. Tenants generally take a long time to leave social housing; most have stayed for more than five years.<sup>85</sup>

But boosting social housing would be expensive: increasing the stock by 100,000 dwellings – broadly sufficient to return the total social housing stock to its historical share of the total housing stock – would cost the Federal Government about \$30 billion.<sup>86</sup> People in social housing receive a much greater average level of assistance – at much greater cost to government – than private renters receive from Rent Assistance.<sup>87</sup>

Given its costs, social housing should be reserved for those most in need, and at significant risk of becoming homeless for the long term.<sup>88</sup> While even an unprecedented boost to the social housing stock – such

82. Daley et al (2018a, p. 134).

83. Daley et al (ibid, p. 62). This is despite some significant investments in public housing, including under the controversial and now discontinued National Rental Affordability Scheme.

84. Daley et al (ibid, p. 132).

85. AIHW (2017).

86. Coates (2020).

87. Productivity Commission (2018, p. 174).

88. New allocations of social housing are better targeted to those most in need. Of all social housing allocations in 2017, almost three-quarters went to 'greatest needs' applicants (Productivity Commission (ibid, Chapter 18)).

## How to make housing more affordable

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as an extra 200,000 dwellings – would make a big difference to people who are homeless if it were tightly targeted towards them,<sup>89</sup> more than two-thirds of low-income Australians would still remain in the private rental market.

Therefore, beyond ensuring a flow of additional social housing for people most at risk of long-term homelessness, further support for low-income housing should be focused on direct financial assistance for low-income renters, and improving housing affordability more broadly by increasing the number of homes constructed.

### 3.6.1 Don't subsidise first home-buyers and downsizers

Over recent decades, federal, state, and territory governments have spent billions of dollars giving cash incentives and stamp duty concessions to first-home buyers.<sup>90</sup> These policies have typically resulted in spikes of first home-buyer activity as they bring forward purchases, then there is a lull in activity, and in the end housing affordability is actually worse because additional demand drives up prices.<sup>91</sup>

Some argue that governments should give senior Australians more incentives to downsize their homes through stamp duty concessions, exemptions from the Age Pension means test, or additional superannuation tax concessions.<sup>92</sup> It sounds good: new incentives would encourage seniors to move to housing that better

89. For example, there were 116,000 homeless Australians on Census night in 2016 (ABS (2017a)).

90. Eslake (2013). Daley et al (2013, p. 49) estimated that abolishing all subsidies for first home-buyers could save federal, state, and territory budgets a combined \$1.3 billion a year. Stamp duty concessions act in a similar way to cash grants for first home-buyers (I. Davidoff and Leigh (2013)).

91. Daley et al (2018a, pp. 135–137).

92. For example, see Ong et al (2016).

suits their needs, while freeing up equity for their retirement and larger homes for younger families.

But the reality is different. Most seniors are emotionally attached to their home and neighbourhood and don't want to downsize.<sup>93</sup> So most of any financial incentives will go to people who were going to downsize anyway.<sup>94</sup> And, as the Productivity Commission found, these incentives have a material budget cost, and distort the housing market by adding even more tax and welfare incentives to own a home.<sup>95</sup>

If governments really want to encourage seniors to downsize, they should do so by including the family home in the Age Pension assets test – which would at least have the virtue of improving the budget bottom line, even if it would have little impact on housing affordability.

### 3.7 Making housing more affordable requires making tough choices

Australian governments have historically avoided the hard choices on housing affordability, preferring policies that merely appear to help. The politics of reform are fraught because most voters own a home (and many own investment properties), and mistrust any change that might dent the price of their assets. But if governments keep pretending there are easy answers, housing affordability will only get worse.

If governments really want to make a difference, they need to stop offering false hope through policies, such as first home-owners' grants, that are well-known to be ineffective. Governments have no chance of bringing the community with them when they keep telling voters that the easy policies will do the job. Instead they need to explain the

93. For two-thirds of older Australians, the desire to 'age in place' is the most important reason for not selling the family home. Often they stay put because they can't find suitable housing in the same local area (Daley and Coates (2017)).

94. Daley et al (2018a, pp. 140–141).

95. Productivity Commission (2015).

## How to make housing more affordable

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hard choices, to prepare the ground for the tough decisions that need to be made. Either people accept greater density in *their* suburb, or their children will not be able to buy a home, and seniors will not be able to downsize in the suburb where they live. Economic growth will be constrained. And Australia will become a less equal society – both economically and socially.

Policy can make a difference. But only if we make the right choices.

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HOUSING

# A place to call home: it's time for a Social Housing Future Fund

by Brendan Coates

28.11.2021    BLOG

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Australia has a housing crisis. Australians are spending more of their incomes on housing than in the past. Poorer people are feeling the pinch most. Many low-income renters are living in **poverty**, and many more are suffering **financial stress**. Inequality is **increasing**, and more Australians are becoming **homeless**.

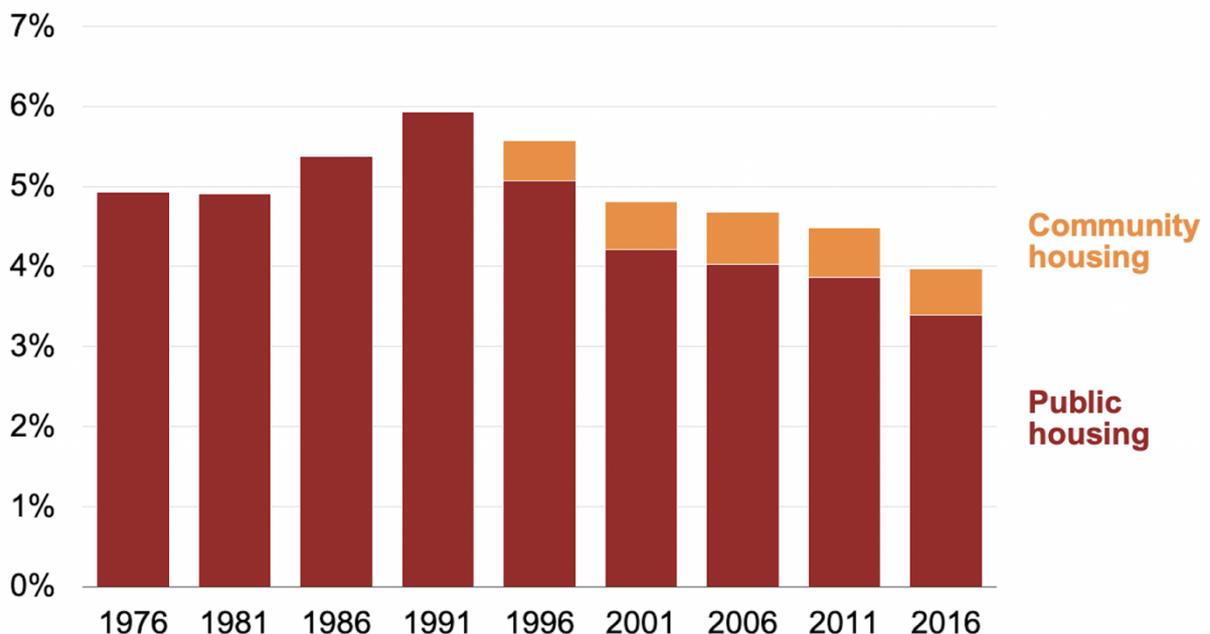
## Australia's social housing stock has stagnated

Social housing – where rents are typically capped at 25 per cent of tenants' incomes – can make a big difference to the lives of vulnerable Australians. Australian **evidence** and international **experience** shows social housing substantially reduces tenants' risk of homelessness.<sup>1</sup>

GRATTAN  
Institute

### Australia's social housing stock is in decline

Social housing as a proportion of all housing



Note: Before 1996 community housing was not recorded in the Census, but only accounted for a small amount of the total social housing stock.  
Sources: Grattan analysis of ABS (1978), ABS (1983), ABS (1988), ABS (1993), ABS (1997), ABS (2001), ABS (2006), ABS (2011), and ABS (2016).

1

Yet the stock of social housing – currently around 430,000 dwellings – has barely grown in 20 years, while Australia’s population has increased by 33 per cent. About 6 per cent of housing in Australia was social in 1991. It’s now less than 4 per cent.

Most social housing tenants stay for **more than five years**. Australia’s stagnating social housing stock therefore means there is little ‘flow’ of social housing available for people whose lives take a big turn for the worse.<sup>2</sup> The result is that a smaller proportion of Australians is living in social housing than in the past, and every year proportionally fewer social housing units become available for new tenants.

More poorer Australians are having to rent in the private market. The median low-income social renter pays 24 per cent of their income on rent, compared with 37 per cent for the typical low-income private renter.<sup>3</sup>

With fewer low-income Australians owning their home or living in social housing, their housing costs are rising. The bottom 20 per cent of households by income now spend 29 per cent of their income on housing on average, up from 22 per cent in 1995.

## **But boosting social housing won’t come cheap**

Social housing is expensive because governments provide a big rental discount to vulnerable tenants.<sup>4</sup> If governments were going to try to recoup these costs over time, as private landlords do, the rents they would need to charge would be higher than vulnerable residents can afford to pay.<sup>5</sup>

This means there is an ongoing ‘subsidy gap’ which can either be paid upfront (i.e. by writing off the net present value of the annual subsidy) or an annual basis by recognising that the social rents will fall short of the market rent for the home.<sup>6</sup>

In 2018, the annual subsidy gap payment was estimated at **about \$13,000**, or around \$15,000 in today’s dollars, although that varies substantially across Australia. The upfront subsidy gap is about \$300,000, which can be covered via capital grants to community housing providers or state governments to expand public housing.<sup>7</sup>

The challenge for the federal government is how to pay for more social housing.

## **The Federal Government should establish a Social Housing Future Fund**

The Federal Government should establish a Social Housing Future Fund, which could make regular capital grants to state governments and community housing providers.

The Federal Government already manages \$247.8 billion in assets across six future funds to address long-term problems ranging from covering federal public servants' superannuation entitlements to funding medical research.<sup>8</sup>

The endowments for existing federal future funds were typically raised from asset privatisations, explicit budget savings, and expected future budget surpluses.<sup>9</sup> The endowment for a Social Housing Future Fund could be established by borrowing at today's ultra-low interest rates and invested with the **Future Fund Board of Guardians**.<sup>10</sup> Some states, including **Victoria, NSW**, and **Queensland** already operate social housing investment funds, in some cases financed by government borrowing.<sup>11</sup>

The value of the new federal Social Housing Future Fund should be maintained over time to keep pace with inflation, and the investment returns above the inflation rate used to fund capital grants for new social housing units, allocated via the National Housing Finance and Investment Corporation (NHFIC).<sup>12</sup> Capital grants would be allocated via a competitive tender, with requirements for dwelling size and location, maximising the housing subsidies delivered to tenants.<sup>13</sup>

Such a fund could boost social housing with little or no hit to the federal government's budget bottom line. Since the initial endowment is an investment, it wouldn't appear on the underlying budget balance. Instead, only the annual returns on the fund, less debt interest costs and any capital grants allocated, would affect the budget balance each year. For example, the government could issue \$20 billion in bonds, and invest it into the fund. The government would have to pay interest on the bonds but can generally earn higher returns on its investment.

Nor would establishing such a fund hurt the federal government's balance sheet. An extra \$20 billion in gross debt is small fry compared to the **nearly \$1 trillion in debt currently on issue**, supported by about \$500 billion a year in federal government revenues.<sup>14</sup> What's more, the increased debt would be offset by assets of equivalent value in the form of investments held by the Future Fund – in the form of stocks, bonds, and infrastructure holdings.

While the Fund would expose taxpayers to extra investment risk – the price of higher returns – the new fund would add less than one-tenth to total existing assets currently managed by the Future Fund.

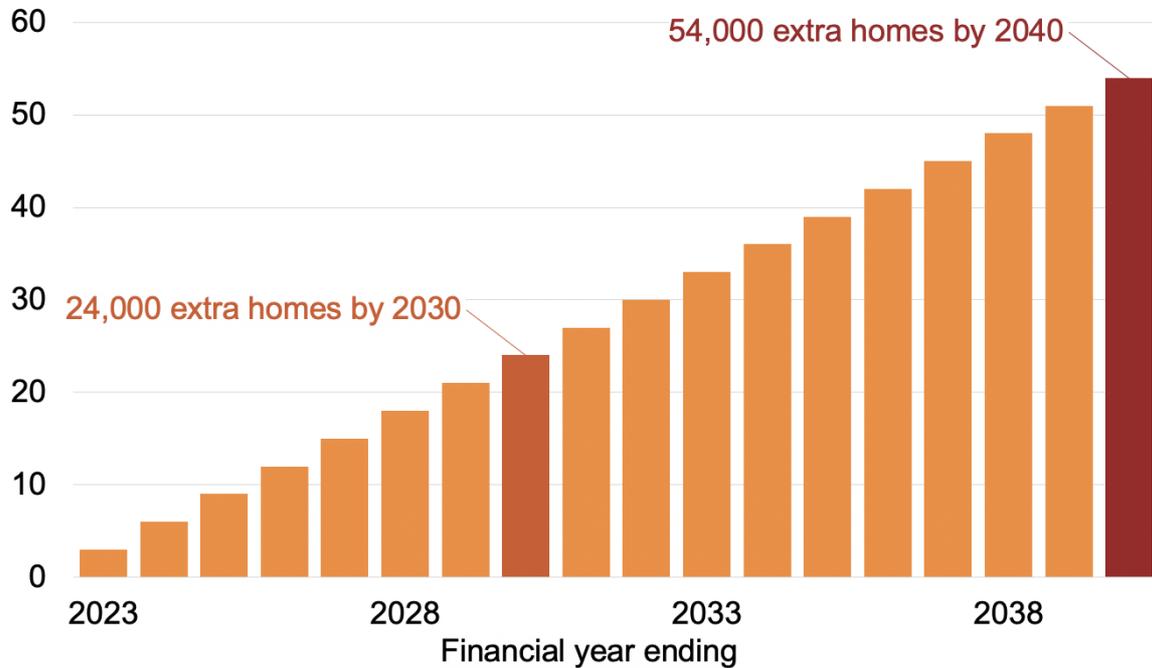
### **How much social housing could a \$20 billion Future Fund support?**

A \$20 billion fund, with an investment mandate to target real (after-inflation) returns of 4-to-5 per cent, could over time provide a dividend averaging \$900 million each year. Such a fund could deliver 3,000 extra social housing units a year in perpetuity, assuming capital grants of \$300,000 per dwelling to cover the upfront subsidy gap.<sup>15</sup> If commenced in 2022-23, the Future Fund could build 24,000 social housing dwellings by 2030, and 54,000 by 2040.

Future governments could choose to top up the fund endowment, helping expand the social housing share of the national housing stock in future.

## A \$20 billion Future Fund could add substantially to Australia's social housing stock GRATTAN Institute

Cumulative extra social housing dwellings, thousands



Notes: Assuming \$300,000 capital grant per dwelling, indexed to inflation.  
 Source: Grattan analysis.

2

The direct financial cost to the federal government would be modest – about \$400 million a year, or less than 0.1 per cent of federal government spending each year, in the form of interest costs on the outstanding debt.<sup>16</sup> Alternatively, part of the return from the Future Fund could be used to cover these debt interest costs, leaving \$500 million available each year to fund the construction of about 1,700 new social housing dwellings each year with no hit to the Government's underlying cash balance.

## Dragging the states to the table

The Morrison Government has been clear that it regards social housing as the **responsibility of state governments**. Yet the history of Australia's federation shows that large social programs, from Medicare to the **post-WW2 expansion of social housing**, only succeed with federal support. This reflects Australia's 'vertical fiscal imbalance': for every five dollars in taxes levied each year in Australia, the federal government collects four and the states only one.<sup>17</sup>

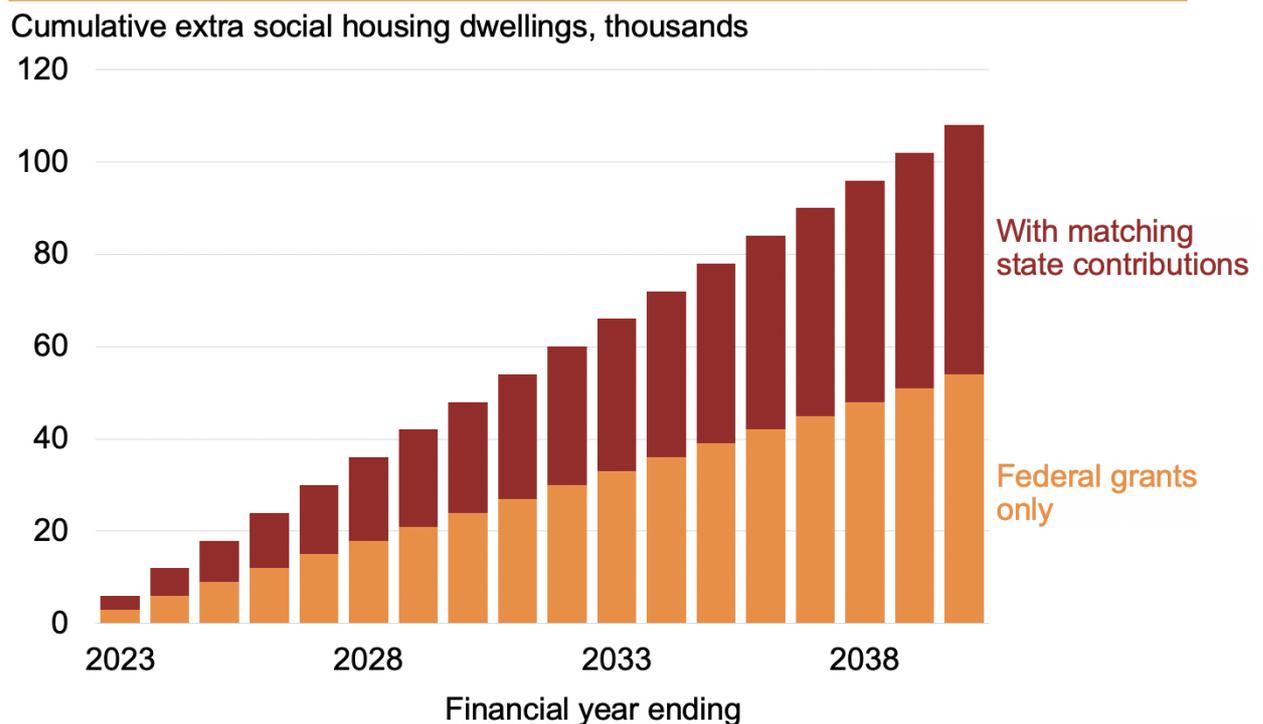
Nonetheless the Federal Government's frustration with state inaction on social housing is not without some basis. In the decade after the last big federal social housing investment – the **\$6 billion Social Housing Initiative** by the Rudd-Gillard governments which built 20,000 social homes during the Global Financial Crisis, and renovated thousands more – state

investment in social housing has been anaemic. In the five years leading into COVID, the total stock of social housing increased by just 1,600 homes. Only in response to the COVID crisis have state governments adopted social housing construction programs as economic stimulus, notably the **Big Housing Build in Victoria**.

The Federal Government should require state governments to match federal contributions to new social housing, as a condition of any grants being allocated to their state. Any state that does not agree to provide matching contributions would be ineligible for any capital grants for social housing in that year, with the proceeds instead reinvested in the Future Fund and re-distributed across all states the following year.

If matched state funding was forthcoming, the Future Fund could provide 6,000 social homes a year – enough to stabilise the social housing share of the total housing stock.<sup>18</sup> It would double the total social housing build to 48,000 new homes by 2030, and 108,000 by 2040.

### **With matching state contributions, Australia could have more than 100,000 extra social homes by 2040**



*Note: Assuming \$300,000 capital grant per dwelling, indexed to inflation.  
 Source: Grattan analysis.*

## **More social housing alone won't solve Australia's housing crisis**

Given its costs, social housing should be reserved for people who are most in need and at significant risk of becoming homeless for the long term.<sup>19</sup> An unprecedented boost to the social housing stock – such as an extra 100,000 dwellings – would make a big difference to

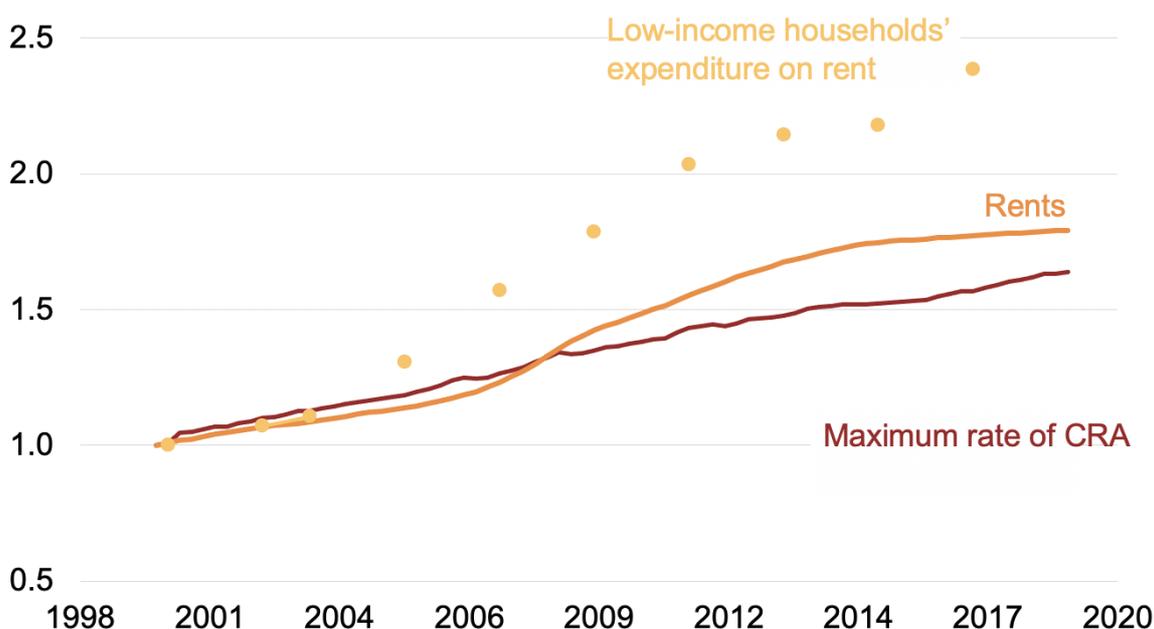
people who are homeless if it were tightly targeted towards them,<sup>20</sup> but even then more than two-thirds of low-income Australians would still remain in the private rental market.

Beyond ensuring a flow of additional social housing for those at greatest risk of long-term homelessness, further support for low-income housing should be focused on direct financial assistance via increases in Commonwealth Rent Assistance.

Commonwealth Rent Assistance should be boosted by at least 40 per cent and it should be indexed to changes in rents typically paid by people receiving income support. This would be a fairer and more cost-effective way to reduce financial stress and poverty among poorer renters. It's well targeted: about 80 per cent of Rent Assistance goes to the poorest fifth of households. **Rents wouldn't increase much**, because only some of the extra income would be spent on housing.<sup>21</sup>

## Commonwealth Rent Assistance (CRA) hasn't kept up with rents paid by low-income Australians GRATTAN Institute

Rent, change in the maximum rate of CRA, low-income household median expenditure on rent, index, weighted average of Australia's eight capital cities



Notes: Rent index for all households is constructed by the ABS using a weighted average of the eight capital cities. Maximum rate of Commonwealth Rent Assistance is indexed to CPI.

Sources: ABS (2019), 6401.0 - Consumer Price Index, Australia, Jun 2019, A2325841T, A2331876F.

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State governments should also relax planning rules that prevent more homes being built in inner and middle-ring suburbs of our largest cities,<sup>22</sup> and the Federal Government should **provide incentives** to the states to do so. And states should **reform tenancy rules**, to make renting more secure.

A Social Housing Future Fund alone wouldn't solve the housing crisis for low-income Australians. But it would give a much needed helping hand to some of our most vulnerable citizens, and ensure social housing will be available for future generations should they need it.

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## Footnotes

- 1 **Infrastructure Victoria** found that social housing tends to be effective at reducing homelessness. Only 7 per cent of residents placed in social housing subsequently become homeless, compared to 20 per cent of similar renters in the private market.
- 2 The gross number of social rental lettings dropped from 52,000 in 1991 to 35,000 in 2017 (Pawson, H., Milligan, V., & Yates, J. (2020), p. 106).
- 3 Grattan analysis of ABS Survey of Income and Housing 2017-18. Low-income defined as poorest 40 per cent by equivalised household disposable income.
- 4 Social housing, like any other housing, may also appreciate over time, improving the net worth of state governments and community housing providers. However, any gains can only be realised by selling the social housing stock, meaning it can no longer be made available as social housing to vulnerable renters.
- 5 Markets rents, plus any expected capital gains, normally provide a fair return on investment, covering these costs over the life of the asset.
- 6 It's the subsidy gap, rather than the upfront financing cost, that reflects the true cost to government of providing social housing. Part of the upfront cost of financing social housing is supported by the (discounted) rental payments made by the tenant. For instance, the **Affordable Housing Working Group** established by the Council on Federal Financial Relations estimated that the rental payment from tenants could support debt equating to 40 per cent of upfront construction and land costs.
- 7 Estimates of the average upfront cost of building a unit of social housing range from \$240,000 to \$330,000. For instance, the **Social Housing Acceleration and Renovation Program (SHARP)** estimates the cost of building 30,000 new social housing units at \$7.2 billion, or \$240,000 per dwelling. A **separate proposal** by the CFMEU and Master Builders Australia estimated the cost of building 30,000 social housing units at \$10 billion. A **recent AHURI (Australian Housing and Urban Research Institute) paper** estimated the cost of additional social housing nationally was about \$270,000 per dwelling in 2018, or roughly \$300,000 by 2022-23. In practice, the required subsidy would be determined via a tender, or reverse auction, ensuring government maximises value for money.
- 8 As of 30 September 2021.
- 9 These approaches are no different in practice to establishing an endowment via borrowing, since asset sales or budget savings could have been used to retire existing

public debt instead. Similarly, existing Future Funds could be liquidated to reduce net debt today.

- 10 The Australian 10-year government bond rate was 1.78 per cent as of 22 November 2021.
- 11 The NSW Social and Affordable Housing Fund was financed from the proceeds of privatising the state's electricity infrastructure.
- 12 By increasing the nominal value of the fund in line with inflation, the fund would be able to maintain the real value of capital grants in line with costs of constructing more social housing.
- 13 Alternatively, fixed subsidies could be set that vary depending on dwelling size and location, based on independent assessments of the costs of providing social housing in different locations.
- 14 For instance, the 2021-22 federal Budget projects \$482 billion in Federal Government receipts for the 2021-22 financial year, rising to \$572 billion by 2024-25.
- 15 Actual cost of capital grants would be determined by a reverse auction run by the NHFIC. The cost of capital grants would be expected to rise in line with inflation in future years. Alternatively, the dividends could fund annual availability payments for 60,000 new social homes, assuming availability payments of \$15,000 a year for 10-15 years. However, using availability payments would commit all Future Fund returns for a 10-15 year period, providing no further additions to the social housing stock in the interim. The federal ALP appears to have adopted this approach, at least in part, for its Housing Australia Future Fund policy, announced in May 2021.
- 16 Assuming an average real government bond yield of 2 per cent on the outstanding debt. Borrowing costs could be higher if the government bond yield rises, which may reduce the returns available to fund social housing for a given fund endowment, above government borrowing costs. However risk-free interest rates are likely to remain lower, for longer, than they have in the past. There is also a strong case for locking in low borrowing costs today to support the Future Fund over the next decade.
- 17 The federal government raises more than 80 per cent of the tax revenue and provides almost 45 per cent of state revenue. See NSW Federal Financial Relations Review Final Report, p. 14.
- 18 There are 436,300 social housing dwellings as of 30 June 2021. Australia's population has grown at an average rate of 1.4 per cent a year over the past 40 years. The 2021 Intergenerational Report expects Australia's annual population growth to decline over the next 40 years to 0.8 per cent in 2060-61. Using projected population growth rates from the 2021 Intergenerational Report, Australia needs 104,430 new social housing units by 2040 to sustain the current social housing share of the total stock, on the basis that the latest IGR expects population growth to slow to 1.1 per cent by 2040. Should population growth remain at 1.4 per cent a year going forward, we would need 131,000 extra social housing units by 2040.

- 19 Nearly three-quarters of social housing allocations in 2019-20 went to greatest needs applicants.
- 20 There were 116,000 homeless Australians on Census night in 2016. Coates and Chivers, *Who is homeless in Australia?*, Grattan Blog.
- 21 A recent AHURI paper estimates that between 7 and 33 cents of any increase in Commonwealth Rent Assistance would be passed forward into higher rents.
- 22 Lowering market rents by, for example, 20 per cent would boost the post-housing incomes of low-income private renters by more than \$3 billion a year, equivalent to an increase of more than 80 per cent in the maximum rate of Commonwealth Rent Assistance.



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