Discussion paper: rent models in social housing

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Contents

Introduction

This discussion paper examines a series of rent setting models operating in Australia and overseas and discusses their benefits and drawbacks. The rent models are categorised into three types:

1. Income based
2. Market based and
3. cost of provision based

Each category is examined using the following five lenses:

- Affordability for tenants
- Viability of providers
- Efficiency of rent subsidy
- Workforce incentives or disincentives
- Tenant choice

There are several issues to be considered in the discussion of rent setting policies, many of which are outside of the control of tenants and community housing providers. At least one million Australians are living in poverty or severe hardship, and in Australia's expensive housing market it is often the high cost of housing which causes poverty. Rental markets, particularly in metropolitan areas, are increasingly unaffordable to very low, low and moderate-income households and have vacancy rates below two percent, placing pressures on social housing waiting lists while social housing supply continues to fall well below demand.

Rent setting is a fundamental and complex area of community housing policy. Rent setting policies determine an organisation's income stream, its ability to provide tenancy management and asset services as well as to raise private finance, and ultimately its financial viability. The level of rent set, together with subsidies, also determines whether housing is affordable for tenants.

The aim of this paper is to stimulate discussion about rent policy possibilities among sectors with a stake in community housing rental policy, such as community housing organisations, tenants and tenant advice and advocacy services.

Discussion of rent models

Rental models can be classified into three broad groups:

1. Income based
2. Market based
3. Cost of provision based

This discussion paper presents the benefits and drawbacks of each of these categories. Examples of each type are given in this section followed by commentary and discussion questions.

1. Income based rent models

The majority of social housing tenants in Australia (approximately 90 percent) pay an income-related rent. Income based rent models include:

- Community housing rent model
- Social Housing Subsidy Program
- City West Housing rent model
- Community Housing Leasing Program

1.1 Community housing - CRA optimised rents

Community housing rent is charged at 25 percent of a household's assessable income calculated to optimise CRA and capped at market rent.

Calculating income based rent in community housing is a complex processes that requires a CRA calculator (developed and updated by Family and Community Services) to ensure that the tenant is in the same financial position that they would be in if paying 25 percent of their assessable income - but the provider receives 50 percent higher rent revenue.[1] As noted in the McClure Welfare Review Interim Report, increases in CRA have not kept pace with increasing rents paid by people on income support payments.[2] Further, CRA does not allow for variations between rents in different housing markets.

In line with Centrelink payment reviews in March and September, every six months community housing providers require tenants to apply for a continuation of their rental subsidies and supply

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1 Community Housing Federation of Australia, *Allocation, eligibility and rent setting in the Australian community housing sector*, 2014, p11
2 McClure Interim Report *A New System for Better Employment and Social Outcomes*, June 2014, p68

information about household income for review. The purpose of this review is to take account of any rise or fall in the gross household income which would result in an increase or decrease to the amount paid as the tenant's contribution towards rent. Households that do not provide proof of household income for this assessment have their subsidies removed, effectively being placed on market rent.

This rent model is effective in ensuring affordability with 1.3 percent of social housing tenants being in housing stress compared with 40 percent in the private rental market.[3] Affordability measures are discussed at the end of this section.

A drawback of income based rent models is that they are resource and time intensive for providers – and intrusive for tenants. This is discussed further at the end of this section.

1.2 Social housing subsidy program (SHSP)

The SHSP is a small housing program of approximately 250 properties in NSW available to low-income households with an income above the eligibility limit for social housing. Rent for these properties is calculated at 25, 27 or 30 percent of household income depending on income of tenants. The income bands for the 2013-14 year are as follows:

Assessment band	Rental assessment rate	Income range (pa)
Very low	25%	Less than $22,301
Low	27%	$22,301 to $38,822
Moderate	30%	$38,822 to $52,613

This is based on the 30/40 model of affordability – designed to avoid housing stress for low income households. This measure of affordability, and affordability more generally, is discussed at the end of this section.

Drawbacks of this model include a more time-consuming process for providers during rent reviews because the annual income for the household has to be established to match to the income bands.

1.3 The City West Housing rent model

Similar to the SHSP, City West Housing charges 25, 27.5 or 30 percent of household income with reference to the income band of the household.

3 99 Consulting, *Rent Setting for Social Housing,* 2012, p8

The significant difference is in the income bands which are higher for City West. The gross household income bands are currently as follows:

Band	Income range (pa)
Band 1	Up to $33,106
Band 2	$33,107 - $55,436
Band 3	$55,437 - $94,274

For this model to be successful, eligibility must be different from that of mainstream social housing to allow cross-subsidisation between very low income households, i.e. those eligible for social housing, and key workers on moderate incomes.

1.4 Community Housing Leasing Program (CHLP)

The CHLP provides subsidies to community housing providers to lease properties in the private market for renting on to tenants as social housing. Funds provided through this program are intended to cover the gap between the primarily income based rent charged to the tenant and the median market value for a property in that housing market. However, there is some discretion for providers as to how this subsidy is used – for example, funding may also be used to subsidise the purchase of capital properties.

This model is an example of an explicit subsidy paid by government to providers to cover the subsidy given to tenants that represents the difference between the tenant's contribution and the operational cost of providing the property.

Issues for discussion:

Affordability

Since income based rents are calculated based on the ability of the tenant to pay, these models are considered the best way to ensure housing affordability and reduce after-housing poverty – but there are questions about what proportion of income guarantees affordability. All bar one of the income based rent models surveyed in this research set the rent charged at 25 percent of household income for very low and low-income households.

A general benchmark for affordability for the lowest 40 percent of household incomes is no more than 30 percent of income allocated to housing costs, beyond which households suffer housing stress. This means they have insufficient income, after housing costs, to meet other expenditure related to basic necessities. This is often referred to as 'the 30/40 model'.[4]

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4 AHURI Final Report no. 199, *Housing affordability, housing stress and household wellbeing in Australia*, p9

There is some concern that the 25 percent of gross income does not alleviate poverty for the lowest income households, and that 'assessable income creep' such as the increase in proportion of income charged as rent from 20 percent in the post Second World War years to 25 percent from 1990s, or 25 percent of the Clean Energy Supplement being income assessable, reduces the affordability of this model.

It has been argued that affordability should not be considered solely as a rent-to-income ratio, but that it should allow sufficient money to live on after paying housing costs.[5] There is value in further consideration of measures of affordability and housing stress, since this is such a key issue for rent setting policies.

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Viability

Income based rent models are not designed to meet the cost of housing provision. Since the greater targeting of social housing of the 1990s, incomes of social housing tenants have been lowering while housing costs have been dramatically increasing. This has a negative effect on the viability of housing providers and lowers the rental income against which they can raise finance.

Income based rent calculation is resource intensive for housing providers and often involves dedicated rent review or income assessment teams and the hiring and training of temporary staff for biannual rent reviews.

CRA is not calculated by housing market or dwelling size but on household income and complement and therefore does not account for variations in costs of different housing markets or dwelling types. CRA does not cover the full cost of the rental subsidy and therefore does not ensure viability.[6]

Income based rents are highly sensitive to changes to income, and since most tenants receive a Commonwealth government income this means rents are sensitive to Commonwealth decisions regarding income support.

Since youth are not eligible for CRA, and Youth Allowance is lower than Newstart and other welfare support payments, youth are particularly vulnerable in the private rental market and require a greater subsidy in social housing.

For providers, market rent paying tenants can contribute to the organisations' financial viability and cross-subsidise high-needs tenancies paying heavily subsidised rents.

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5 AHURI Final Report no.95, *Rental systems in Australia and overseas*, 2006, p69
6 CHFA p42, 99 Consulting p9

Efficiency of rent subsidy

Social housing organisations are providing a high subsidy in charging income based rents. Further, this subsidy is hidden. Elsewhere, such as in the UK, these subsidies are met by an explicit fund from government.

Income based rents require different sized subsidies depending on the housing market. In some housing markets, particularly in rural areas, income based rents can be more than the market median - however in high-demand areas, such as inner city areas or towns with a mining presence, a large subsidy is required to fill the gap between the market and income based rents. This is a consequence of charging a flat income rate over a spikey housing market.

Workforce incentives or disincentives

There are differing views on the effect of social housing rents on workforce participation. AHURI, The Tenants' Union of NSW and ACOSS, among others, have undertaken modelling on effective marginal tax rates (EMTRs) in public housing – that is, how much of an additional dollar of income would go to tax, social security withdrawal and, in income-related rents, rent charges. This acts as a disincentive to enter the workforce as a significant proportion of income gained will be lost to rent, tax and loss of income support and concessions such as travel.

National Shelter highlighted in its research that the major reason for the low workforce participation of tenants in social housing is related to the tenancy profile of social housing.[7] That is, that people who are allocated social housing will already be less likely to be engaged in the workforce.

If any social housing landlord, or public policy setting more generally, wants tenants to access education and employment, an income based rent model is likely to be a barrier. Further consideration of how to moderate the impact would be valuable.

Tenant Choice

Tenants are put under scrutiny in income based rent calculation. To ascertain tenants' incomes, accurate information is required from a wide range of sources. Tenants are required to declare income-earning dependent or non-dependent members of their household and these members must make a rental contribution. This can create problems for tenants who are reluctant to seek rent contributions from other household members, particularly children. Income based rents are also considered to be confusing for tenants.

In general, tenants have a constrained choice when it comes to income based rents. They can choose not to have their income assessed, and pay market rent. Community housing can be a more secure form of rental accommodation than renting with a real estate agent, and the service

7 National Shelter, *Response to the Interim Report of the Reference Group on Welfare Reform to the Minister for Social Services*, 2014, p8

level may be higher because the community housing sector is regulated to ensure minimum satisfaction levels with maintenance, property and overall housing services. However, the choice to have income scrutinised or pay market rent is a limited choice.

A further issue with income based rent models is that rents do not reflect the location, quality or amenity of dwellings. Tenants living in older stock in poor condition could be paying the same rent as those on similar incomes living in good quality or newly built housing in sought after locations. An unintended consequence of these rent models is inequity between tenants who may pay the same but receive a different service. Tenants paying income based rents have few choices in terms of property type or location because their rent will be the same regardless of the property.

In 1993 the Industry Commission made a proposal for an amenity charge in which a subsidy for would be calculated for each household based on the average rent for a house that met their needs, and tenants would have the option to choose a property with greater or lesser amenity at either greater or lesser cost.

Factoring amenity into rent calculation would be a significant departure for providers – offering choice and a range of contribution levels so that prospective tenants can decide what is best for them. Potential constraints with the amenity factor approach are the limited availability of properties and a perhaps more involved allocation process. Financial capacity of tenants would also need to be considered to ensure affordability was not eroded, and transfers would have to be available if tenants' circumstances change.

2. Market based rent models

Market-related rents are less widely used in community housing. Models include:

- National Rental Affordability Scheme (NRAS)
- Brisbane Housing Company (BHC)
- Transitional Housing Plus
- Macquarie Park Urban Activation Precinct proposed model

2.1 National Rental Affordability Scheme (NRAS)

NRAS properties are rented to very low, low and moderate income households at a discounted rent of up to 80 percent of market value. For community housing providers to be considered charitable by the ATO this must be below 75 percent. These tenancies are intended to end after a fixed period of time.

Income limits for NRAS eligibility (2013-14) are, for example, $47, 289 for a single person household, $65, 423 for a sole parent with one child and $112, 433 for a couple with three children. Tenants must meet the income eligibility limits on application but their incomes can increase by up to 25 percent during their tenancy. If tenants are over the income eligibility limit by more than 25 percent for more than a year they are exited from their NRAS property to the private rental market.

Drawbacks of this model include that in high-cost housing markets such as inner city areas it is difficult to avoid housing stress for low-income households since NRAS does not use the 30/40 affordability measure. This is not the case in NSW where the Affordable Housing Guidelines require that for very low and low income households rent will not exceed 30 percent of income.

The model is also administratively complex with regular assessment of market rents and ongoing eligibility assessments for tenants. Another drawback is finding eligible applicants, who are more likely to be found applying for private rental properties than applying for community housing since their incomes are usually above the eligibility limits for social housing.

Benefits of this model include the provision of relative affordability to tenants. Affordability and market-related rent models is discussed in the commentary at the end of this section.

2.2 Other affordable housing programs

This is a relatively small portion of the community housing portfolio and includes properties managed on behalf of local government or affordable properties built through the SEPP (Affordable Rental Housing).

The Centre for Affordable Housing NSW Affordable Housing Guidelines, which community housing providers must comply with for affordable housing programs that include state government funding, allow flexibility in the rent model adapted - however they ensure affordability by charging a maximum of 30 percent of income for very low and low-income households. This is effective in ensuring affordability for tenants using the 30/40 measure.

Income eligibility for these affordable housing properties takes different workforce markets into account by providing two income bands – for Sydney and for the rest of NSW. This recognises differences in housing markets. For example in 2013-14 the household income bands for a single person household were:

	Sydney	Remainder of NSW
Very low	$22,900	$20, 200
Low	$36, 600	$32, 300
Moderate	$54, 900	$48, 400

2.3 The Brisbane Housing Company (BHC) rent model

BHC, a large housing provider in Queensland, rents properties at 50, 60 and 74.9 percent of market rent, depending on household composition and income.

A drawback of this model include that the 30/40 measure of affordability is not applied.

2.4 The Transitional Housing Plus rent model

Transitional Housing Plus is a rent subsidy that reduces over time. It is aimed at young people (aged 16-25) and women experiencing domestic violence in NSW. This model provides six-month fixed term leases that can be renewed for a period up to five years and includes a support package. Lease renewals are subject to the tenants' continuing need for housing and support, and meeting the agreed commitments in their case plan. At the end of the tenure period (a maximum of five years) tenants are expected to transition to the private housing market. If this is not possible the case worker will identify alternative housing and support options.

The rent paid by tenants is scaled to increase over the tenure period on an annual basis. The scaled rent levels will be set out at the beginning of the first tenancy period as five consecutive annual rent levels that must be paid if the fixed term tenancy continues to be renewed. Rent is initially set by property type for a one, two or three-bedroom dwelling. The rent is then scaled up over a five-year period so that it reaches a benchmark market rent for the property in Year 5.

Rent increases are calculated using the following formula:

Rent increase increment	Calculation
Year 2	(Year 5 – Year 1) x 20%
Year 3	(Year 5 – Year 1) x 20%

Year 4	(Year 5 – Year 1) x 30%

For example, the rent paid in Year 1 for a one bedroom property commencing in 2014 is $150 per week. If the market rent for this property in 2014 is $300 (an estimate only) then this will be the Year 5 rent. Following the table above, $300-$150=$150, so the rent for Year 2 for this property will be $150 plus 20 percent of $150, or $150 + $30 = $180 per week.

A benefit of this approach from a provider viability perspective is that variations in housing markets are factored in by providing two rent tables: standard and lower market rent areas. From a tenant perspective this may provide incentives to live in lower-cost areas, however it must be noted that lower housing markets generally offer fewer work opportunities and have less developed transport infrastructure so that the aim of this program, to provide support to people to enter the workforce, may be undermined in these areas. Another benefit is that dwelling size is factored in via a variation in rent by bedroom number.

A drawback of this model is that the 30/40 affordability measure is not factored in. However, there are concessions made. For example, rent paid by tenants sharing accommodation is split evenly by the number of bedrooms. Rent paid by single people is equivalent to the rent paid by a single tenant sharing a two-bedroom dwelling. Discretion is given to providers to lower the rent in special circumstances, such as if the tenant is in hardship.

2.5 Macquarie Park Urban Activation Precinct proposed model[8]

This model (proposed at the time of writing this paper) is to lease properties for a five year period with the rent subsidy tapering off and tenants are paying market rent at the end of the five year tenure.

Unlike Transitional Housing Plus, this model does not appear to be coupled with case worker support. There is value in investigating whether there are client groups for whom this model might be appropriate.

Issues for discussion:

Affordability

Market based rents provide a relative affordability within housing markets, thus opening up the market to lower-income households who otherwise would not be able to live there. Up to now market based rents are considered appropriate for moderate income rather than very low and low income individuals and households. Affordability is difficult to achieve in high-cost housing markets.

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8 Wood, Alicia, *Tenants to pay market rent within five years under new public housing trial in Macquarie Park being considered by government*, The Daily Telegraph, 30 June 2014

The Centre for Affordable Housing NSW Affordable Housing Guidelines, which community housing providers must comply with for affordable housing programs that include state government funding, allow flexibility in the rent model adapted, however they ensure affordability by charging a maximum of 30 percent of income for very low and low-income households.

This dual approach to setting rents (market-related and income-related) leads to a complex rent-setting system. Tenant income must be determined annually, and market rents must be determined regularly. Providers must ensure that 74.9 percent of rent is not more than 30 percent of income for charitable status purposes. This becomes a very complex exercise for providers and is difficult to achieve in a high cost housing markets.

Viability

An important consideration in market-related rents is how market value is determined. Housing markets change and therefore market rent must be regularly reassessed. There are several methodologies:

- Rent and sales report produced by the Rental Bond Board
- RP data
- Independent valuation
- The FACS method - approximations based on location and size of properties

A benefit of market based rent models is that they allow organisations to make more accurate estimates about income levels for the purpose of repaying loans than income based rents.[9]

A disadvantage of market based rents is that housing markets can fluctuate considerably, affecting revenue certainty.

Another consideration is tax treatment by the Australian Taxation Office (ATO). Organisations can claim GST concessions if they are charging less than 75 percent of market and their supply of housing is considered 'charitable'. Community housing providers therefore charge 74.9 percent of market rent, not 80 percent as allowed for NRAS properties. In September this year the Australian Charities and Not-for-profits Commission (ACNC) released a Commissioner's Interpretation Statement on the provision of housing by charities. This was broadly positive for the community housing industry however this area of tax law remains somewhat uncertain.

Efficiency of subsidy

The NRAS model offered a transparent subsidy paid directly to housing providers.

9 CHFA, p12

Workforce incentives or disincentives

Market based rents allow tenants to increase their after-housing income more efficiently when they increase their pre-housing income. In other words, market based rent models do not provide workforce disincentives of income based rent models.

Tenant choice

Providing relative affordability through a discounted market rent does have merits – for example, by providing tenants with greater choice to live in housing markets with better access to employment opportunities and services that they otherwise would not have been able to afford, and providing the ability for people to save money for home ownership.

3. Cost of provision based rent models

Cost based rent models take as their starting point the cost of housing provision. The cost of housing is established, and this needs to be fully funded to ensure the provision of housing is sustainable. The task is then to determine who pays what contribution to meet this cost.

This kind of system is used in a number of other countries including the United Kingdom, Germany and Sweden. In these countries rent is charged based on housing costs, and tenants are provided with an explicit subsidy from government, the size of which is dependent on their ability to pay.

This model ensures that rental income meets the cost of operation without compromising affordability for tenants. Drawbacks for the implementation of this model in Australia include a lack of explicit housing subsidy and unfamiliarity with this rent model.

3.1 Build and grow model for the NSW Aboriginal community housing sector

The Aboriginal Housing Office “Build and Grow” rent model offers an example of a type of cost based housing. In this model, rent is determined either by household rent or property rent, whichever is lower. Household rents are calculated by household composition and are aligned with maximum CRA. Property rents are calculated at either market rent or comparable market rents provided by Aboriginal Housing Office (AHO).

Benefits of this model include breaking the link between rent contribution and employment, therefore removing the workforce disincentive. Another benefit is that it reduces the intrusive and resource-intensive practice of rent reviews of income based rent models. Part of the success of this model is that a rent gap subsidy is given to providers by the AHO.

Some of the drawbacks of this model include a lack of recognition of differences in housing types and markets (i.e. the cost of housing provision) if household rents are used and, without an explicit subsidy to make up the difference between rent received and housing cost, not a guaranteed financial viability for the housing provider.

Issues for discussion:

Affordability

Cost of provision-based rents are not calculated on income and therefore do not ensure affordability. Further, they may be higher than market based rents in some housing markets. In the Build and Grow model, this risk was mitigated with the use of household-based rents.

Viability

Cost based rents ensure that housing providers have sufficient revenue to cover their costs.

A drawback to cost based rents is the complexity in establishing the cost of housing provision. This can include administration, rates, insurance, maintenance, debt and depreciation. Cost increases in these areas can be outside of the control of housing providers.

Efficiency of subsidy

In European models, the subsidy is paid by government directly to providers.

Workforce incentives or disincentives

In cost based rent models, if tenants' economic circumstances improve there is not a corresponding change in rent and therefore not a workforce disincentive.

Tenant choice

Cost based rents factor in quality, location, size and general amenity of properties, providing tenants with more choice than income based rents.

Next steps

This paper has documented current rent setting models across the New South Wales social housing sector, including community housing, affordable housing, transitional housing and Aboriginal community housing. The various models each have benefits and drawbacks, and apportion risks differently.

The Federation encourages its members and other stakeholders to provide feedback on the issues raised in this paper to nswfha@communityhousing.org.au

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