The Housing Lifeline: A Policy for Short-Term Housing Affordability Problems*

by

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Abstract
Problems with housing affordability for low income households can have two alternative sources; long term poverty or short-term income fluctuations. Most government housing programs, such as the provision of government-owned public housing, are designed to deal with long-term low income. In contrast, we present a policy that deals with short-term housing distress. This policy, the *housing lifeline*, provides an income contingent loan to households facing short-term loss of housing due to, say, unemployment, illness or accident. By providing a form of income insurance for low-income households, the housing lifeline helps these households to avoid slipping into long term poverty. The lifeline also helps to overcome market failures in housing and financial markets for low income households, making it easier for these households to access appropriate housing solutions. This paper develops the concept of a housing lifeline and discusses a variety of issues relating to the practical implementation of the policy.

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1. Introduction

Housing affordability, particularly for low income households, is a major public policy issue. In part, low income housing policies are motivated by the concern that housing is becoming less affordable for some Australians, particularly those living in larger capital cities.

The concept of housing affordability is directly linked to the price of housing. But there are at least three dimensions to that price. First, for home owners, housing is a dual good involving both investment and consumption features. Physically it is a joint product of a long-lived physical housing asset that depreciates over time and land. Second, for the rental market, the price of housing services depends on the supply and demand for rental accommodation. This in part reflects the alternative investment opportunities that face potential landlords. Third, the rental price of housing services and the cost of housing are intimately linked as the flow of rent associated with a property makes up a considerable portion of the investment value of that property.

The nature of housing as an investment product and its large fixed nature links housing and investment markets. In Australia, the past decade has seen relatively low interest rates both for home owners and potential investors in housing. Unemployment has also been at a low level that is unmatched since the early 1970s. The low interest rates have raised housing affordability and lowered the risk of housing investment for many households. This has spurred demand for housing, particularly in a stable high-growth macroeconomic climate. As a result, house prices have risen significantly over the past decade in many Australian urban areas. For example, Australian Bureau of Statistics

figures show that over the three years from July 1998 to June 2001 the weighted average price of existing dwellings in Australia's capital cities rose by almost 8 per cent per year.[1] The increase in housing prices feeds directly into rental prices, although the rental market, for example in inner Melbourne and Sydney, has been complicated by a significant growth in apartment stock in recent years.

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

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

This paper re-considers the affordability problem. In so doing, we distinguish between long-term affordability – that has motivated programs of public housing and rent subsidies – and short-term affordability that has not to date received focused policy

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

attention. Our goal is not to review existing housing policies for low income households.[2] Instead we highlight the nature of the short-term affordability problem and consider market failures associated with it that might motivate a policy response. Our chief contribution, presented in section 4, is to suggest an innovative policy response – The Housing Lifeline – that uses an income contingent 'loan' to fund assistance for low income households in overcoming problems associated with short-term housing affordability. We consider both the theoretical basis for the housing lifeline and a variety of issues relating to its practical implementation. In particular, we note that a housing lifeline may generate fewer adverse side effects from a policy perspective than existing housing policies.

2. The Affordability Problem

In this section we briefly consider the notion of housing affordability. In particular, we focus on the determinants of any affordability problem. After all, if a policy to aid low income families merely raises general housing prices then it may provide little gain for low income families and simply lead to a windfall gain for existing home owners. Thus, it is important to understand the determinants of housing affordability in order to design policies to tackle problems of affordability. To do this we needs to consider the constraints that operate on the supply of housing.

[2] Gans and King (2003) conducts such an overview.

Defining Affordable Housing

Affordable housing is usually defined with reference to the income of a household. For example, the National Housing Strategy considered housing to be affordable if "housing costs … leave households with a sufficient income to meet other basic needs such as food, clothing, transport, medical care and education." In that definition, if a household is spending more than 25 percent (for rent) to 30 percent (for mortgage repayments) of its income on housing, then that household is experiencing an affordability problem. Of course, this definition could apply to high income households who spend a lot on housing. Thus, this benchmark on affordability is usually only applied to households that fall into the bottom 40 percent of the overall distribution of income. In Australia in 2001 the affordability threshold based on 30% of the second quintile of average weekly household income was only $141 compared with the median weekly rent in Australia of $183 and a median weekly mortgage repayment of $230.[3]

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

This approach to housing affordability, however, does not allow us to easily distinguish between a housing problem and a low income problem per se (Glaeser and Gyourko, 2002). Moreover, it does not take into account the period of time over which there is an affordability problem. This is relevant in terms of policy responses and whether affordability is a long-term structural problem or a temporary situation.

[3] ABS figures presented in HIA (2003).

Long-Term versus Short-Term Affordability

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

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

of overall social welfare programs, the long-term affordability problem is not the focus of this paper.

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

3. Market Imperfections and Short-Run Affordability

The market failures associated with long-run affordability problems are well-known: focussing on the indivisibility of housing assets, externalities between housing submarkets, government regulation and taxes and the slow response of supply to changes in demand. For short-run affordability, the potential market imperfections that generate a need for policy analysis have not played a prominent role in housing policy to date. For this reason, we review those market failures here.

Financial and Rental Market Imperfections

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

In theory, financial markets should operate to provide finance to potential homeowners and investors who are likely to be able to make the relevant repayments. However, it is well understood that financial markets suffer from potential problems of asymmetric information that may lead to market failures and credit rationing.[4]

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

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

[4] See, for example, Stiglitz and Weiss (1981).

loan, will be less influenced by interest rates. In this way, a simple interest rate charged equally to all potential borrowers, adversely selects for borrowers with a higher risk profile. To attempt to solve this problem a lender might try to ration credit; attempting to infer borrower risk through indirect means.

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

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

A similar adverse selection problem arises in rental markets. Investors are keen to rent properties to households or individuals who will be able to pay the relevant rent and who will not impact too heavily on the depreciation of the dwelling. But landlords cannot tell the exact risk associated with particular tenants and will try to infer this risk from other factors. Again, an obvious method used by investors to distinguish between tenants

is their employment history and their current job and income. This discriminates against low income households who are viewed as having a higher risk by landlords.

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

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

Income Risk and Affordability

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

housing, either as tenants or owner-occupiers, these households remain particularly vulnerable to future income risk.

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

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

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

These solutions to reduce the cost of income risk, however, are less likely to be available to low income households. For a household with a history of unemployment, income protection insurance is likely to be either unavailable or prohibitively expensive.

The moral hazard problem facing the insurer makes such insurance unviable. Self-insurance through discretionary saving is difficult, if not impossible, for low income earners. And renegotiation to avoid foreclosure or eviction is less likely to occur for higher risk, marginal households. Consequently, low income families are likely to face significant residual income risk that creates short-term housing crises for these families.

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

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

Similarly, a national recession can create significant housing distress, but this does not require the creation of new housing stock. Rather, it requires macroeconomic policies to move the economy back to positive growth and increased employment. In contrast, regional risk, particularly if it leads to a long-term down-turn in a region, is

likely to lead to longer term emigration from the relevant region to other parts of Australia. This has implications that feed into the supply of housing.

Summary

Low income households may find housing unaffordable. They may also find adequate food and clothing unaffordable. For low income households who are in poverty, even the basic goods and services that most Australians consider essential will be unaffordable. These households require general poverty programs to provide them with adequate resources to gain these essentials. But the focus of this paper is on government policies to help low income households who find housing *in particular* to be unaffordable. Our focus is not on general alleviation of poverty but on the idiosyncrasies that relate to housing.

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

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

4. The Housing Lifeline

If a major problem for low income households relates to the *risk* that they face and the affect of this risk on their prospects of success in either the rental or the mortgage markets, how should the government address this problem? Unable to meet rental or mortgage payments, low-income households faced with short-term income distress can face the loss of appropriate housing. Current assistance programs, however, are not well equipped to deal with short-term distress. For example, Federal government rental assistance in Australia only becomes relevant once a household becomes eligible for other forms of benefits. In the US, Section 8 voucher programs often involve waiting lists, meaning that they are unable to meet the needs of low income families facing short term distress.

As we have already noted, the risks associated with low income households mean that landlords and lenders will rationally discriminate against low income households in

the housing market. Landlords and lenders will be reluctant to provide relevant services to low income households. Thus, the risk of short-term income fluctuations can lead to a long-term housing problem for low income families. In the extreme, appropriate housing solutions may be unavailable to these households at any price.

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

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

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

The obvious question is how would such insurance work? After all, if an individual is unemployed, they can (after the relevant waiting period) receive unemployment benefits and rental assistance. Isn’t this already a form of government

income insurance? Yes. But it is a form of benefit that is not designed as insurance but as a form of long-term assistance. In addition, housing stress can arise for income shocks not necessarily the result of unemployment (e.g., sickness or profit reductions for small business owners). From the perspective of providing income insurance for low income households, existing rent assistance does not address short-term income fluctuations, requires low income households to draw down (possibly non-existent) savings while waiting for eligibility, fails to offer security to lenders and landlords, and creates undesirable incentives for the low income household as it tries to overcome the temporary setback.

In this section, we consider an alternative approach that we call a 'housing lifeline.' This is essentially a government provided insurance product. It has a number of similarities to the Higher Education Contribution Scheme (HECS) in that it is based on lifetime income rather than current income, it limits the impost of government funds while providing short-term relief for relevant households and it is a product where benefits are determined by the needs and requirements of the low income household themselves.[5]

The basic concept of a housing lifeline

Suppose that a household suddenly finds itself facing a crisis where they are likely to be unable to meet short-term commitments for housing payments. A housing

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

lifeline would mean that the household would be able to draw down a payment from the federal government to tide it over the short-term crisis. This payment would be a loan to the household, but the loan would be automatic. In other words, the household would need only to prove relevant need, possibly subject to satisfying a simple liquid asset tests in the short-term. However, the household would incur a future tax liability associated with this loan. The payment of this liability would be tied to future income, like the HECS. Further, the liability may or may not have a reduced interest rate associated with it, depending on government policy.[6]

Payments to a household would be capped. The housing lifeline is designed to provide short-term relief, not to provide a permanent source of support for those families who will not have the means to adequately fund housing in the medium to long-term. Thus, the lifeline *does not replace* other long-term poverty programs but supplements these programs providing more appropriate assistance to low income households facing temporary crisis. The payments may be capped on both a weekly and a total basis. For example, it might be possible to 'borrow' up to $200 per week under the cap up to a total of $10,000. Thus, the scheme would provide up to 50 weeks (or more if less than $200 was drawn upon) support for a relevant household.[7]

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

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

We envisage that the payments under a housing lifeline would be tied to housing.[8] Thus, funds would be paid directly to a (registered) landlord or lender specified by the relevant household. This would require a contractual agreement that ensures that the funds do reduce the household's liability to landlords and lenders directly. At present, Medicare payments operate in this manner.

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

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

It is recognised that there are significant differences from the government's perspective in the positions of people who are in housing stress because they cannot meet their mortgage payments and those who cannot pay their rent. The housing lifeline proffered to a struggling mortgagor can readily be constituted as a second (or third) mortgage ensuring that the government has some real security for its advance over and above the promise of the borrower to repay. Advances to a struggling tenant are

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

supported only by the obligation of the borrower to repay and that of course being contingent on earning sufficient income in the future to enable him or her to do so. It is for that reason that government may consider this housing lifeline is best first tested with those in the process of buying homes.

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

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

How would the lifeline be funded?

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

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

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

Who should be eligible for the lifeline?

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

home), shares and other financial assets but not superannuation (which is currently illiquid).

The idea of basing eligibility on an asset rather than income test goes to the heart of the lifeline concept. An income test is inappropriate because (1) it is income that is fluctuating and generating the need for a lifeline (so it is unclear what the appropriate measure of income would be); and (2) income-based eligibility tests have the potential to create poverty traps. On the other hand, assets are a measure of lifetime income and wealth accumulation. Thus, for the same reason that these are used for eligibility to old-age pensions, they are an appropriate sorting mechanism for who should be entitled to a housing lifeline.[9]

What maximum debt should be allowed?

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

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

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

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

What interest rate should be charged?

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

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

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

The level of interest rate ultimately depends upon whether the government wishes to use the lifeline as just pure insurance or something more. This is not a policy judgment that can be easily made here. However, in terms of interest rates charged, there is an issue as to whether those rates will be fixed or variable. Again, this brings in issues of sound management of government debt as well as other macroeconomic considerations.

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

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

What will the lifeline do to household incentives?

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

Because the lifeline repayment is based on a notion of lifetime income rather than current income, it is less likely to create a poverty trap for households. While repayments through the taxation system will create income zones where the household faces slightly

higher taxation rates than otherwise, these changes are small compared to the effective marginal taxation rates under, for example, rent assistance schemes. Thus, a housing lifeline can retain incentives for households to take appropriate actions and risks to improve their standard of living.

The lifeline is based on a loan, not a gifted payment, so there are reduced incentives for higher income households to try and abuse the system. For example, in the simplest scheme a household only needs to provide a tax file number and appropriate identification to access the lifeline. But repayment begins as soon as the household income exceeds a certain level. A household earning income above that level has little incentive to 'borrow' funds then immediately repay them through the taxation system.[10]

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

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

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

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

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

Is the debt incurred by individuals or households?

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

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

This, in turn, raises other difficulties. For example, issues of liability in case of the break-up of the household need to be considered.[11] The accumulated household debt would need to be divided; although the same issue is faced by all home mortgage lenders.

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

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

5. Conclusion

The basic approach of the housing lifeline is to directly address an important problem that faces low income families in a way that is likely to be cost effective for government and that addresses the relevant problem without creating issues of welfare dependency and poverty traps. The housing lifeline is not about providing new housing solutions for low income families but rather opening up housing opportunities through the private market for low income households and helping them to retain appropriate existing housing in the face of temporary setbacks. The policy is about housing insurance. Thus, it should help low income households gain adequate housing with almost no micro-management. It increases choice for low income households rather than decreasing choice, so it respects the preferences and wishes of individual households.

While the housing lifeline improves the availability of housing for low income families, and does so in a way that does not artificially separate the market on 'eligibility' grounds, it is not aimed at addressing broader housing affordability. The housing lifeline will make it more desirable for private investors to develop housing for low income families, but supply constraints on housing will still arise. For this reason, the housing lifeline should be considered in tandem with other policies that help improve general housing affordability, such as the re-evaluation and reform of transaction taxes and planning laws discussed in Caplin et.al. (2003).

The housing lifeline helps to bring private funds to play in low income housing solutions. In particular, it brings the private funds of the low income households themselves into the market to provide appropriate housing. Unlike other policies, it does not view low income households as 'victims' to be 'helped' through benefits funded by

others. Rather, it empowers the low income household and helps them to access their future income rather than just depending on their current low income.

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

The housing lifeline avoids artificial increases in constraints on mobility for low income households, unlike schemes that are tied to particular dwellings. It is highly flexible and the choice of how much or how little of the scheme to use at any point in time is largely up to the relevant household. Thus, while the scheme does not explicitly allow for geographic differences, the household itself can adjust for those differences within the payment bounds set by the government. Further, because it is based on individual household needs, as seen by that household itself, it responds instantly to the changing circumstances of that household.

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

housing lifeline allows the individual household to determine which source of housing; rental or owner-occupied; best suits that household's circumstances.

Finally, the housing lifeline avoids creating poverty traps that harm low income households. Indeed, a primary benefit of this scheme is that it would potentially enable to the government to save on social security costs by preventing short-term income problems from transitioning into longer-term poverty.

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

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