

National Rental Affordability Scheme: insights from America

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Australia's National Rental Affordability Scheme (NRAS) was launched earlier this year, promising to build as many as 100,000 affordable homes over the next decade. By giving tax breaks to encourage institutional investment, NRAS copies many of the ideas of America's Low-Income Housing Tax Credit program. Can we learn from 20 years of US practice?

Tax credits were introduced in America by a Republican President as part of tax reform legislation in 1986, and made 'permanent' under a Democrat administration in 1993. Bipartisan support and consistency of policy over

two decades have been key features. The US scheme is backed by a broad coalition of for-profit and non-profit developers, banks, business leaders, equity investors and consultants.

Between 1986 and 2005 tax credits helped fund one and a half million units of affordable housing in 27,410 schemes.

The current annual cost of the scheme is some five billion US dollars.

Tax credits for affordable housing in the US and Australia look similar on the surface, but there are deep design differences that will affect how they work in practice.

As NRAS moves from start-up to consolidation over the next two years, four areas where there may be important and timely lessons for Australia stand out.

1. Finding investors

It is a truism that tax credit schemes will only work if there are willing investors. The US scheme succeeded in creating an entirely new asset class that was able to tap funds from institutional investors. However, 92% of the US investors are banks and financial institutions, many satisfying their requirements under the *Community Reinvestment Act* of 1977. This re-



Burbank Housing used tax credits for this low to moderate density suburban development in Santa Rosa, California. The development included community facilities (photo by Tony Gilmour).

quires banks to serve the credit needs of households, including low-income and minority households, in the areas where they operate.

Australia investors have not had an opportunity to fully understand the risks and rewards of affordable housing through prior experience. This is unlike the US where investors became familiar with projects prior to the introduction of tax credits in 1986. Australia's institutional investment market will probably take longer to develop than in the US, offer less liquidity and investors will seek higher rates of return. More profit for investors means less cash available to help people in housing need.

Banks will probably be more reluctant backers of Australian tax credits than in the US, with the funding shortfall needing to be filled by superannuation funds and corporate investors. We do not have a *Community Reinvestment Act*. Can ways be found to coax Australia's well-funded super funds to invest in affordable housing to help diversify their portfolios and bring long-term social benefits?

Unfortunately for Prime Minister Kevin Rudd, the current stage of the economic cycle – with a credit crunch and falling property prices – is hardly a good time to launch the scheme. Yet this is the time when we most need an increase in the supply of affordable homes.

2. Spreading the benefits

The US scheme allocated tax credits between states based on population from the start. This has given a reasonable spread of benefits around the country – if not always to exactly where housing need is greatest within a state. State governments control tax credit allocation policy and this has allowed them to overlay their own political objectives. In California, for

example, schemes which are environmentally sustainable are more likely to be funded.

In Australia, tax credits allocation will be at a national level. This could create more uniform types of affordable housing projects, but a national allocation system seems less well placed than the US system to match public funding to housing stress. Tax credits do not fund all project costs, therefore states with generous top-up funding will win most allocations.

Cities with high capacity affordable housing organisations will be better placed than regional and remote Australian settlements. States such as Victoria who have invested in building sector capacity and have a clear regulation regime may get more funding than New South Wales and Queensland.

3. Profiting from affordable housing

Tax credits in the US have led to the expansion of both for-profit and non-profit affordable developers. However, the dominant providers are profit-making organisations who take three quarters of tax credit funding. The good news is that these commercial developers normally have greater economies of scale and ready access to equity markets. Many researchers consider that commercial developers can build at a lower cost than non-profit developers, though the numbers are disputed.

On the downside, private companies earn profits on the back of public investment. They probably have shorter-term planning horizons leading to a neglect of maintenance and may show less interest in tenant welfare and community building. Non-profit housing providers are most likely to have missions better aligned with public policy goals than private companies.

In the US and Europe non-profits have played an important role in achieving wider objectives such as community building and social inclusion.

Striking the right balance between for-profit and non-profit providers under Australia's NRAS scheme will be difficult. The community sector has a great opportunity to play an important role but will need help in building capacity – and quickly.

However, compared to the US, Australia's housing non-profits are small, localised and do not receive many philanthropic donations. Less than 20 have experience in property development and long term asset ownership. Arguably, they have lower capacity than America's non-profits when tax credits were launched in 1986.

Australian policy makers need to consider funding non-profit capacity building programs, and encouraging partnerships as a positive way to combine private sector development skills with non-profit tenancy management expertise. Funding allocated for capacity building and facilitating partnerships in the 2008 federal Budget is a good start.

4. Long-term affordability

The biggest initial problem with US tax credits was the preservation of housing affordability as the initial legislation only kept rents low for a 15 year period. Thankfully this was later changed by Congress and there is now a national minimum of 30 years affordability built-in. In some states such as California the affordability period is 55 years.

The design of NRAS has not addressed this important issue. Tax credit supply and rent discounting are only for 10 years, and institutional investors will also expect capital gain. It will be expensive for the government to



US tax credits were used to convert a heritage property in downtown Oakland, California to affordable accommodation for mainly Asian families. The property was developed by East Bay Asian Development Corporation (photo: Tony Gilmour).

claw-back or replace NRAS funded homes from 2018, when affordability problems are projected to still be significant. US investors only look to tax reductions and depreciation allowance – not capital gain as in Australia.

Paradoxically with NRAS's objective of encouraging large-scale investment, any thoughts of modifying the scheme mid-term may scare investors. Certainty of government regulation and bipartisan support proved crucial to attracting large volume institutional investment in US affordable housing. Both are absent presently in Australia. Experience from the US confirms that with market-based policies such as tax credits, it is hard to strike the right balance between the needs of investors and those seeking affordable housing.

Final thoughts

Political motives, driven by widespread public concern about housing affordability in Australia, have prompted the federal government to move quickly and introduce NRAS. There has been consultation, but it has been rushed.

The tax credit approach is new to Australia, and it is not widely used around the world. European countries generally mix strong support for tenant incomes with grants and conventional bank borrowing. US tax credits have built a strong political coalition of support, but critics point to the (un)healthy profits made by investors and the need for an army of consultants trying to make a complex system work.

Australia is in for an interesting decade ahead as it makes a major change to its affordable housing policies. Tax credits work reasonably well in the US – what is less clear is whether we have learned the lessons from two decades of US experience when designing a scheme for Australia. ☉

This article is based on research by Tony Gilmour and Dr Vivienne Milligan originally presented at the 3rd Australasian Housing Researchers Conference in Melbourne, 18–20 June 2008.

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