Regulation Impact Statement:
First Home Loan Deposit Scheme

Background

On 12 May 2019, the Government announced it would implement the First Home Loan Deposit Scheme (the Scheme), which will provide a limited guarantee to allow first home buyers (FHBs) to purchase a home with a minimum deposit of 5 per cent of the property purchase price without needing lenders mortgage insurance (LMI). A number of policy details were announced by the Government, including that the Scheme would assist 10,000 FHBs per year and will be implemented by the National Housing Finance and Investment Corporation (NHFIC).

Given the Government's election commitment, alternative policy options are not considered in this Regulation Impact Statement. However, the rationale behind the scheme, implementation considerations, and likely impacts are discussed.

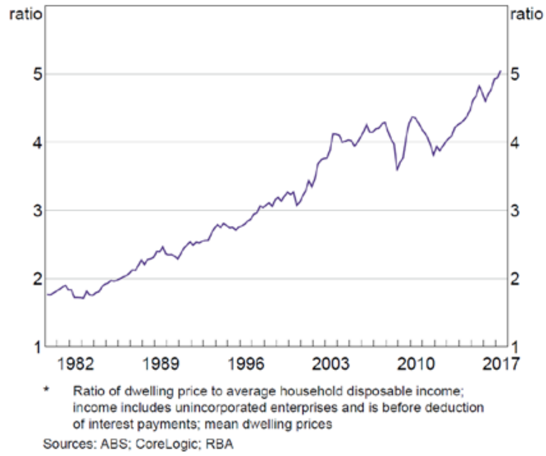
1. The problem

In recent decades, it has become more challenging for FHBs to save a deposit to purchase their first property. Saving a sufficient deposit can be a barrier to home ownership, and the proportion of households that own a home has fallen to 66 per cent, down from 70 per cent in 1997-98.[1]

There are a range of housing affordability measures that consider indicators such as housing prices, incomes and interest rates. A common measure of housing affordability is the ratio of housing prices to household incomes. This measure has increased steadily since the early 1980s, and has increased particularly rapidly over recent years.[2]

[1] Australian Bureau of Statistics (2019), More households renting as home ownership falls.
[2] Reserve Bank of Australia (2017), Housing Accessibility for First Home Buyers.

Figure 1: National housing price-to-income ratio (RBA)[3]



The mortgage debt-servicing ratio, which captures the cost of servicing mortgage debt relative to income, suggests that housing affordability is around its long-run average due to low interest rates in recent years. Similarly, the Reserve Bank of Australia (RBA) found that national housing accessibility for FHBs is around the long-run average, however cities such as Sydney and Melbourne have become significantly less affordable.[4] In addition, FHBs have become more constrained by the size and location of properties available for their purchase.

Therefore, despite borrowers' ability to service a loan, especially given historically low interest rates, relatively high housing price-to-income ratios mean that FHBs must save for a longer time to accumulate a deposit.[5] Based on a median household income and a 15 per cent saving rate (on before tax income), it takes approximately eight years to save a 20 per cent deposit on a median priced home.

Deposit requirements and lenders mortgage insurance

Borrowers may have access to loans with deposits of as low as 5 per cent of the property purchase price (95 per cent loan-to-value ratio (LVR)), however, lenders require them to pay for LMI. Lenders generally require borrowers to have a deposit of at least 20 per cent of the property purchase price (80 per cent LVR) to not require LMI or a parental guarantee.

LMI protects a lender from losses in the event of a borrower defaulting on a home loan. Lenders typically require a borrower to purchase LMI for high-LVR loans, as these loans have a higher risk of default and have a smaller deposit (less equity).

LMI providers charge an upfront premium to lenders (e.g. banks) that is then passed on to borrowers, often by capitalising it into the home loan. The size of the premium depends largely on the LVR of the home loan and is generally equivalent to one to two per cent of the loan value (i.e. $5,000-$10,000 for a $500,000 home loan). LMI is widely utilised by FHBs.

Some lenders do not require borrowers with an LVR above 80 per cent to pay LMI if the loan is covered by a parental guarantee with additional collateral, in the form of equity in a property owned by the parent. Additional equity from the parent reduces the risk of loss to the lender in the event of the borrower defaulting.

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[3] Ibid.
[4] Ibid.
[5] Reserve Bank of Australia (2017), The Property Ladder after the Financial Crisis.

Other government measures

The Government has implemented measures to assist FHBs saving for a deposit, including the First Home Super Saver Scheme (FHSSS), announced in 2017. The FHSSS assists individuals to build a deposit for a first home inside their superannuation fund by making voluntary contributions. In addition, the measures the Government has implemented to improve housing affordability, such as the City Deals, encourages additional supply of dwellings which may assist FHBs to enter the housing market. In addition, state and territory governments provide assistance for FHBs by providing grants and offering stamp duty concessions. While these initiatives are helpful for FHBs, saving a sufficient deposit to remove the need for LMI remains challenging.

2. Objective of reform

Many prospective FHBs have the ability to service a mortgage, however take considerable time to save a 20 per cent deposit. The Scheme aims to facilitate earlier access to home ownership for FHBs without needing LMI.

When announcing the Scheme, the Government also prioritised other parallel objectives. The Scheme will have a cap of guarantees (10,000 per year) which will limit potential wider market impacts. The Scheme will involve contractual arrangements with a panel of lenders, and smaller banks and non-bank lenders will be prioritised to encourage competition. Additionally, the property price of eligible homes will be determined on a regional basis, to ensure that benefits of Scheme participation are spread across the country.

It is a central objective to assist FHBs access the market earlier than they would have without needing LMI while maintaining the viability of the LMI market. While lenders' LMI requirements increase the cost of borrowing faced by many FHBs, it remains a viable and economically important market solution to facilitate high-LVR lending. The LMI industry is concentrated, comprising of three independent providers (QBE, Arch and Genworth) and two 'captive' providers that are wholly owned subsidiaries of ANZ and Westpac and supply those entities exclusively. In contrast to other comparable countries, where governments have provided LMI to support access to home ownership, there is no government provider or public support for LMI in Australia.

3. Policy options

On 12 May 2019, the Government announced that it would implement the Scheme. The announcement included the following policy details:

- The Scheme will have a cap of 10,000 FHBs each year.
- The Scheme will enable access to housing finance without the need to save a 20 per cent deposit or pay LMI.
- Borrowers will face lenders' usual loan serviceability tests.
- The Scheme will be available to FHBs with an income (in the prior financial year) less than $125,000 (or $200,000 combined income).
- Support will be targeted by setting maximum dwelling prices, set on a regional basis.
- NHFIC will implement the Scheme.
- The Scheme will commence on 1 January 2020.

Policy design

Given the Government's election commitment, alternative policy options are not considered in this Regulatory Impact Statement. In line with the announced policy parameters, it has been determined that the Scheme will provide a first-loss guarantee on eligible loans for the difference between the deposit and 20 per cent of the property purchase price, subject to a minimum deposit of 5 per cent. In the event of default and subsequent claim being made, the lender may claim for amounts owed by the FHB after the sale of the property up to the amount guaranteed. The guarantee will be broadly consistent with the coverage provided by some lenders under parental guarantee products in the existing market.

To implement the Scheme, NHFIC will contract with a panel of lenders who will have access to the Commonwealth guarantees. NHFIC will not have direct contact with borrowers. Rather, participating lenders or mortgage brokers will assess Scheme eligibility alongside normal considerations such as loan serviceability tests. In the event of a default, the lender will liaise with NHFIC to access the guarantee.

An alternative model would offer the Commonwealth guarantee product to lenders on the same terms, however with a different application process. Under this model, borrowers apply to NHFIC directly to confirm eligibility. Approved borrowers then approach a participating lender (directly or via a mortgage broker) to obtain the loan.

More specific implementation details will be determined and announced by the Government and NHFIC prior to the commencement of the Scheme.

Analysis of policies in other jurisdictions

The proposed model for the Scheme shares some objectives with initiatives implemented in other jurisdictions. Australia is relatively unique in having an active market for LMI without government intervention. For example:

- In the United States, loans insured by the Federal Housing Administration (FHA) made up approximately 17 per cent of all mortgages originated in 2017.
- The publicly owned Canada Mortgage and Housing Corporation (CMHC) controls approximately 40 per cent of the Canadian LMI market. Premiums paid by borrowers recover CMHC's costs.
- In New Zealand, the publicly owned Housing New Zealand issues Welcome Home Loans, where LMI premiums are shared between borrowers and the government.

Other jurisdictions have supported high-LVR lending in other ways:

- The Western Australian Government offers Keystart Loans, which are high-LVR loans designed to assist borrowers until they have built sufficient equity to refinance. Borrowers face relatively high interest rates on these loans to encourage them to refinance out of the program once they have built sufficient equity.
- The United Kingdom offered a Mortgage Guarantee Scheme between 2013 and 2016 which guaranteed high LVR loans offered by private lenders. The program was discontinued when lenders were prepared to offer these loans without government support.

4. Impact analysis

First home buyers

The Scheme will have a cap of 10,000 guarantees each year. The recipients will be able to access a high-LVR loan without needing LMI or alternative products (LMI premiums are typically between one and two per cent of the property purchase price). Scheme applications will occur as part of normal loan application processes. Therefore, there will be limited additional effort involved for prospective FHBs seeking a guaranteed loan, compared to applying for a regular mortgage.

Under the alternative model, where FHBs apply directly to NHFIC to access guaranteed loans, an administrative burden is shifted from lenders to households and NHFIC who would assess applicants against the eligibility criteria. If successful, NHFIC would grant the applicant a time-limited access pass to the guarantee, which they could then use with participating lenders to purchase their first home. While this will impose an individual regulatory burden, successful applicants to the Scheme will derive a significant benefit. This individual cost has been estimated and is outlined at Table 2.

Given the limited supply of guarantees, the potential financial benefits for successful applicants, and the relatively high income eligibility thresholds, it is likely that there will be a large pool of eligible FHB, a proportion of whom who may wish to apply for the Scheme. Therefore, a key implementation detail will be how the 10,000 annual guarantees should be allocated. A key demand management measure will be setting dwelling price caps for Scheme access.

Currently, FHBs purchase approximately 100,000 properties each year. The prospective FHBs who are unable to access the Scheme, or are seeking to purchase a property above the price caps, will remain able to borrow with relatively low deposits (albeit while paying for LMI). The limit of 10,000 annual guarantees will mean little, if any, impact on house prices (see below for further discussion on housing market impacts).

The Scheme aims to facilitate earlier FHB property purchases, and will likely encourage some FHBs who would have otherwise delayed their entry to the property market and saved a larger deposit. Therefore, these borrowers will start with a relatively smaller equity buffer and may pay more interest over the life of the loan. However, this would be no different if FHBs entered into high LVR loans with either LMI or a parental guarantee. Offset against this, the Scheme should allow FHBs to not require LMI, which is typically capitalised into the loan amount and paid down over the life of the loan. Participation in the Scheme is ultimately a personal financial decision for prospective FHBs.

The Scheme will not directly interact with other initiatives that assist FHBs, but will complement measures such as the Government's FHSSS and the FHB grants and stamp duty concessions offered by state and territory governments.

Lenders and mortgage brokers

The Scheme will benefit the panel of lenders, chosen by NHFIC, as they will be the only lenders eligible to offer guarantees loans. All else equal, lenders selected to form the Scheme's panel may attract some business away from other lenders, to the extent that participating borrowers would have taken out a loan with a non-panel lender in the absence of the Scheme. However, impacts on the overall lending market are not likely to be significant, as the cap of 10,000 guaranteed loans represent a small portion of the approximately 394,000 loans made in the last 12 months (excluding refinancing).

Distributing the guarantee via lenders places an administrative burden on these institutions. Before offering guaranteed loans, lenders will need to update their internal systems, and train front-line lending staff, including on how to apply the eligibility criteria. Additionally, mortgage brokers who wish to offer the guaranteed loans to their clients will require training or self-education. There will also be a per-loan regulatory cost to write a guaranteed loan, as the process will involve determining Scheme eligibility and communicating with NHFIC. These regulatory costs have been estimated and are outlined at Table 1. However, these costs are discretionary. Lenders will choose to participate if they feel that the commercial benefits of participating in the Scheme are sufficient to offset the associated administrative and regulatory costs.

Under the alternative model (borrower application to NHFIC), the regulatory burden on lenders and mortgage brokers per loan will be smaller, as they will not need to assess Scheme eligibility. However, there remains some additional time to process a guaranteed loan for a certified borrower compared to a normal mortgage. Additionally, start-up educational costs for front-line lenders and brokers will be smaller compared to the other option, since they will not be required to assess borrowers' eligibility for the Scheme. Costs associated with updates to lenders' systems and managing potential loan defaults are consistent with the other option. These business costs have been estimated and outlined at Table 2.

In the event of loan arrears and defaults, lenders will interact with NHFIC to recover any shortfall amounts covered by the Commonwealth guarantee. This is expected to occur infrequently, given lenders will continue to assess credit and serviceability requirements.

Lenders mortgage insurance providers

The development of the Scheme has prioritised the maintenance of a viable and profitable LMI industry, as LMI enables high-LVR lending and benefits the financial system more broadly. LMI allows potential home buyers the ability to enter the property market sooner than they would otherwise be able to. Without LMI, potential home buyers with deposits of less than 20 per cent would not ordinarily be able to obtain a mortgage. In addition to insuring lenders against the higher risks involved in lending to FHBs, LMI providers also provide a 'second pair of eyes' on the loan assessment process. Taken together, this increases the willingness of lenders to lend to FHBs.

One key consideration is the potential impact on the LMI market. Approximately 23 per cent of owner-occupier loans in Australia are covered by LMI. A large proportion of these LMI covered loans are made to first home buyers.

The guarantee under the Scheme removes the need for borrowers to take out LMI. While the scheme would expand the pool of potential FHBs, there is a risk that the guarantee is provided to a FHB who would have otherwise taken out LMI, thereby reducing demand for LMI policies. Constraining the size of the Scheme is important. The risk of an unconstrained Scheme is a larger impact on the private sector provision of LMI by displacing a proportion of the LMI market and affecting the ongoing viability of the market. The exit of one or more LMI providers would make the LMI sector less competitive, which could increase prices. If the industry became completely unviable, the Government would be faced with the question of whether to directly support high-LVR lending more broadly. Private sector provision of LMI should be supported given the functional market that currently exists in Australia.

However, the cap of 10,000 guarantees per year and property price caps (to target those purchasing modest properties) will help to limit the degree to which the Scheme displaces demand from potential FHBs who would have otherwise purchased LMI. The Scheme may also displace those that would have otherwise taken out a parental guarantee or alternative products. 10,000 guaranteed loans is relatively small compared to the overall LMI market, which insures around one-fifth of all mortgages in Australia. It is difficult to predict how the introduction of the Scheme will specifically impact the different LMI provider business models (independent and captive providers), or whether there will be any impact on LMI pricing. However, there will be continued monitoring of the effect of the Scheme on the LMI market.

The importance of the private LMI market

LMI also plays an important role in the credit creation process. LMI increases confidence for lenders to lend against residential housing assets through the economic cycle and reduces volatility in financial markets. LMI helps lenders manage risks by transferring the risk of borrower default of LMI-covered mortgages to LMI providers (and their global reinsurers). The ability to manage these risks is particularly relevant for smaller lenders, which are generally more geographically concentrated than larger banks and would otherwise find it difficult to manage higher-risk lending.

Smaller banks also benefit from LMI provision. Under prudential regulations, loans with LMI require banks to hold less capital compared to loans without LMI. Therefore, the absence of LMI would restrain the competitive position of smaller banks compared to larger competitors.

Finally, LMI contributes to the stability of the Australian financial system by providing the banking sector with a layer of additional private capital to absorb losses, which can be an important buffer for the system during an economic downturn.

Housing market

The Scheme aims to accelerate home ownership for prospective FHBs who would not ordinarily have been able to purchase a property without LMI or a parental guarantee. Therefore, demand for housing will increase to some extent. However, in the past 12 months, there were approximately 386,000 residential property transactions in Australia.[6] The cap of 10,000 guaranteed loans will represent a small portion of the market overall and is expected to be distributed across the country. Additionally, property price caps will constrain the ability of FHBs to buy properties that are more expensive than they ordinarily would have purchased. It is reasonable to expect that demand from FHBs, incentivised by the scheme, may have a modest impact on prices in some limited locations and at specific price points. The impact of the Scheme on property prices overall, including for housing developers and sellers of existing dwellings, is expected to be negligible.

Table 1: Regulatory burden estimate of implementing the scheme

Average annual regulatory costs (from business as usual)				
Change in costs ($ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	$2.17	$0	$0	$2.17

[6] Australian Bureau of Statistics (2019), *Residential Property Price Indexes: Eight Capital Cities (6416.0)*.

Table 2: Regulatory burden estimate of alternative implementation model

Average annual regulatory costs (from business as usual)				
Change in costs ($ million)	Business	Community organisations	Individuals	Total change in cost
Total, by sector	$1.14	$0	$0.32	$1.46

A regulatory offset has not been identified. However, Treasury is seeking to pursue net reductions in compliance costs and will work with affected stakeholders and across Government to identify regulatory burden reductions where appropriate.

5. Consultation plan

Treasury and NHFIC have conducted broad stakeholder consultations to assist in identifying the issues faced by FHBs, informing the policy implementation design and to understand the likely impacts. Consultations has informed design considerations including the setting of property price caps, the integrity of the Scheme, as well as operational details such as the FHB application process and the relationship between NHFIC and lenders participating under the Scheme.

Preliminary consultations were initiated in late-May 2019 and involved a large number of meetings with a broad range of stakeholders, including lenders (large and small), LMI providers, industry associations, financial intermediaries, mortgage brokers, housing developers, financial regulators, and consumer advocates. These stakeholders comprise the supply chain for arranging home loans, through which the Scheme is intended to operate, as well as other stakeholders that the Scheme may influence or may influence the Scheme.

Consultations have not directly involved potential or actual FHBs. However, Treasury and NHFIC have reviewed available research and collected confidential data from stakeholders to better understand the experience of and issues faced by FHBs.

To complement bilateral engagement with individual institutions and industry groups, the Government established a reference group comprising a variety of stakeholders to serve as a multilateral forum through which to receive confidential feedback. The reference group first convened in July 2019 to discuss key design elements of the Scheme. The reference group also met August 2019 to discuss further implementation details that must be finalised prior Scheme commencement.

Further consultation will continue on the legislative framework to enable the Scheme. A public consultation process is planned for the proposed amendments to the NHFIC Investment Mandate, which will contain the core implementation principles of the Scheme, including the Scheme's eligibility and operations. With the Scheme's commencement on 1 January 2020, public consultation on amendments to the NHFIC Act was not undertaken. The amendments to the NHFIC Act operate at a high level and provide broad authority for NHFIC to administer the Scheme. Consultation on the Investment Mandate enables stakeholders to focus on key aspects of the Scheme.

Given the importance of LMI, emphasis will also be placed on continued consultation and monitoring of these insurers to manage the Scheme's impact on the sector.

6. Option selection and conclusion

Stakeholder consultations played an important role in supporting implementation of the Scheme. Consultations have so far indicated that:

- there is broad-based support for the policy objective of supporting FHBs and demand from potential FHBs is high;
- to make a decision on whether to seek to participate, lenders will require some degree of certainty over their respective allocation of loans;
- the proposed policy is functionally similar to parental or family guarantees currently used by some borrowers to obtain a home loan;
- there are some operational pressures that need to be resolved quickly to ensure the Scheme is implemented in an effective and timely manner and that a critical element of the Scheme's success will be ensuring a relatively seamless experience for FHBs;
- public understanding of the Scheme is essential and this must be balanced with Scheme complexity;
- the LMI claims process is complex and typically takes many months to resolve, and not all defaults of home loans covered by LMI lead to LMI claims.

In particular, consultations have highlighted the important role served by the LMI sector, including supporting the ability of smaller lenders to compete with the major banks and of borrowers to obtain low deposit home loans. Also noted was the challenge in tailoring Scheme access to benefit subsets of potential FHB and to avoid crowding out the LMI sector.

The Government's preferred approach is for NHFIC to work with participating lenders, who would be responsible for assessing eligibility for the guarantees subject to the eligibility criteria. This approach will minimise the associated operational costs and risks for the Commonwealth. While the regulatory cost estimate for this implementation model (see Table 1) is slightly higher than the alternative (Table 2), the preferred option does not increase regulatory costs faced by individuals. While the cost to business is slightly higher, lenders' participation in the Scheme is discretionary and will ultimately be a commercial decision.

7. Implementation and evaluation

Property price caps

A key implementation challenge may be managing potential demand for the Scheme. While the Scheme will be limited to supporting 10,000 guarantees per year, managing demand and targeting those first home buyers in most need of support will make the task of allocating places in the Scheme considerably easier. The annual income thresholds announced for the Scheme ($125,000 for singles; $200,000 for couples) are higher than median incomes and a large proportion of potential first home buyers will qualify against those thresholds. Setting caps on the value of properties that can be purchased under the Scheme will be a key lever used to constrain potential demand. It will be necessary to set these caps so that only modest properties in regional towns and capital cities can be purchased. This will also help to target access to the Scheme to those first home buyers in more genuine need of assistance. At the same time, the caps will need to be set in such a way that access to the Scheme is reasonably open to potential first home buyers regardless of the city or region in which they live. Caps will be set for each state and territory, with consideration given to median house prices (in both capital cities and outside of capitals), state and territory FHB stamp duty concessions and FHB grants.

One potential price cap model is to apply a consistent discount to median dwelling prices in each state and territory for both capital cities and outside of capital cities. This model would create caps that are simple to administer but target relatively affordable properties in respective locations. The Government will determine the exact specification of the caps after further industry consultation. The price caps may be updated periodically to ensure they remain appropriate.

Communication strategy

Industry feedback indicates that the announcement of the proposed Scheme has attracted a high degree of community interest. Some potential first home buyers may be holding off on purchases in anticipation of gaining access to the Scheme when it commences. Early communication of how the Scheme will be made available to first home buyers, including eligibility criteria, will be important to manage the impact of the Scheme on the housing and mortgage finance markets.

Loan and guarantee application process

Critical to the Scheme's success will be ensuring that the application and approval process for FHBs wishing to access the Scheme is relatively seamless and transparent. Providing lenders who may wish to participate in the Scheme with early clarity on how the guarantee will operate will enable them to incorporate the Scheme into their existing customer on-boarding processes. The arrangement that NHFIC enters into with participating lenders will ensure that the customer experience and customer expectations are appropriately managed. NHFIC will determine more specific implementation details.

Ongoing monitoring of the housing market

A key indicator of whether the Scheme has achieved its objectives will be whether the Scheme is able to enable prospective first home buyers to enter the housing market sooner, without having to wait longer to save the requisite deposit. It should operate alongside a viable and profitable LMI industry that continues to support other FHBs' access to the market. Maintaining the viability of the LMI industry, as it allows potential home buyers the ability to enter the property market sooner than they would otherwise be able to. An independent review of the Scheme will be undertaken within three years of the Scheme's commencement to ensure that objectives are being met.