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Dear Sir/Madam

The Treasury Consultation – National Housing Finance and Investment Corporation Investment Mandate Amendment (First Home Loan Deposit Scheme) Direction 2019
Submission by Australian Finance Group Ltd ACN 066 385 822

Australian Finance Group Ltd (**AFG**) was founded in 1994, was listed on the Australian Securities Exchange in 2015, and has grown to become one of Australia's largest mortgage broking groups. Approximately 2,950 brokers (of which 1320 are credit representatives of AFG) arrange residential mortgages, commercial finance and other loan products through AFG.

AFG also operates its own securitized lending business AFG Securities, which has a book of over $2.3B in home loans under management.

AFG welcomes the opportunity to respond to the exposure draft *National Housing Finance and Investment Corporation Investment Mandate Amendment (First Home Loan Deposit Scheme) Direction 2019* (the **Direction**) issued by the Australian Government on 27 October 2019. For the purposes of this submission, AFG's response is limited to providing the key observations below.

1. Requirements for cessation of guarantees

Section 29H of the Direction provides for the form of guarantee. Sub-section 29H(3) provides that:

"(3) Subject to subsection (4), the terms of a guarantee issued by the NHFIC under this Part must provide for the guarantee to cease when the balance of the loan becomes less than 80 per cent of the value of the residential property."

AFG submits that the term '*balance of the loan*' used in subsection 29H(3) should be clarified. If Treasury intends this term to mean the actual balance of the loan at a point in time, rather than the scheduled balance of the loan in accordance with its payment terms, there is a risk that the guarantee will cease if a borrower whose actual loan to value ratio (**LVR**) is below 80% but has a redraw facility incorporated in the loan product which it then activates and causes the actual LVR to go back above 80% of the value of the property.

The risk of losing the benefit of the guarantee should a borrower's loan drop briefly below a 80% LVR and the ability to redraw funds from a loan (if this product facility is allowed for eligible loans) creates risks that do not exist with lenders mortgage insurance (**LMI**). This is potentially a problem for securitized participating lenders and ADIs on the standard model. This would also disadvantage smaller non-bank lenders who would not have the resources and risk appetite to carry these loans where the guarantee had ceased (and alternative LMI was not in place).

Preventing an eligible loan to redraw loan funds which would bring the LVR back above 80% would add additional cost and complexity, create potential conflicts between participating lenders and borrowers, and create risks to participating lenders that don't exist with borrowers who have purchased LMI.

AFG suggests that the guarantee remains in place until the LVR drops below 80% based on the <u>scheduled</u> balance and original valuation. The NHFIC will be in receipt of reporting from the participating lenders which will allow the NHFIC to assess the current exposure of guarantees based on actual balances of eligible loans and limit the maximum possible future exposure (in the case of redraw, if allowed) to the scheduled balance of the eligible loan. This will enable the NHFIC to assess its exposure and manage risk under the Scheme on an ongoing basis.

An alternative such as using 75% LVR threshold for the release of the guarantee would be preferable to using the actual LVR balance, but would still give rise to the need to create a more restrictive eligible loan product or create new and unacceptable risks for participating lenders.

AFG proposes that Treasury amend the term '*balance of the loan*' in sub-section 29H(3) to be '*scheduled balance of the loan*'.

Please do not hesitate to contact AFG if you require any further detail about the matters raised in this submission or if AFG can provide any further assistance in the development of alternative proposals.

Yours sincerely

Damian Percy
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