1 November 2019

Submission: National Housing Finance and Investment Corporation Investment Mandate Amendment (First Home Loan Deposit Scheme) Direction 2019

Manager
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[Home Loan Experts]() is an award-winning specialist mortgage brokerage focused on helping people with complex financial situations and those who do not meet standard lending policies. Our company mission is to help people who are being let down by the Australian banking system.

Unlike the majority of brokers, we are credit experts in the lending guidelines used by both the major banks and other lenders. We have an extensive in-house credit assessment process which we complete before applying with any bank or lender.

We understand that the Government has released for consultation the draft National Housing Finance and Investment Corporation (NHFIC) Investment Mandate Agreement (First Home Loan Deposit Scheme) Direction 2019.

We would like to take this opportunity to provide some insights from our front line customer-facing staff since more than 60% of our customers are first home buyers. This may give the Treasury a different perspective compared to submissions.

Sincerely,

Otto Dargan
Managing Director
Home Loan Experts

Executive Summary

Home Loan Experts recommends that the government:

- Limit risk by adopting standard Genworth or QBE policy
- Implement strict approval criteria or expand the scheme
- Engage with foreign governments who've developed clever long term policies
- Manage the risks of a housing bubble
- Avoid creating a rush when the scheme ends
- Limit the number of guarantees per state
- Select more small lenders to boost market competition
- The effect on mortgage insurers should be considered

Our Recommendations

Limit risk by adopting standard Genworth or QBE policy

The approval criteria for the Scheme should be strict so that the government can limit their risk. We would recommend that the **government adopt standard Genworth or QBE policy** as this is a good benchmark to avoid losses. If banks apply the criteria that they usually have for an 80% LVR loan then the government will take on more risk than they anticipated.

Generally, for loans with a loan to value ratio of greater than 80%, mortgage insurers require borrowers to have genuine savings or a rental history. Genuine savings or a rental history are an excellent way for a borrower to prove that they are ready for a mortgage. Since the government will essentially act as the mortgage insurer, it makes sense to adopt their well-established policies.

Prior to the global financial crisis (GFC) of 2008, First Permanent (Establishment Loan) and St George Bank had no deposit home loans that didn't require a guarantor from the borrower's parents. The credit criteria for these products was conservative and as a result, the loan book performed well with few losses. There may be lessons from this for Treasury about how to minimise losses from this guarantee. We recommend that you contact St George Bank for more information.

Pepper Money purchased the loan books of several lenders who exited the market after the GFC. This has given them data and insights regarding the performance of certain lending policies. We note that Pepper has adopted a requirement for loans over 90% LVR to have stronger servicing and that this is effective at limiting Pepper's risk. We believe it would be prudent to adopt a minimum Net Surplus Ratio of 1.1x for all loans over 90% LVR as opposed to the standard 1.0x used by most lenders. We note that Genworth uses a similar policy for loans approved under their Homebuyer Plus product which is for customers without genuine savings.

Limiting risk is critical to ensuring that Australian taxpayers do not end up facing substantial losses in the future.

Implement strict approval criteria or expand the scheme

According to the recent 'Genworth First Home Buyer Sentiment Report', almost 75% or three in four prospective FHBs are planning to apply for the scheme.

The limit on the number of people that can take up this scheme is likely to be a problem as demand will outstrip supply. For reference, there were 110,000 first home buyers in 2018, while the scheme in its current form is limited to 10,000 buyers.

This can be mitigated using strict approval criteria or alternatively, they can extend the number of people that can take this up if they see that it is successful.

Engage with foreign governments who've developed clever long term policies

Ultimately, the government should engage with foreign governments to learn from their successes and failures in this area to develop clever long term policies to solve the longer term issue of housing affordability. We would recommend that Treasury send one to two senior staff on The Adviser Magazine's Study Tour each year to learn about the mortgage and housing market in different parts of the world.

The MFAA (Mortgage & Finance Association of Australia) and FBAA (Finance Brokers Association of Australia Limited) have relationships with several foreign mortgage broking associations and can also assist with researching future policies. There are several structural issues in the housing market such as a lack of supply, complexity in getting a home loan and the complexity of development applications which will continue to be a challenge if they are not addressed. Several prior tax reviews have recommended the removal of stamp duty after the introduction of GST, which has been effective for first home buyers in the states that have offered this benefit.

Manage the risks of a housing bubble

Currently, the economy is in an unusual situation where lower interest rates and increased borrowing power has had a dramatic impact on the housing marketing in Sydney and Melbourne but has not as yet had an impact on the economy as a whole. There is a risk of a housing bubble forming if interest rates are low for an extended period of time.

We believe that the proposed first home buyer deposit scheme will not have as large an impact on overall house prices as interest rates and borrowing power do. Treasury should consult with the RBA, APRA, ASIC, FBAA, MFAA and HIA to carefully manage the risk of a housing bubble. It could be that certain limitations on lending may need to be implemented by APRA even though they may be frustrating for borrowers and us as mortgage brokers.

We do not have the necessary holistic understanding of the economy to comment further on possible unforeseen consequences.

We note that limitations on borrowing power in Ireland are particularly tough where the maximum loan amount is 3.5x a borrower's income and this has resulted in a variety of unintended consequences. A considered approach with significant research and consultation is advised.

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Avoid creating a rush when the scheme ends

When a benefit like this is eventually removed, it can create a rush before the final date followed by an extended quiet period in the market. One method to avoid this is to not increase the maximum purchase price, so as house prices increase the take up of this offer reduces until it can be removed with little effect.

This has worked well in the Netherlands with their National Mortgage Guarantee (aka Nationale Hypotheek Garantie).

Another method is to time the removal of this benefit to match a particularly strong time in the housing market so that removing this scheme assists to achieve a stable housing market.

Limit the number of guarantees per state

Currently, there's no specific limit on the number of guarantees that can be issued per state in the draft. This will favour some states/areas more than the others.

Select more small lenders to boost market competition

The draft states, "The NHFIC must not approve more than 2 major banks as eligible lenders for a financial year." and "The total number of guarantees issued to major banks in a financial year must not exceed 5,000."

Limiting the number of guarantees to 5,000 from the big four and their subsidiaries is the right step to boost market competition. Considering that only 10,000 guarantees can be issued by the NHFIC in a financial year, this is still half of all available guarantees.

Curtailing the number of guarantees that can be issued by the major banks further will ensure that the government's expectation that smaller lenders play a more significant role in the First Home Loan Deposit Scheme will be met.

The effect on mortgage insurers should be considered

Mortgage insurers such as Genworth and QBE are important participants in the mortgage industry. This scheme may take impact their share of the market and therefore their viability.

If either of them were to exit the Australian market this would have a disastrous impact due as the remaining company would effectively be a monopoly. In turn the cost of LMI could increase and more home buyers could be locked out of the market due to stricter lending policy.

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