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# First-home buyers save with First Home Loan Deposit Scheme

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Housing affordability has been a hot topic for many decades. The truth is that property has always seemed expensive, particularly for first-home buyers as their financial positions tend to be relatively weak.

Governments have tried numerous ways to ease the affordability challenge with grants, concessions and incentives. A criticism of first-home owners grants is that they artificially distort property values. We observed this in 2008 and 2009, when vendors factored in the higher FHOG receipt when they set their selling price. So, essentially, when the Rudd government doubled the grant, property prices increased commensurately, so it did nothing to make property more affordable.

State governments have tried to ease the housing affordability challenge, too. Most states waive stamp duty for first-home buyers if the property's value is below a certain limit, which typically ranges from \$400,000 to \$650,000, depending on the state. This incentive can save a first-home buyer more than \$30,000, so it's a very effective tool.

However, perhaps the biggest "hidden" cost of buying a first property is mortgage insurance. In the event that a borrower requests a loan that is more than 80 per cent of a property's value, the lender requires the loan to be insured by either QBE or Genworth (there are only two mortgage insurers in Australia).

The lender will arrange an insurance contract to cover its risk, not the borrower's. That is, the risk that the bank loses money if it has to sell the property, but the proceeds are not enough to repay the loan. The lender passes the insurance premium cost on to the borrower.

The problem is that mortgage insurance fees have skyrocketed in recent years.

In 2011, someone who borrowed \$500,000 at a 90 per cent loan-to-value ratio would pay a mortgage insurance fee of about \$7500. Today, that fee has increased to up to \$14,000. That equates to an annual rate increase of more than 8 per cent. According to data from the Real Estate Institute of Australia, the median house price in Australia has only increased by 3.7 per cent over the same period. And the inflation rate has been even more benign at only 1.9 per cent. If these cost increases are not arrested, an increasing number of first-home buyers will be locked out of the market.

To add insult to injury, most states charge stamp duty on the mortgage insurance premium, adding up to 11 per cent onto the total cost (so, the cost increases from \$14,000 to \$15,500).

In an effort to make first homes more affordable, NSW and the ACT abolished stamp duty on mortgage insurance premiums in 2017. No other states have followed, however.

The federal government's new First Home Loan Deposit Scheme will provide some much-needed relief to the escalating cost of mortgage insurance. The scheme begins on January 1 but it will only be available to 10,000 borrowers a year. The government will offer lenders a guarantee in respect to eligible first-home borrowers that will replace the need for mortgage insurance. This scheme is only available to those who earn less than \$125,000 a year (or \$200,000 for couples) and who buy a property below the mandated threshold, which ranges between \$250,000 and \$700,000, depending on state and location.

Eligible borrowers can apply to participate in the scheme via a participating lender. NAB is the only lender appointed to date, but more are expected to be added.

Stamp duty and purchasing cost concessions do not artificially distort property prices as much as grants do, if at all. Giving someone a wad of money that they never had to work hard to accumulate is psychologically different to waiving a fee. A grant is a windfall gain whereas a fee waiver does not put you in a better position; it just helps you avoid being put in a worse position. A fee waiver is unlikely to change how judicious you are when contemplating how much to offer to buy a property.

Hopefully, the First Home Loan Deposit Scheme simulates much-needed competition in the mortgage insurance sector. Economists estimate there are 110,000 first-home buyers in Australia each year. Therefore, the First Home Loan Deposit Scheme in its current format will help less than 10 per cent of the market.

If the scheme is successful, perhaps the government should consider extending it and maybe also introducing a fee to participate to ease the burden on the public purse.

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