

# Imi outlook first home owner scheme

Impact of changes to the First Home  
Owner's Grant Boost Scheme  
on the Residential Market  
May 2009



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## Introduction

Welcome to our latest report on the residential property market, focusing on the impact of the First Home Buyer Grant Boost Scheme (FHOGBS) on the residential market, compiled exclusively for QBE LMI by leading business research and forecasters BIS Shrapnel.

The First Home Owners Grant Boost Scheme (FHOGBS) has provided a substantial stimulus to the residential property market activity since its introduction by the Federal Government in October 2008. The research conducted shows that if the FHOGBS is extended beyond 30 June, then First Home Buyer demand could peak at 180,000 loans in 2009. However, if the FHOGBS expires, demand for new and established dwellings will be pulled forward, with short term rises in property prices of 5% expected.

With rising rents and lower interest rates, the motivation for renters/first home buyers to get into the housing market has never been more compelling. This is reflected in the report which shows a rebound of First Home Buyer's share of new loans up 25.7% in December quarter 2008 compared to December quarter 2007, activity remaining positive in January (+19.6%) and February (+35.8%) 2009\*.

The research also highlights that First Home Buyers in a lower interest rate environment, following the introduction of FHOGBS are able to borrow more. The average size of a loan to first home buyers has increased from \$264,500 in October 2008 (when the FHOGBS was first announced) to \$280,600 in February 2009\*.

I trust you will find this report informative and its forecasts insightful into what we can expect from any change in the FHOGBS scheme and the likely outlook and impact on the residential market.



Ian Graham  
CEO, QBE LMI

\* Source: Australian Bureau of Statistics

“With rising rents and lower interest rates, the motivation for renters/first home buyers to get into the housing market has never been more compelling.”

### History

- As compensation for the increased costs of building a new dwelling due to the introduction of the GST on 1 July 2000, the Federal Government introduced the First Home Owner's Grant Scheme (FHOGS), comprising a grant of \$7,000 to first home buyers (FHBs), which was paid out to FHBs of both new and established dwellings.
- To boost activity after the collapse of new dwelling construction subsequent to the introduction of the GST, the FHOGS was increased by \$7,000 (additional amount) in March 2001 (to a total of \$14,000) for the purchase/building of new dwellings. This additional amount was reduced to \$3,000 in January 2002, and was removed entirely at the end of June 2002. The original \$7,000 FHOGS for all dwellings remained.
- In October 2008, in response to a rapid decline in residential construction during 2008 as a result of increased interest rates, and subsequently a sharp downturn in the economy, the Federal Government's First Home Owner's Grant Boost Scheme (FHOGBS) temporarily increased the original FHOGS to \$14,000 for the purchase of an established dwelling and \$21,000 for the purchase of a new dwelling, for contracts entered into up until 30 June 2009. The aim of the FHOGBS is to boost new dwelling construction to assist in stimulating an otherwise weakening economy, as well as help support prices and prevent possible negative equity impacting on consumer confidence and spending.

The FHOGBS has not only helped those into the market who would have otherwise purchased later, but also encouraged renters to move into owner occupation and those that would have purchased an established dwelling to purchase a new dwelling.



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## Impact on the market

The FHOGBS has had a significant impact on FHB demand since it was introduced. Lending to FHBs decreased by 1.1% in 2007/08 (Table 1), and accelerated to an 11.1% decline in September quarter 2008 in year-on-year terms. After the introduction of the FHOGBS in October 2008, growth in new FHB loans rebounded to 25.7% in December quarter 2008 compared to December quarter 2007\*. The FHB activity remained strong in January (+19.6%) and February (+35.8%) 2009.

The increase in FHB activity due to the FHOGBS is having a greater relative impact on the new home market, than the established home market, and in particular the new finished home market (newly erected dwellings). While growth in total owner occupier lending has remained negative in year-on-year terms, the declines have been more moderate for the construction of new dwellings, and were positive for newly erected dwellings in 2009, since the FHOGBS was introduced. This indicates that FHBs have favoured newly erected dwellings, and to a lesser extent, building new dwellings, over established dwellings to obtain the full benefits of the FHOGBS.

FHB demand is expected to peak at a higher level than with the previous boost in March 2001, due to the growth occurring in the number of FHB-aged (20 to 39 year old) households (Chart 1).

This should reduce the risk of a decline of the same magnitude as the one that occurred subsequent to the expiry of the last boost in June 2002.

FHB loans peaked at 150,000 in the twelve months to March 2002 as part of the previous boost, compared to an average of 102,000 per annum in the eight years leading up to the introduction of the original FHOGS in July 2000. Interestingly, this also occurred during a period where the number of FHB-aged households was declining.

The decline in FHB loans to 88,400 by 2003/04 occurred after the original boost expired, due to FHB demand being “pulled forward” into the years that the boost was available. Nevertheless, average annual FHB loans of 113,000 per annum over 2001 to 2005 were higher than the average up to 2000—accounted for by a return to growth in the number of FHB-aged households.

Since 2006, FHB demand has stabilised at an average 129,000 loans per annum, with the number of FHB-aged households increasing by 30,000 per annum in this period. This would suggest that FHB loans could peak at 160,000 per annum as a result of the FHOGBS, based purely on a comparison of the number of FHB-aged households in 2001 compared to the number of households now. However, given the tighter rental market conditions than when the previous boost was in place, and the narrower gap between renting costs and mortgage repayments, a greater movement of renters into owner occupation is expected.

As a result, FHB demand could peak at 170,000 to 180,000 loans in 2009, if demand is fully allowed to play out through an extension of the FHOGBS. This would reflect a similar total percentage increase in FHB loans prior to the previous boost being put in place.

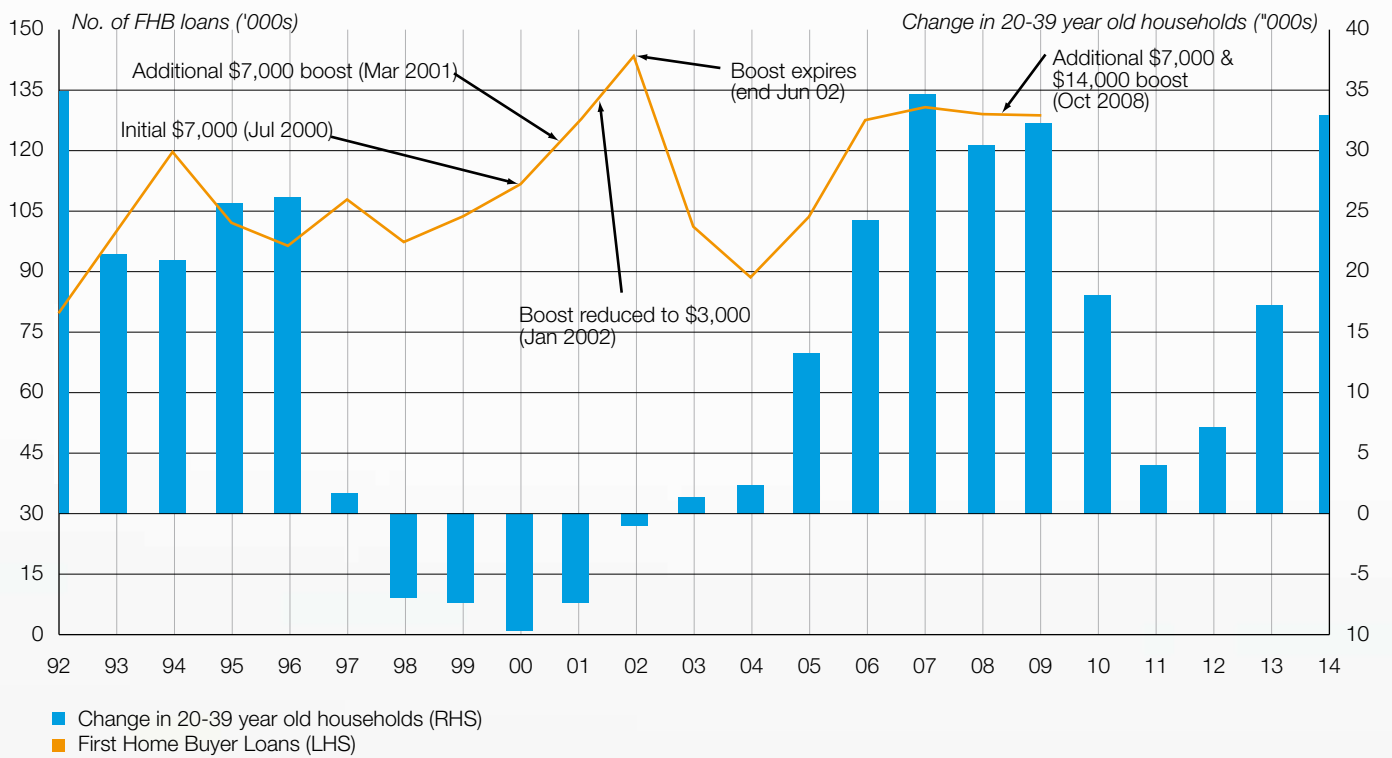
**Table 1: Home loans for owner occupation, Australia**  
Source: Australian Bureau of Statistics

Type of dwelling/ purchaser	Change on same period of previous year (%)				
	2007/08	Sep-08	Dec-08	Jan-09	Feb-09
Construction of new dwellings	1.5	-14.0	-16.1	-10.5	-5.8
Newly erected dwellings	-17.4	-43.7	-17.7	2.1	4.2
Established dwellings	-4.3	-27.3	-24.4	-16.7	-7.2
Total dwellings	-4.6	-27.0	-23.2	-15.1	-6.4
First home buyers	-1.1	-11.1	25.7	19.6	35.8

\* Source: Australian Bureau of Statistics

**Chart 1: Annual number of FHB loans vs growth in FHB-aged (20 to 39 year old) households**

Source: Australian Bureau of Statistics/BIS Shrapnel



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**Is the increased FHB demand a risk?**

Without equity in an existing home, FHBs typically borrow on a higher loan-to-value ratio (LVR) than non-FHBs, with a consequent higher rate of arrears and defaults than non-FHBs. As a result, there has been concern that the FHOGBS is encouraging FHBs into the market who could otherwise not afford a home, and who will be exposed as unemployment rises or interest rates revert back to more sustainable levels.

The average size of a loan to FHBs increased from \$264,500 in October 2008 (when the FHOGBS was announced) to \$280,600 in February 2009\*, representing a rise of \$16,100 in the average size of a loan to FHBs since October 2008. This is more than the \$7,000 or \$14,000 increased Grant, although the variable housing rate has also fallen by 3.8 percentage points in the same period, indicating that this amount can be easily covered by the reduced mortgage interest rates.

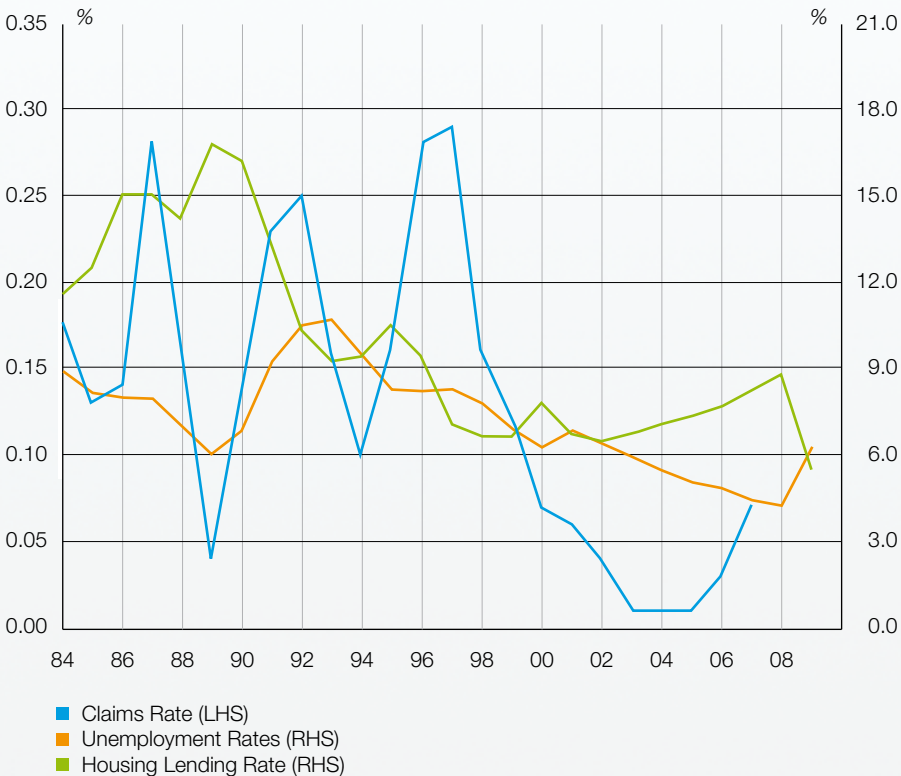
Chart 2 indicates the relationship over time between claims against the mortgage insurance (the default rate) and changes in unemployment and the housing variable rate. Claims increased and peaked in:

- 1987 — after a period when interest rates were rising and there were small falls in unemployment;
- 1992 — subsequent to a period of record interest rates, and when there was a sharp rise in unemployment (although interest rates were declining when claims peaked); and

- 1997 — a couple of years after rising interest rates, and through a pause during a longer term decline in the unemployment rate.

Consequently, it appears that a combination of both rising interest rates and rising unemployment may have an impact on defaults.

**Chart 2: Total owner occupier claims vs unemployment rate and housing rate**  
Source: QBE LMI, ABS, BIS Shrapnel



\* Source: Australian Bureau of Statistics



After being unsustainably low during the period 2003 to 2005, the claims rate edged upwards in 2006 and 2007. Equivalent 2008 calendar year data is not yet available, although analysis by QBE LMI indicates the total arrears rate increased by 0.2 percentage points from January 2008 to December 2008, compared to an increase in the arrears rate for FHOGS policies by 0.4 percentage points from January 2008 to December 2008. Through this period, unemployment was at long term lows, indicating that rising interest rates has been the main driver of increased arrears/claims. Based on the 2008 analysis, while FHB arrears have increased, they have not increased significantly out of line with the overall market.

Consequently, there is every likelihood that claims will continue to increase in 2009 and 2010, based on increased unemployment (forecast by BIS Shrapnel to peak at a rate of 8.0% in early 2010). However, with this peak being less than the previous periods associated with higher claims activity, as well as housing interest rates being significantly lower (and having fallen more sharply and hence alleviated repayment pressures more quickly), claims are not expected to rise to the levels seen during previous peaks in 1991.

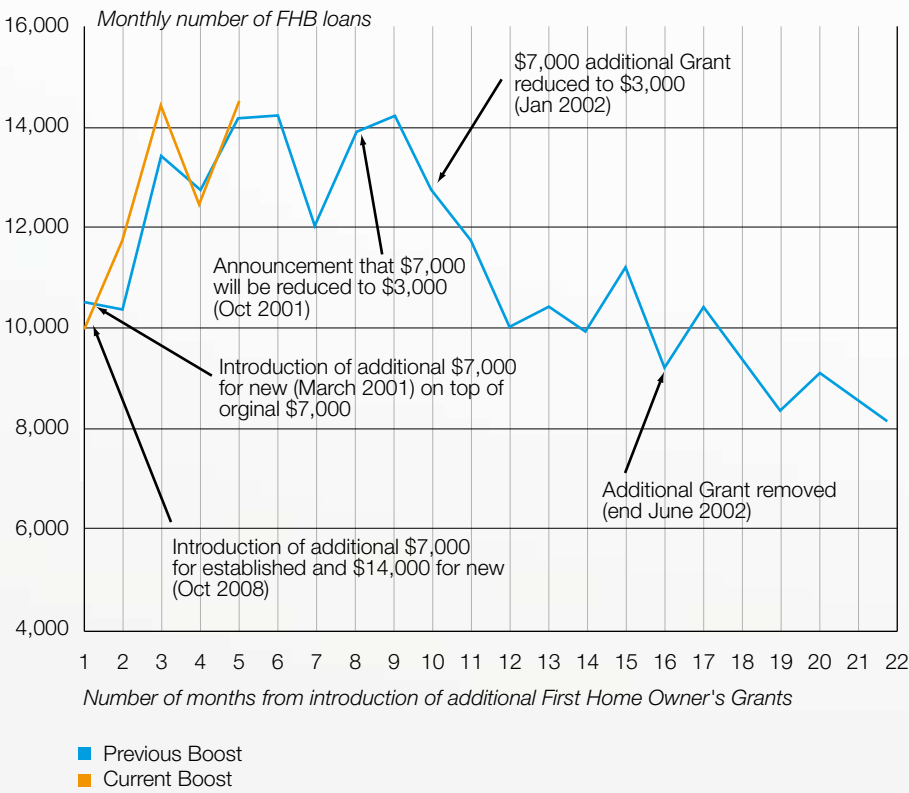
Going forward, any future tightening interest rate cycle should also not result in large scale defaults predominantly by FHBs. As a maximum LVR of 95% or 90% is now more common, FHBs are more likely to borrow within their means. Moreover, with the FHOGBS likely to form the entire 5% of purchase price, or in some cases the total 10% deposit, there is also a requirement by many lenders and lenders' mortgage insurers for purchasers to demonstrate genuine savings of 5% of purchase price to ensure that some of their own money is also at risk in the purchase.

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## Possible outcomes after 30 June 2009

At this stage, there has not been any definitive announcement of whether the FHOGBS will be extended in its current form beyond the announced expiry date of 30 June 2009. However, a guide to the possible outcome can be taken from when the FHOGBS was last boosted to \$14,000 for new dwellings in March 2001. So far the trend in FHB activity in the five months since the introduction of the FHOGBS is almost identical to the first five months after the previous increase was introduced (Chart 3).

**Chart 3: Monthly loans to first buyers since additional FHB Grants were introduced, previous grant vs current FHOGBS**  
Source: Australian Bureau of Statistics/BIS Shrapnel



“If the FHOGBS expires on 30 June 2009, we expect higher First Home Buyer demand for new and established dwellings to be funnelled into May and June 2009.”

FHB activity after the initial FHOGS boost in 2001 saw loans to FHBs increase from around 10,000 per month, to 12,000–14,000 per month, with a brief surge in the final three months prior to the additional FHOGS being reduced from \$7,000 to \$3,000 at the end of December 2001. FHB loans then settled at around 10,000 per month with this lower Grant, before falling to well under 10,000 per month subsequent to the additional Grant expiring.

Following this pattern, **if the FHOGBS expires on 30 June 2009**, we expect higher FHB demand for new and established dwellings to be funnelled into May and June 2009, as FHBs rush to take advantage of the extra funds while they are available. Current low interest rates would assist in placing upwards pressure on prices at the affordable end of the market, with short term rises of 5% possible. Competition for established dwellings may also lead to some FHBs opting to avoid this and purchase land to build a new dwelling.

As a result of this surge, there is a risk that prices (and new dwelling demand) will subsequently weaken due to the “hole” in FHB demand from July after the FHOGBS expires. The urgency to purchase will be removed and FHBs will be prepared to wait to see the outcome on the market. It is likely that there would be an immediate brief shock (in terms of reduced prices and new dwelling demand) at the affordable end of the market, and this could potentially flow through to the rest of the market, as upgraders will not have the FHB market to sell their existing dwelling into—causing the nascent signs of recovery at the start of 2009 to stall.

However, the combination of further FHB-aged household growth, rising rents, and long term low interest rates will continue to be supportive of FHB demand, despite the removal of the FHOGBS, rising unemployment and a weaker economic environment. Unlike upgraders, who can stay in their current dwelling for an indefinite period and dampen activity, potential FHBs establishing a new household require a dwelling to move into (unless they remain in the family home). With the comparative cost of owning versus renting at its most favourable level for many years, this will encourage owner occupation amongst FHBs despite the adverse economic conditions. Consequently, while prices and new dwelling activity

may subsequently ease, they should only fall at least back to pre-FHOGBS levels—i.e. prices losing the 5% or so gained in May/June 2009, and FHB loans averaging around 10,000 to 11,000 per month.

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“If the FHOGBS is extended in its current form then our expectation of 180,000 First Home Buyers in 2009 is more likely to be played out.”

**If the FHOGBS is extended in its current form, or is only partly reduced, for a further period,** then our expectation of 170,000 to 180,000 FHBs in 2009 is more likely to be played out. As occurred when the additional Grant was reduced in the first half of 2002, there is likely to be a more modest surge in FHB demand in May and June 2009, before settling at a slightly lower, albeit still high, level in subsequent months.

If the FHOGBS is extended to, say, the end of the year in its current form, there is the possibility of the additional funds being built into prices. Moreover, it will encourage more purchasers to buy/build “ahead of their time” prior to the ultimate expiry, with an associated risk of a larger drop off in FHB demand later on. However, by this stage, upgrader demand should be moving into a stronger recovery, and this will be able to partly compensate for the weaker FHB demand.

If the FHOGBS is reduced after June 2009 and removed later, then we are likely to see a surge in demand for both new and established dwellings come through in May/June 2009 before the additional amount is scaled down—the size of this surge depending on how the FHOGBS is phased out. FHB demand will subsequently weaken from July, although it is likely to stabilise at a slightly higher level than the last three years. This scenario should maintain momentum in FHB demand until upgrader demand picks up to be sufficient to somewhat offset the sharper fall in FHB demand when the additional grants are removed entirely.

However, with a higher FHB-aged population, and the gap between rents and mortgage repayments narrower, annual loans to FHBs are expected to fall to around the 100,000 to 110,000 mark, well above the 88,400 low in 2003/04, and are likely to stabilise at a higher level, averaging around 130,000 per annum as we have seen over the last three years.



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