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Australia's property industry
Creating for Generations

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Dear Sir or Madam

Investment Mandate Exposure Draft: Ensuring eligible first home buyers have the opportunity to choose a newly constructed home

The Property Council of Australia welcomes the opportunity to comment on the National Housing Finance and Investment Corporation Investment Mandate Amendment (First Home Loan Deposit Scheme) Direction 2019 (the Scheme).

This submission provides a number of recommendations to ensure the Scheme enables eligible first home buyers the widest opportunity to choose a newly constructed home if that is their wish. The challenge is to ensure the Scheme can provide an eligible first home buyer with the confidence to purchase an off-the-plan apartment or a house-and-land package where land registration has not yet been secured. These long-dated purchase decisions would require the eligible purchaser to know whether they have secured a guarantee at the time of signing their contract (when they make their purchase decision). The draft Scheme rules would not provide this certainty until the time of settlement, which may be some years later.

We propose that the concept of a Provisional Guarantee be added to the Scheme design to ensure that eligible first home buyers are able to purchase these long-dated property types if they choose.

Background

The Property Council is the leading advocate for Australia's biggest industry and biggest employer – property. Our members include Australia's largest residential developers. They are committed to meeting Australia's housing needs and actively support policy choices that will improve housing outcomes and provide additional jobs for the many trades employed in the construction of new homes.

The Property Council warmly welcomed the Government's announcement of the Scheme to help eligible first home buyers purchase a house with a deposit as low as 5%. We have also appreciated the thoughtful engagement that the National Housing Finance and Investment Corporation (NHFIC) has undertaken to ensure all stakeholder views are heard.

This announcement comes at a very important time in the residential property cycle given that construction of new homes has fallen more than 20% year on year. This will have a very significant broader economic impact. Australia's residential property market is worth $6.2 trillion, directly employs more than 995,000 jobs and generates over $100 billion directly into the economy.

Key issue – long-dated purchase decisions

We are pleased to note that Investment Mandate references the inclusion of new housing in the Scheme, including off-the-plan apartment purchases and house-and-land packages. Clearly it is the Government's intention to allow eligible first home buyers to have the choice of purchasing eligible properties whether they be newly constructed or existing.

However, we believe that the current detailed design of the Scheme will unnecessarily restrict eligible first home buyers from purchasing off-the-plan apartments and house-and-land packages where land registration has not yet been secured.

First home buyers actively seek to compare off-the-plan apartment and house & land purchases given that they often provide more affordable options and customisation of home choice as compared to established stock.

The three distinct benefits for first home buyers of new product are:

- Choice and tailoring of product that meets their current and future needs (e.g. those with mobility challenges can design an accessible property that meets their needs, or a couple with a growing family).
- Additional savings time to increase their deposit size while locking in a price in today's market.
- Access to targeted state and territory FHB grants and/ or stamp duty incentives.

Recommended solution – a Provisional Guarantee

Please find enclosed our submission recommending technical design changes to ensure the Scheme can properly support new dwelling construction that:

- Adds to the total stock of homes nationally.
- Exerts downward price pressure, especially for new homes.
- Creates significant direct construction and sales jobs and indirect supply chain and retail jobs as well as government activity, not otherwise generated by sales of existing homes.
- Increases GDP through additional utilisation of commodities and materials beyond the boosted labour contribution.

We believe that these technical improvement to the Scheme can be achieved with a simple addition to the design: the addition of a Provisional Guarantee. The concept of a Provisional Guarantee would be a mechanism to enable a participating financial institution to give an eligible first home buyer the certainty to purchase a newly constructed property with the knowledge that they would be provided with a Scheme guarantee at the time of settlement.

A Provisional Guarantee would operate as follows:

- An eligible lender can reserve a Guarantee from a future year's 10,000 cap allocation to give the FHB certainty that they have secured a guarantee when their pre-approval has been secured and the FHB has entered into an unconditional contract to purchase a new dwelling.
- At the time of property settlement, when unconditional financing is granted, the FHB's eligibility (income and price cap) is reconfirmed and the Guarantee issued to the loan.
- The reservation of a Guarantee by is upheld regardless if the lender is no longer a part of the eligible panel at the time the FHB's loan is made unconditional.
- The Provisional Guarantee can be extended up until the unconditional contract sunset clause has be reached.

An alternative solution to this concept would be to reserve a set number of annual allocations for new homes - say 30 percent or 3000 homes - and allow the banks to work further on product design to allow access to this new home allocation. However, this solution would provide less certainty to eligible first home buyers when making their purchase decision.

We look forward to working with Treasury and NHFIC to further refine the technical details underpinning the Scheme. If you would like to discuss this submission further, please contact Rebecca Douthwaite, National Policy Manager - Housing (rdouthwaite@propertycouncil.com.au).

Yours sincerely

Ken Morrison
Chief Executive

Property Council of Australia

Submission:

Ensuring the First Home Loan Scheme allows eligible first home buyers the opportunity to choose a newly constructed home

November 2019

Purpose

The purpose of this submission is to recommend solutions to ensure the First Home Loan Scheme enables eligible first home buyers the widest opportunity to choose a newly constructed home if that is their wish.

Long-date unintentional technical issues with the detailed design of the First Home Loan Scheme (The Scheme) that, if addressed, would:

- Deliver to the Government's stated aims to allow eligible First Home Buyers (FHB) the choice of purchasing new housing through the Scheme.
- Ensure that the Scheme supports jobs and economic growth through construction.
- Maintain the integrity of the Scheme and its design principles.

Context

FHBs tend to favour new dwellings due to:

- Access to more affordable product being available in new release areas rather than established areas to meet their budget constraints.
- Choice and tailoring of product that meets their current and future needs (e.g. those with mobility challenges can design an accessible property that meets their needs, or a couple with a growing family).
- Additional savings time to increase deposit size while locking in a price in today's market.
- Access to targeted FHB grants and/ or stamp duty incentives, state & territory specific.

Most State FHB schemes have been designed to support new construction because, unlike existing dwellings, this approach:

- Adds to the total stock of homes nationally.
- Exerts downward pressure on prices especially in the market for new homes.
- Creates significant direct construction and sales jobs and indirect supply chain and retail jobs as well as government activity, not otherwise generated by sales of existing homes.
- Increases GDP through additional utilisation of commodities and materials in addition to the boosted labour component.

Problem with the Scheme design

The Investment Mandate references the inclusion of new housing in the Scheme, including off-the-plan apartment purchases and house-and-land packages. It is clearly the Government's intention to allow eligible first home buyers to have the choice of purchasing eligible properties whether they be newly constructed or existing.

However, we are concerned that the current drafting of the Investment Mandate will unintentionally prevent most eligible first home buyers using the Scheme to purchase two vitally important classes of new dwellings due. These are:

- Off-the-plan apartments that are more than four months away from settlement.
- House and land packages where the land is currently unregistered.[1]

This needs to be addressed if the Scheme is to contribute to meaningful construction activity or allow FHB to purchase new properties without potentially putting their savings at risk. The challenge is to ensure the Scheme can provide an eligible first home buyer with the confidence to purchase an off-the-plan apartment or a house-and-land package where land registration has not yet been secured. These long-dated purchase decisions would require the eligible purchaser to know whether they have secured a guarantee at the time of signing their contract (when they make their purchase decision). The draft scheme rules would not provide this certainty until the time of settlement, which may be some years later. Timeframes for these classes of new dwellings differ from project to project but can take anywhere from:

- Off-the-plan apartments: 4 months to 5 years from the time a buyer enters an unconditional contract until the property is able to be valued for finance approval prior to settlement.
- House & land packages: approximately 12 months to register land depending on the project, development stage and the competence of the planning approval authority.

[1] Unregistered land is land that is for sale where the certificate of title is not yet available.

Impact on First Home Buyers

The technical design of the Scheme will actively discriminate against certain types of new housing. This is often the type of housing that is structured to be more affordable than existing homes to attract FHBs and will unintentionally:

- **Deny the FHB choice** - Uncertainty as to whether or not they will they will be able to access a Guarantee due the under the Scheme in a future financial year due to the 10,000 cap when it comes time to settle the purchase will be a determining factor when they are deciding to enter into an unconditional contract.
- **Place the FHB in a risky situation** - If they entered into an unconditional contract but are unable to access a Guarantee under the Scheme at the time of settlement, they may be forced to forego their deposit if they cannot bridge the remaining deposit gap.

As such, **only those FHBs with alternative funding channels will proceed with an unconditional contract** if they know they have alternative channels to bridge the deposit gap should a Guarantee from the 10,000 cap be unavailable. We understand that it is not the Scheme's intent to support FHBs that have the capacity to bridge the deposit gap through alternative channels in addition to direct saving of wages income.

Recommendation – use of a 'Provisional Guarantee'

We believe that these technical issues with the Scheme can be resolved with a simple addition to the design - the addition of a Provisional Guarantee.

A Provisional Guarantee would operate as follows:

- An eligible lender can reserve a Guarantee from a future year's 10,000 cap allocation to give the FHB certainty when a pre-approval has been secured and the FHB has entered into an unconditional contract to purchase a new dwelling.
- At the time of property settlement, when unconditional financing is granted, the FHB's eligibility (income and price cap) is reconfirmed and the Guarantee issued to the loan.
- The reservation of a Guarantee by is upheld regardless if the lender is no longer a part of the eligible panel at the time the FHB's loan is made unconditional.
- The Provisional Guarantee can be extended up until the unconditional contract sunset clause has be reached.

For example: One of the 10,000 FY 2023 cap can be reserved in FY20 as a Provisional Guarantee to give a FHB the confidence to enter into the contract.

- **Step 1**: On 1 January 2020, a FHB secures pre-approval from a bank included on NHFIC's panel of lenders.
- **Step 2:** The FHB enters into an unconditional contract with the off-the-plan apartment developer for an apartment that has a contract price within the Investment Mandate's price caps.
- **Step 3**: The FHB notifies the bank of the contract and the approximate date of settlement as 1 March 2023.
- **Step 4:** The Bank notifies NHFIC and reserves guarantee to the Scheme is recorded against FY2023's 10,000 allocation until settlement.
- **Step 6:** When the loan is made unconditional to the FHB as they still meet the eligibility criteria, NHFIC issues the guarantee to the bank in FY 2023.

The success of this scheme relies in part on it supporting the delivery, not the aspiration, of a balanced range of housing options for FHBs and not ending up as a clearing house for existing dwellings which do nothing to support construction jobs.

An alternative solution to this concept would be to reserve a set number of annual allocations for new homes - say 30 percent or 3000 homes - and allow the banks to work further on product design to allow access to this new home allocation. However, this solution would provide less certainty to eligible first home buyers when making their purchase decision.

Issues and solutions:

The table below identifies additional issues and solutions grouped into three priorities of recommendations:

1. A priority change that needs to be made to ensure eligible FHBs have the appropriate choice of newly constructed housing under the Scheme.
2. Key changes required to support the operation of the Scheme as it applies to new construction – several solutions have been provided for consideration in a number of cases.
3. A recommendation to better strengthen the integrity of the Scheme in managing new construction purchases.

Issue	IM reference	Context	Solution
HIGHEST PRIORITY: **Confirming access to the Scheme only once the loan is unconditional (close to settlement) not when unconditional contracts are exchanged will not give FHB confidence to purchase new dwellings.**	**29A Eligibility for guarantees** The NHFIC must not issue a guarantee to an entity other than an eligible lender, in relation to an eligible loan. **29I Limit on guarantees in a financial year** (1) The NHFIC must not issue more than 10,000 guarantees in a financial year. (3) For the purposes of this section: (a) a guarantee is issued in the financial year during which its issue is approved by the NHFIC, even if the arrangement relating to the guarantee is entered into in a later financial year;	• **A Guarantee is only issued from NHFIC to the eligible panel member when an unconditional loan is approved to settle on the property. As there is no formal financial arrangement other than a preapproval between the bank and FHB until settlement, a Guarantee cannot be secured from the 10,000 cap.** • The IM must recognise that the settlement timeframe for the purchase of new dwellings differs to that of established dwellings, meaning eligible first home buyers need certainty that they will be able to access the Guarantee at the point of entering an unconditional contract with a developer. • It is too high risk for a FHB to enter an unconditional contract with a low deposit without knowing if they will be able to access the guarantee under the Scheme. Particularly if they believe they will be unable (due to cost or credit reasons) to access mortgage insurance from the private market if they were unsuccessful. • This means that the Investment Mandate must allow the 'reservation' of guarantees by lenders from future financial years' cap based on the approximate FY of settlement based on the pre-approval of the FHB (including the review of their eligibility under the Scheme) and the submission of a signed unconditional contract. For example: One of the 10,000 FY 2023 cap can be reserved in FY 20 to give a FHB the confidence to enter into the contract. Step 1: On 1 January 2020, a first home buyer secures pre-approval from a bank included on NHFIC's panel of lenders. • Step 2: The first home buyer enters into an unconditional contract with the off-the-plan apartment developer for an apartment that has a contract price within the Investment Mandate's price caps.	**Preferred approach:** Add a subpoint to 29A Eligibility for guarantees to read: "The NHFIC must not issue a guarantee to an entity other than an eligible lender, in relation to an eligible loan. 29 A (1) The NHFIC can issue Provisional Guarantees for future financial years for eligible lenders when an eligible first home buyer is issued a pre-approval and has presented an unconditional contract to a developer to the eligible lender." Change 29I Limit on guarantees in a financial year to read: (1) The NHFIC must not issue more than 10,000 guarantees in a financial year a. NHFIC can reserve guarantees as a Provisional Guarantee for future financial years when the arrangement relating to the guarantee is entered into in a later financial year. b. The allocation of the Provisional Guarantee is removed from the Scheme's 10,000 quota of the advised financial year of settlement. **Alternative solution:** An alternative solution to this concept would be to reserve a set number of annual allocations for new homes - say 30 percent or 3000 homes - and allow the banks to work further on product design to allow access to this new home allocation. However, this solution would provide less certainty to eligible first home buyers when making their purchase decision.

Issue	IM reference	Context	Solution
		• Step 3: The first home buyer notifies the bank of the contract and the approximate date of settlement as 1 March 2023. • Step 4: The Bank notifies NHFIC and reserves guarantee to the Scheme is recorded against FY2023's 10,000 allocation until settlement. • Step 6: When the loan is made unconditional to the first home buyer, NHFIC issues the guarantee to the bank in FY 2023.	
PRIORITY: Property eligibility determined by third party valuation, not contract price.	**29C Eligible loan** Section (2) (g) The value of the residential property does not exceed the price cap in the area the property is located.	• Price caps are important to retain integrity of the Scheme. • In the case of off-the-plan purchases, the relevant test should be the contract price (which is agreed at exchange), not the third-party valuation undertaken at settlement. • An unconditional contract is a commitment to purchase a new dwelling at an agreed price regardless of valuation. • Regardless of the property valuation by the third-party valuer, the FHB has agreed to pay the contract price for the new dwelling. It is this contract price that determines the subsequent loan amount, not the property valuation. • As currently drafted the IM would require that a guarantee can only be provided to an eligible first home buyer if the value of the property is within the price caps at the time when the FHB receive unconditional financial approval (typically 90 days before settlement). • In most circumstances, new dwellings are valued higher than the contract price once built. This reflects the fact that the purchaser has taken on some construction risk in their purchase. This needs to be acknowledged in the IM.	**Preferred solution:** • Change 29C (2) (g) to read "the value of the residential property does not exceed the price cap in the area in which the property is located at the time an unconditional contract is signed." **Alternative solution:** • If the valuation of the property exceeds the price cap, but the contract price is below the price cap, the loan is still considered eligible.

Issue	IM reference	Context	Solution
PRIORITY: Income eligibility may no longer be satisfied on settlement	**29E Income test** A person is required to satisfy the income test at the time of entering into a loan agreement.	• In off-the-plan apartment purchases and house-and-land packages where land registration has yet to occur, the timeline between entering into an unconditional contract and settlement can be extended over several years. During which time a person's income may increase due to CPI wages increases or one off bonuses. • State schemes verify eligibility when entering into a unconditional contract.	**Preferred approach:** • Change 29E Income test to read "A person satisfies the income test at the time of entering into an unconditional contact to purchase a property". **Alternative solution:** • Allow NHFIC the discretion to review income eligibility test when a FHB has entered an unconditional contract in good faith while meeting income thresholds, but has *modestly* exceeded thresholds at the time unconditional financing is secured.
Unnecessary administrative complexity: **Lender exits the Scheme after granting pre-approval.**	**29B Eligible Lender** (1) & (4) The NHFIC must not approve more than 2 major banks as eligible lenders for a financial year.	• The timeline between pre-approval and settlement is typically extended beyond one financial year. • A FHB needs certainty that the financial institution from which a pre-approval was obtained will still belong to the panel at the time of settlement when they enter an unconditional contract. • This timeframe will discourage lender participation in the Scheme due to the cost of compliance, redesign of mortgage processes, advertising the Scheme etc would no longer be a worthwhile investment of resources for only one year on the panel.	**Preferred solution:** • Remove 29B (4) from the IM given that the number of panel of lender members is not limited, so the presence of all major banks on the panel would not preclude a non- major bank lender from participating. • State the 5,000 cap to major banks will apply regardless if all four major banks participate on the panel. • Any reserve guarantees provided must remain valid regardless if the issuing lender is no longer on the panel (regardless if the financial institution is considered a major bank or non-major bank. **Additional solution:** If a FHB has secured a Provisional Guarantee from a lender on the panel(regardless if the financial institution is considered a major bank or non-major bank), that has since departed prior to settlement, the access to the reserve guarantee is still valid.

Issue	IM reference	Context	Solution
Clarity in wording: **Clarify the limit on amount of guarantee**	**29H Form of Guarantee** (2) (b) the amount worked out using the following formula: A – B where: A is 20 per cent of the value of the residential property that is the subject of the eligible loan. B is the deposit paid by the borrower or borrowers under the loan agreement.	• Clarify that the deposit can include the FHB's equity used to secure an unconditional contract.	**Preferred solution:** • Change (2)(b) to read B is the equity paid by the borrower or borrowers under the acquisition.

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