the case for continuance...

FIRST**HOMEOWNER**
GRANTBOOST

A WESTERN AUSTRALIAN CASE STUDY

MARCH**2009**

EXECUTIVE SUMMARY

The Urban Development Institute of Australia (WA Division) is the key representative body of the land development industry in Western Australia.

This submission highlights the stimulus to the land and housing market in Western Australia and the contribution to the economic health of the state provided by the boost to the First Home Owner Grant (FHOG). The paper proposes extension of the boost to the FHOG to at least the end of the 2009 calendar year with gradual phasing out of the boost through incremental reduction when conditions are appropriate.

Key points of this submission are:

- The boost to the FHOG has resulted in first home buyers returning to the market after being priced out during the housing boom in 2006.
- First home owner representation in the market has a 10 year historical average of 18% but is currently at 26.7%. When housing affordability was at its lowest in Western Australia in December 2006 first home owners represented a mere 12.3% of the market.
- Whilst the industry was responsive to the affordability crisis and adjusted product and lot size to better suit market conditions the land and housing market suffered significant downturn.
- First home owner loan commitments have grown 42% in the three months since the introduction of the FHOG boost. Non-first home owners have grown at just 1.4%.
- First home owners purchasing existing properties stimulate the industry by freeing equity for use in the new construction of new dwellings by non-first home buyers.
- The full economic impact of the boost has yet to be felt and it is imperative that it is continued in the short term and phased out only gradually in order that consumer confidence is restored and maintained.
- The limited activity of non-first home buyers in the market and low consumer confidence will continue to have a detrimental impact on the broader economy unless it is reversed. The boost to the FHOG is a proven strategy that helped the market normalise and return to long term trend lines.
- The stimulus effect of a boost to the FHOG is irrefutable. Extrapolating data prior to the FHOG boost in 2001/02 and comparing it with actual data saw construction activity increase of 132% and significant job creation/retention.
- Declining loan to value ratios are a continuing barrier to investment by the property development industry exacerbating the current situation. High job losses a genuine peril.
- UDIA recommends the boost be retained until there is normalisation in the market to support the health of the broader WA economy. Any reduction of the FHOG boost must be graduated to allow for market adjustment.

THE CASE FOR CONTINUANCE

FIRST HOME OWNER GRANT BOOST

The Urban Development Institute of Australia (UDIA) WA is the peak association representing the property development industry in Western Australia with a membership drawn from the land development, planning, financial, legal, engineering, environmental and urban design professions.

This paper presents unequivocal evidence that continuance of the boost to the First Home Owner Grant (FHOG) is imperative if normalisation of the residential property market in Western Australia is to be realised in the immediate future.

MARKET BACKGROUND

UDIA surveys quarterly the forty largest developers in Western Australia to collect data on land sales, stock, price and intended supply over the following 12 month period. The market for land has faced numerous challenges over the past 10 years with significant variations in relation to price, stock and sales (Figure 1).

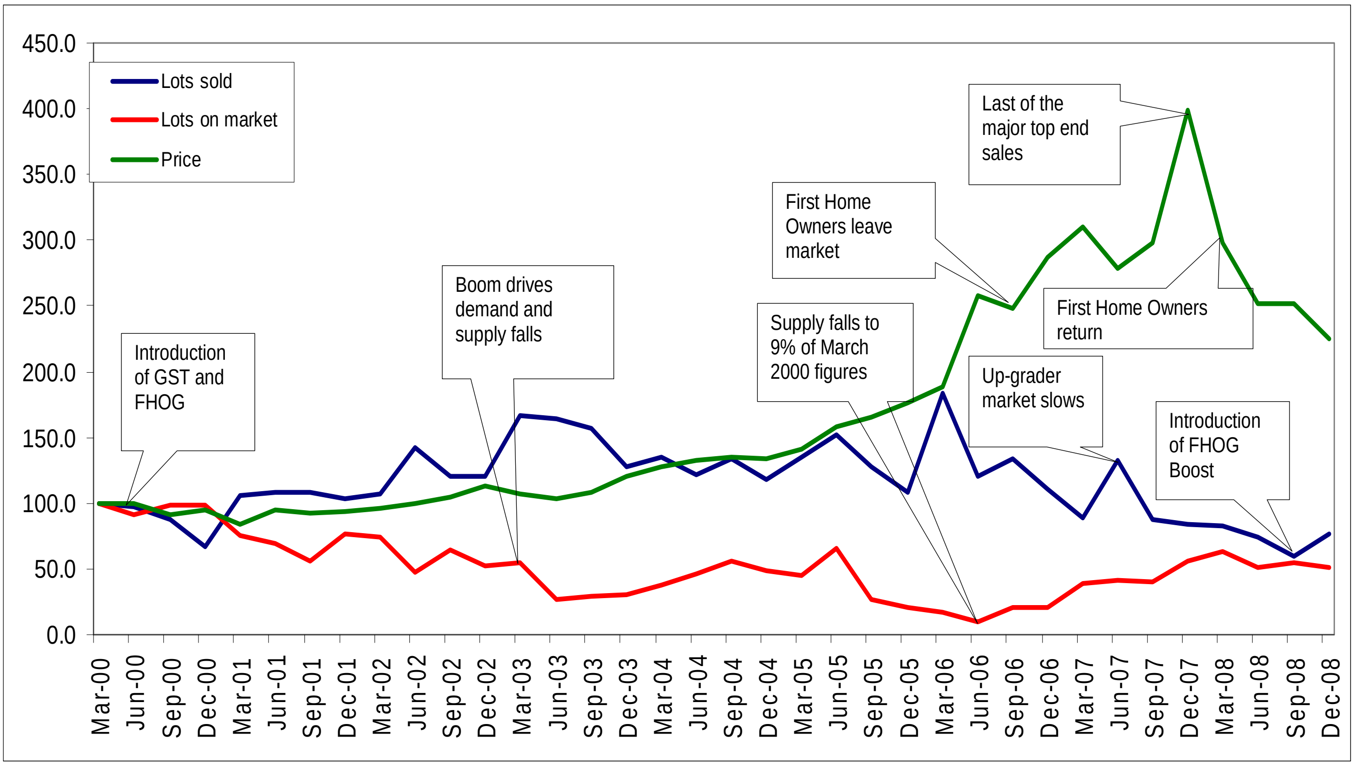
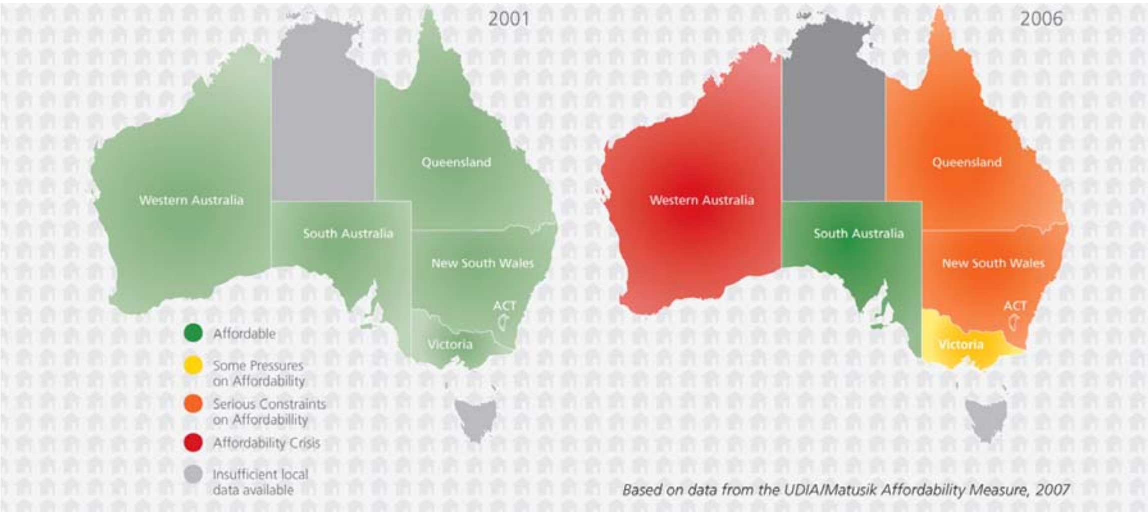


Figure 1: Index of lots sold, lots on the market and key milestones 2000 - 2008
Source: Urban Development Index, UDIA (WA)

Figure 1 illustrates that whilst the current global economic crisis is certainly impacting on the property industry the situation can be traced back to the introduction of GST in 2000 and the emerging mining boom in this state. In the early years of the current decade, industry failed to predict change in demand and supply was inversely affected. During 2005 supply more accurately reflected demand but the sudden peaking of demand in June 2006 led to a significant shortage of supply and stock fell to 9% of the holdings in March 2000. At this time a frenzy of demand was triggered as buyers tried to get in on a rapidly ascending market.

By late September 2006 first home buyers were no longer competitive in the market place and this had a significant impact on the average price of lots being sold. Western Australia became the least affordable state in Australia according to the UDIA Affordability Measure published in 2007 (Figure 2). Whilst the top end of the market was active there was declining activity in the middle market. First home buyers returned to the market in early 2008 as prices began to fall and the growing impact of the FHOG boost is demonstrated in the 28.5% increase in the number of lots sold in the December 2008 quarter.

Figure 2 - UDIA Affordability Measure Comparison 2001 - 2006

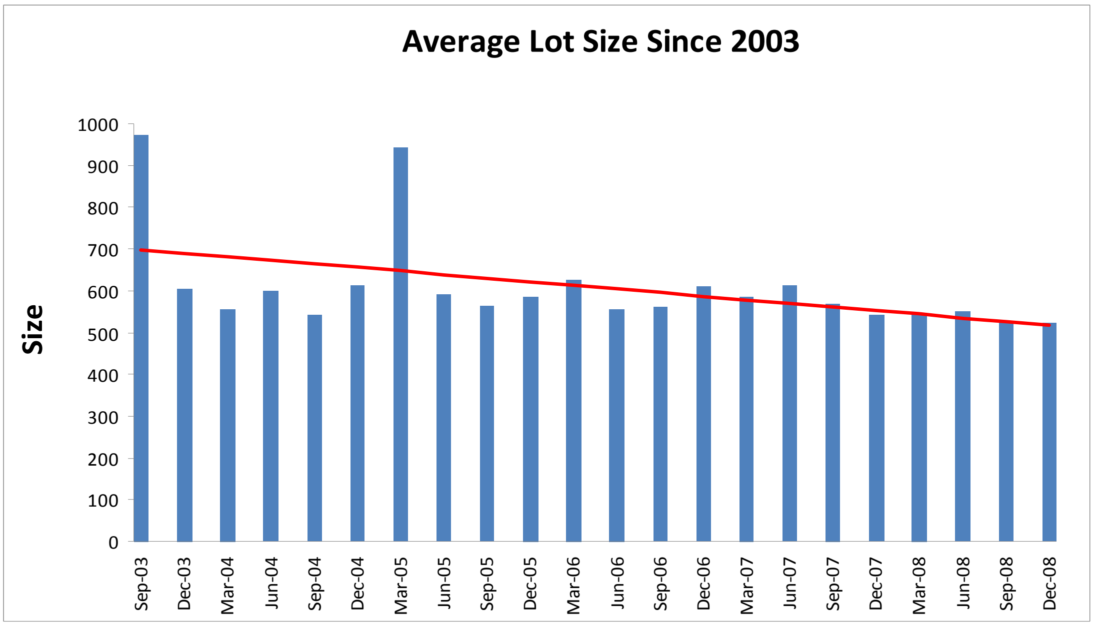


RESPONSE BY DEVELOPERS TO THE AFFORDABILITY CRISIS

The rapid decline in market activity from mid 2006 not only impacted on land sales, the existing housing market was also affected in Western Australia with ABS data showing that loan commencements in December 2008 for people who had previously owned a house had fallen to only 51% of the May 2006 figures (ABS – 5609.0 Housing Finance, Australia 2009).

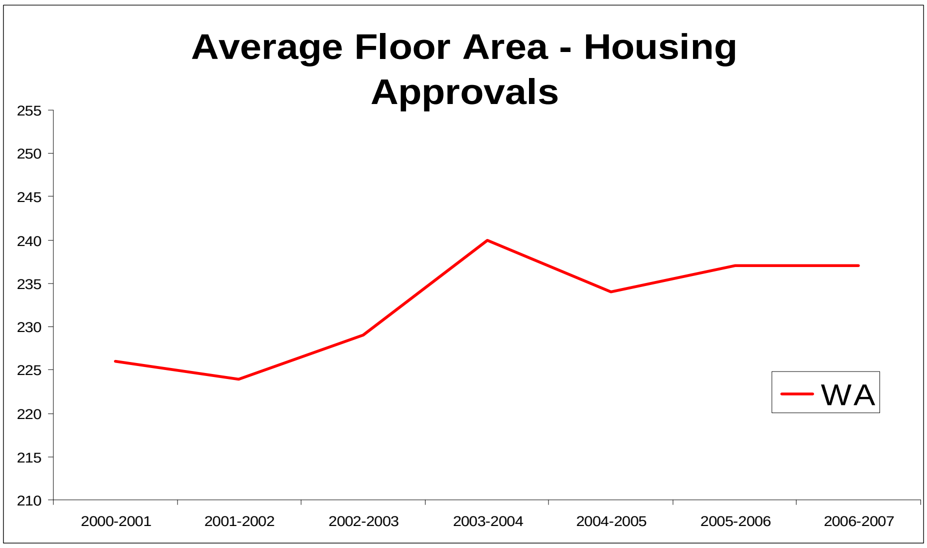
The development industry adjusted stock rapidly during 2007 and 2008 with a reduction in lot size (Figure 3) and the reintroduction of 3x2 and 3x1.5 housing opportunities. Cottages, attached or separate, became an affordable entry point for many first home owners who would not have previously considered this option. ABS dwelling approval data indicate the floor area for houses reducing to reflect this market shift (Figure 4).

Figure 3: Variation in average lot size 2003 – 2008



Source: Urban Development Index, UDIA (WA)

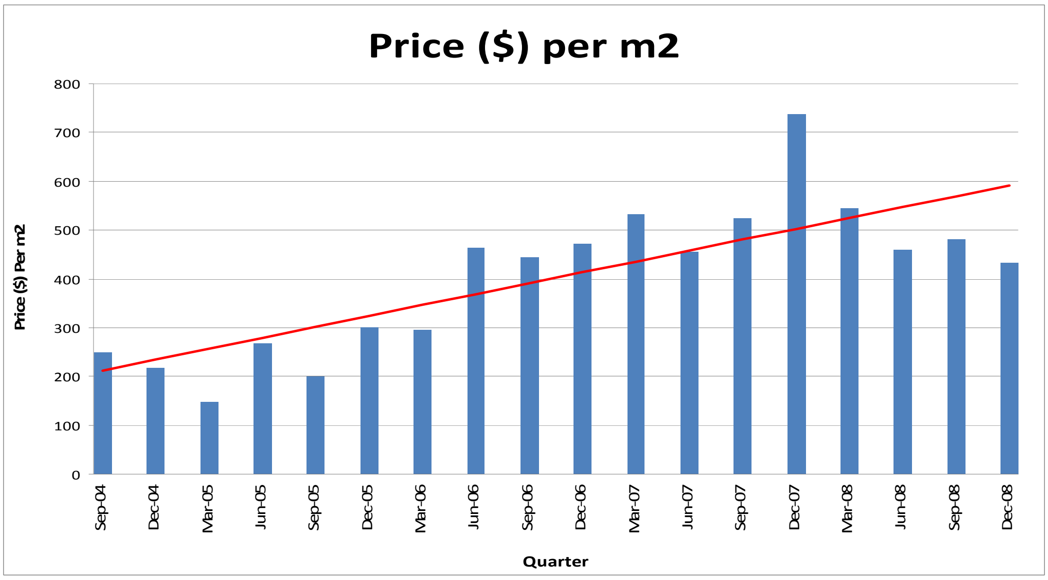
Figure 4: Average floor area – housing approvals



Source: ABS – 8731- Building Approvals Feature Article February 2008

Whilst real land value, measured as dollars per square metre rather than dollars per lot, continued to grow during 2007 declines in value were evidenced from early 2008. Affordability was no longer the key issue; confidence in the property industry began to stifle demand with values in some areas falling throughout 2008 (Figure 5).

Figure 5: Changes in land value 2004 – 2008



Source: Urban Development Index (December 2008), UDIA (WA)

IMPACT OF FALLING PRICES ON BUSINESS AND INDUSTRY

For the development industry falling sales and rising stock levels were problematic but far more serious were the margin calls as loan to value ratios moved outside contractual arrangements. The impact of falling land values not only effects the development industry it has a significant impact on broader investment as a significant proportion of business loans use property equity as security. The global economic crisis and the resulting tightening of credit, when combined with falling values and reducing equity, is now a major barrier to new projects whether they be proposed by small business or large companies.

For the development industry the falling market has also removed any buffer that the industry had in relation to delays in the approvals system and margins became extremely tight and in some cases virtually non-existent. Whilst some developers reported half yearly profits as of December 2008 most property shares dropped significantly in value and companies restructured with resulting job losses.

Ongoing land availability is essential to avoid another boom/bust cycle. Low sales and high cost of capital is likely to slow land provision which may potentially lead to land shortages as the market picks up over time.

Developers are currently reliant on the first home buyer to keep the market moving, to prevent catastrophic failure and subsequent major job losses.

THE ROLE OF FHOG BOOST IN RESTORING A NORMAL MARKET

To understand the full importance of the first home owner market there needs to be an understanding of the market as a whole. There are three tiers of the market in Western Australia being: First Home Owners; Upgraders and investors; and Top of the Market

Demand in the first home owner market is driven through family creation and immigration and is impacted by affordability and opportunity. First home owners fall out of the market when product pricing is prohibitive and they react strongly to stimulus. For many it is the decision of when, not if, they will enter the market and much of that is related to the deals that are on offer when compared to their current rental commitments or other living arrangements.

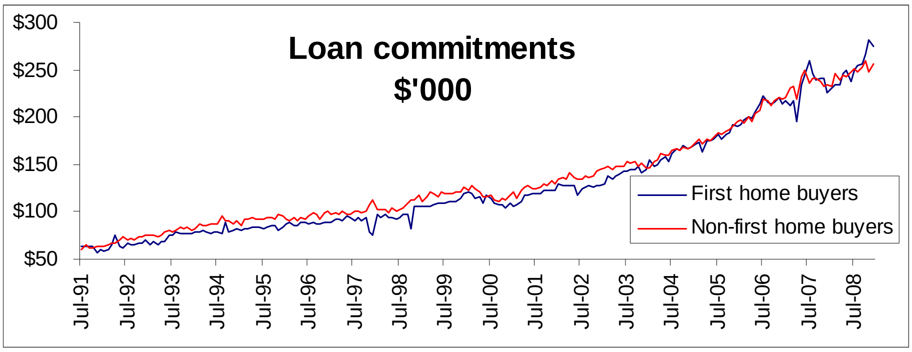
The top end of the market is the most susceptible to international economic conditions as many are either foreign investors tied by legislation to new dwelling investment or "high rollers" with stock and other assets that are significantly impacted by global trends. Whilst these buyers have a major impact on price averages they are a relatively small proportion of the market. They are, however, the most profitable and underpin the health of some development companies.

The middle market, representing the typical "mums and dads" is the bulk of the market and is highly susceptible to localised economic impacts and confidence. To a large extent there is no imperative for this group to move and, where there is an issue of confidence, this market will act conservatively. Whilst there are some that "must move" due to interstate transfers this is by far the minority. For the middle market the "wait and see" attitude prevails and this applies equally to the "mum and dad" and the investor purchasers.

Without the middle market however, the property development industry cannot function effectively and community development does not occur in a positive manner. Key to the middle market is confidence that, should they purchase a property, the chance of selling their current residence is fairly high. Without that confidence the middle market, the major market, fails.

The loan commitments of a first home owner when compared to a non-first home buyer are surprisingly similar (Figure 6). One of the key benefits of the FHOG boost is that it stimulates first home owners to purchase existing properties, freeing that equity for new construction. It is access to this latent capital that is absolutely crucial in the current market to stimulate activity.

Figure 6: Loan commitments of established and first home buyers



Source: ABS

What is required to normalise the industry is to return the non-first home owner market to the trend line shown in Figure 8 through the stimulus of first home owners as occurred in 2001-02. At that time the boost package, as can be seen in Figure 7, ran from:

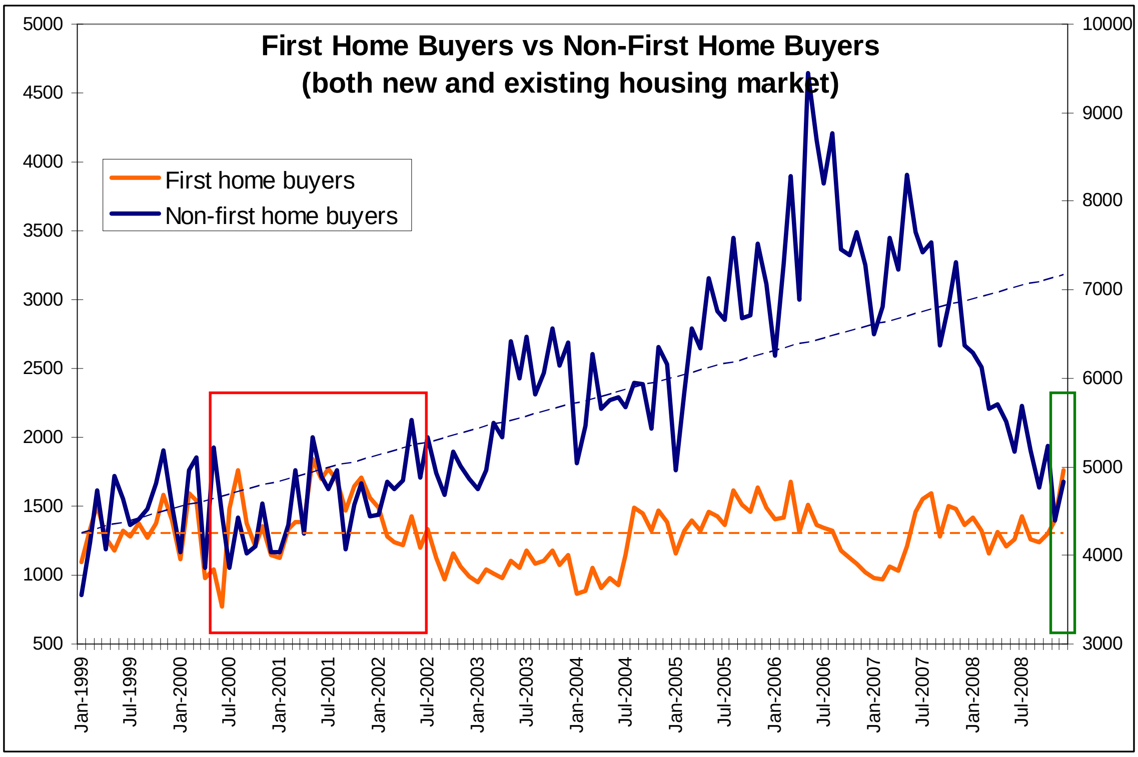
- 9th March 2001 to 31st December 2001 an additional $7,000 for a total of $14,000 (9.5 months)
- 1 January 2002 to 1 July 2002 an additional $3,000 for a total of $10,000 (6 months)

The total stimulus period was 15.5 months.

The current property market crash in Western Australia is significantly deeper than previously experienced and it is expected that normalisation will take considerably longer, especially when job security and consumer confidence is factored into the assessment.

It is recognised that, whilst normalisation of the market was achieved, first home buyer representation diminished after the boost was withdrawn but this was compensated by the reinvigorated market for other buyers who represent the bulk of the market.

Figure 7: Comparison of first home owners and existing buyers 2000 - 2008



Source: WA Department of Treasury and Finance 2009

Latent capital in existing housing must be unlocked if the market is to function effectively.

First home buyers create a stimulus to the existing market triggering housing construction in the middle market which is the major sector in the industry.

The FHOG boost must continue until the non-first home owner market moves back towards long term trend lines.

THE FIRST HOME OWNER GRANT AS AN ECONOMIC STIMULATOR

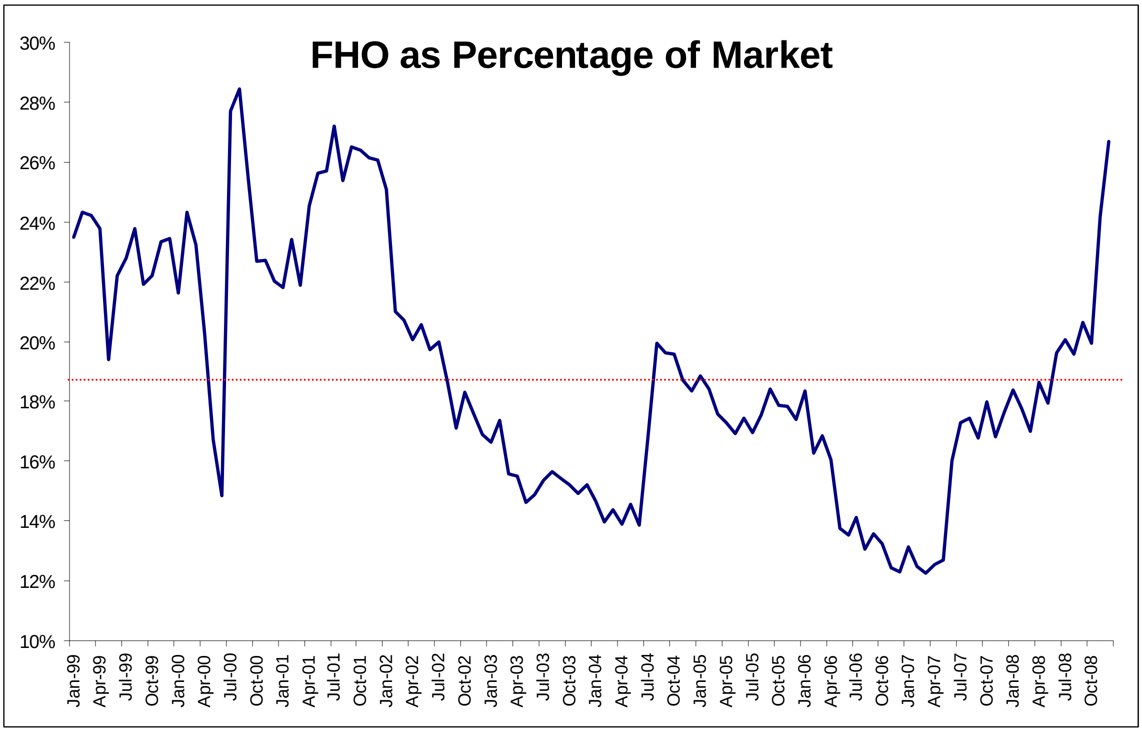
Across both the new and existing housing market the current of first home owner representation is extremely strong at 26.7% (based on ABS housing finance commitments). This is significantly above the 10 year historical average of 18.5% (see Figure 8).

Prior to the introduction of the boost on the 17th October 2008 first home owners represented 20.6% of the market. First home owner loan commitment jumped a massive 42% from September 2008 to December 2008 against a growth in non-first home buyers of just 1.4%. This is also reflected in land sales which increased 65% when comparing the 6 weeks post-boost sales period to the six week period commencing 1 November 2008 (Urban Development Index, December 2008, UDIA WA).

In the December 2008 quarter the 40 top developers in Western Australia recorded 1,058 lot sales (Urban Development Index). Whilst the FHOG data from WA Department of Treasury and Finance is not directly comparable (as the trigger for the grant is based on housing contract not a land contract and includes all new dwellings including apartments, units and flats) it is interesting to note that there were 1076 grants for new housing for the same period.

The substantial growth in first home owner activity is viewed by some commentators as negative and is commonly described as the “bring forward demand” effect. Whilst this view has merit the stimulus effect of the FHOG boost needs to be considered in terms of activity in the broader land and housing market and the multiplier effect that the FHOG boost stimulus has on non-first home buyers. This is clearly demonstrated in the data presented and the significance to the broader economy should not be underestimated.

Figure 8: First home buyers as percentage of the market



Source: WA Department of Treasury and Finance, 2009

Long term average

When the initial FHOG boost was introduced in 2000 it was to compensate for the inevitable down turn that was to occur in the market following the introduction of GST which put an immediate impost of 10% tax on the market.

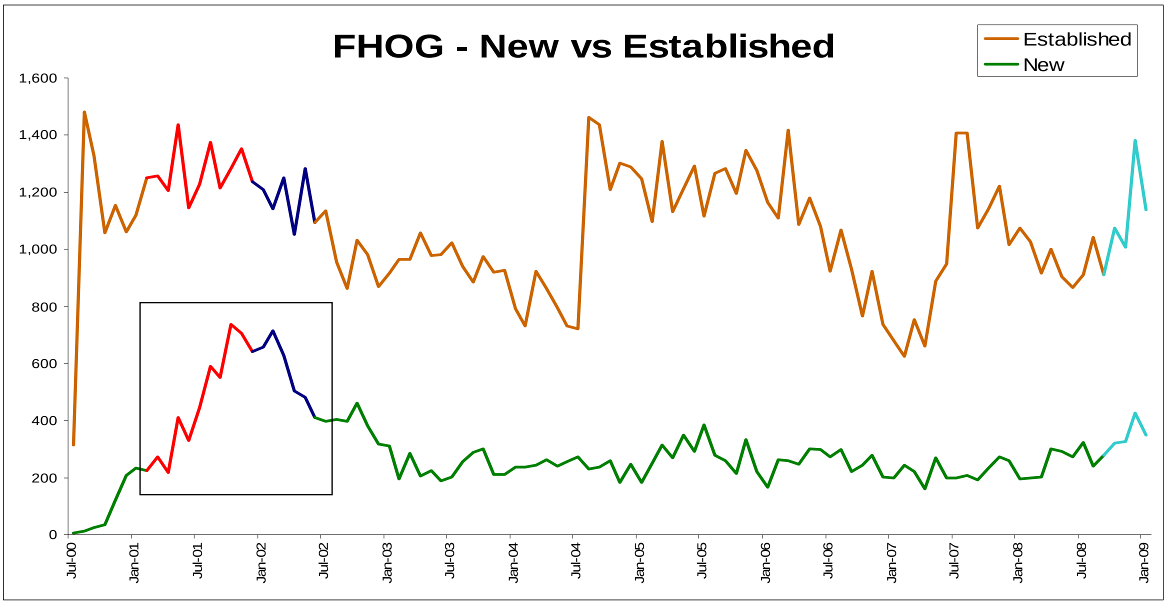
According to the Urban Development Index (UDIA WA), at this time the average price of a block of land was $125,000 (Perth metropolitan area) and $99,000 (average regional areas). The GST payable on these figures was $11,363 and $9,000 respectively which is clearly greater than the $7,000 FHOG. Obviously for a house and land the GST was significantly higher and the market suffered a resultant net down turn.

The Federal Government recognised the problem and in March 2001 increased the grant by $7,000 to a total of $14,000 to which the market reacted positively. The full boost was replaced from the 1st January 2002 by a $3,000 boost to give a total FHOG of $10,000. This provided a soft landing for the industry and consumers when that boost was withdrawn on 1 July 2002.

The FHOG boost experienced a peak increase in sales of 39.6% however there was a major disparity between new and existing dwellings. The peak of the increase of FHOG for existing housing was evidenced just two months after the boost, peaking in May 2001 with an increase of 14.8% in monthly sales. In comparison, sales of new dwellings peaked at a 229% increase in October 2001, seven months after the boost.

The economic stimulus was considerable and unequivocal. Extrapolating February 2001 land sales data in WA for the period of the stimulus there were likely to have been 3,584 new dwellings created for first home buyers. However Treasury data indicate 8,297 new dwellings were created, an incredible 132% additional growth. The stimulus effect on the broader economy was significant with 990 jobs created to service the dwelling growth and 2,437 indirect jobs in Western Australia (Economic Impact Study 2007, UDIA WA). The stimulus period for construction can be seen in Figure 9, highlighted by the black square. The red line on the graph shows the first boost the blue line shows the second, reduced boost. The aqua line shows the current boost.

Figure 9: Impact of FHOG 2000 – 2009



Source: WA Department of Treasury and Finance 2009

The current FHOG boost has been operating less than 5 months and comes off a much lower activity base than the previous boost. It is absolutely essential that the current boost runs for at least 10 months before any reduction is made and it is critically important that any reduction is "staged" in increments of no more than $4,000 to allow for market adjustment as occurred in 2001/02. In Western Australia the appropriate duration is likely to be 12 months will a staged reduction over at least 9 months.

The economic stimulus of the FHOG Boost is considerable.

During the 2001/02 FHOG boost period there were likely to have been 3,584 new dwellings created for first home buyers if there was no stimulus. Treasury data indicates 8,297 new dwellings were created, an incredible 132% additional growth.

The stimulus effect on the broader economy was significant with 990 jobs created/retained to service the dwelling growth and 2,437 indirect jobs in Western Australia.

The current FHOG Boost has not yet had time to be fully effective.

KEY INDICATORS OF LAND AND HOUSING MARKET HEALTH

There would appear to be three major indicators that can be used to assess market health:

1. The first home buyer representation
2. New finance commitments by non-first home buyers
3. Land Supply

First Home Buyer Representation

First home owner purchasing trends are an excellent barometer of the health of the land and housing market. Over a ten year average, first home owners represent 18.5% of the market but this slipped to a low of 12.3% in December 2006 when escalating prices and reduced affordability critically impacted on this section of the market.

When the market is not operating normally first home owner purchasers are disproportionately represented. They currently represent 26.7% of the market, almost reaching the 10 year peak of 28.4% in August 2000 when the introduction of GST was creating significant distortion in the market.

New Finance Commitments by Non-First Home Buyers

From the December quarter 2007, and when compared with the previous quarter, new financing commitments for non-first home owner market fell -3.9% (December 2007), -11.8% (March 2008), -9.4% (June 2008), -4.6% (September 2008) and -7.5% (December 2008) (ABS, 5609.0 - Housing Finance Australia 2009). On the back of those falls land sales crashed in the September quarter to the lowest point since the introduction of GST. Monitoring of non-first home buyer activity will provide early awareness of market instability.

Land Supply

UDIA monitors land supply through the Urban Development Index which is a quarterly survey of developers. Land supply is indexed to the land on the market as of March 2000. When the affordability crisis was triggered in June 2006 land supply fell in four successive quarters from an index of 62.2% in June 2005 to 26.7%(Sept 05), 20.7% (Dec 05), 17.6 (March 06) and finally to 9% in June 2006. Land supply must be monitored to avert shortages that can impact on the market.

Key market health indicators monitored by UDIA are:

- First home buyer representation of less than 18% or above 20% (without stimulus)
- A fall in new finance commitments by non-first home buyers of greater than 4% over 2 quarters.
- Land supply with a UDI of 40%.

CONCLUSIONS

Whilst interventionist economic strategies are controversial, the land and housing markets must remain robust if broader economic health is to be achieved. Not only does this sector provide a major multiplier effect it also reflects consumer confidence at the highest level.

The current boost to the First Home Owner Grant has not yet realised its full economic impact and it is essential for the health of the land and housing market and the broader economy that it is continued in the immediate term. Any reduction of the boost must be staged to minimise the negative impact this may have on consumer confidence and the market in general.

The minimum operational effectiveness of the grant, based on the previous experience, is nine months followed by a graduated reduction of at least six months. Given the current economic drivers the effective time lines are expected to be at least twelve months and a staged reduction of at least nine months.

The activity of first home buyers in the market is to be encouraged through continuing the boost to FHOG.

This encourages first home owners to purchase new product which directly stimulates construction of housing.

The FHOG Boost also encourages first home owners to purchase existing properties freeing equity for construction by non-first home buyers. The constriction to capital that is occurring due to the current global economic crisis access makes access to the latent capital in existing dwellings crucial in the current market to stimulate activity.

Analysis of the boost to the FHOG in 2001-02 demonstrated that it helped to stimulate the market and aid normalisation to long term trend lines.

UDIA recommends the boost be retained to ensure the health of the broader WA economy and any reduction only occur after consideration of the key indicators and be graduated to allow for market adjustment.

e udia@udiawa.com.au
t 08 9321 1101
f 08 9321 1102
w www.udiawa.com.au

Urban Development Institute of Australia
(Western Australia)
Level 5 150 St Georges Terrace
Perth WA 6000