

# The First Home Buyer Grant and house prices in Australia

*David Blight, Michael Field and Eider Henriquez*

## Abstract

Australia's First Home Buyer Grants (FHBG) was designed to assist first home buyers into the market through a range of measures, grants and assistance packages. From the year 2000 there has been a strong increase in house price resulting in house prices nearly doubling between 2000 and 2008, well above the CPI or normal investment growth rate. This paper sets out that the FHBG was a main driver of these increases and attempts to measure by how much. We have considered if the FHBG is a direct driver of increasing median house prices and an indirect driver through increased borrowing ability. Due to the combination of the FHBG, the ability to borrow more, and an inelastic supply, we have concluded that the FHBG did increase the median price of houses in Australian by approximately \$57,321.

## 1. Introduction

In July 2000 to offset the cost of the GST on houses after the introduction of Australia's New Tax System (ANTS), the Commonwealth Government through the State Governments introduced a First Home Buyers Grant (FHBG) of \$7,000 in the form of a cash grant. This grant was given to those entering the housing market for the first time and was not means or income tested. The FHBG was designed to assist the entry of First Home Buyers (FHB) into the housing market, counter the effects of the GST and to maintain activity in the sector. This grant did not discriminate between new nor existing houses, suggesting it was aimed more at stabilizing the housing market than driving new construction.

Between March and December 2001, an additional grant of \$7,000 was introduced for new home sales. The additional grant was reduced to \$3,000 from December 2001 to June 2002 and then the total grant reduced to the original \$7,000.

During the Global Financial Crisis and part of the Rudd Governments stimulus package, the FHBG was boosted by \$7,000 from July 2008 to \$14,000 for an existing home and increased to \$21,000 for a new home. This new boost remained in place until the end of 2009 when the FHBG and boost was reduced to \$10,500 dollars for an existing home and \$14,000 for a new home. These additional boosts in FHBGs ended in January 2010 and remains at \$7,000 until 30 June 2102.

In addition to these FHBGs there was a plethora of state grants, concessions on state stamp duties for new houses, additional grants for regional home construction and reduction of some statutory charges on construction and development were given to new home buyers.

## 2. Hypothesis

There has been much debate in the industry, media and by academics on the effectiveness of the FHBGs (The Age, 2010) and if they have in fact assisted first home buyers to buy into the housing market or has it only increased the costs of housing by the value of the grant or greater.

The housing industry defends the grant (HIA, 2010) “that without these packages not only would families not be able to afford housing that the supply of housing would reduce, restricting supply and in effect pushing housing out of reach of many Australians”. The Real Estate Institute of Australia suggests there is a chronic undersupply of housing and these grants stimulate demand to increase supply. (REIA, 2010). In addition, the loss of jobs in the sector would have a long term effect on the costs and supply of housing from a reduced labour force with the loss of industry skills.

By the same token, academics such as Professor Steven Keen, simply suggest that the FHBGs are simply “First Vendors Bonus Schemes” (FVBS), and have only added to demand side in a market that has an effectively inelastic supply given it takes up to 12 months to have a new home on the market and therefore have driven prices up.

The interest therefore is, if the Governments policy to assist FHB but has the policy only increased the price of houses?

Our hypothesis is that these grants did directly and indirectly push up the Australian median house price.

The alternate hypothesis is that the FHBG did not directly or indirectly effect house prices. This hypothesis will hold if there is no correlation to the FHBG to house prices and other factors are the main drivers for increased house prices such as increased migration and economic growth.

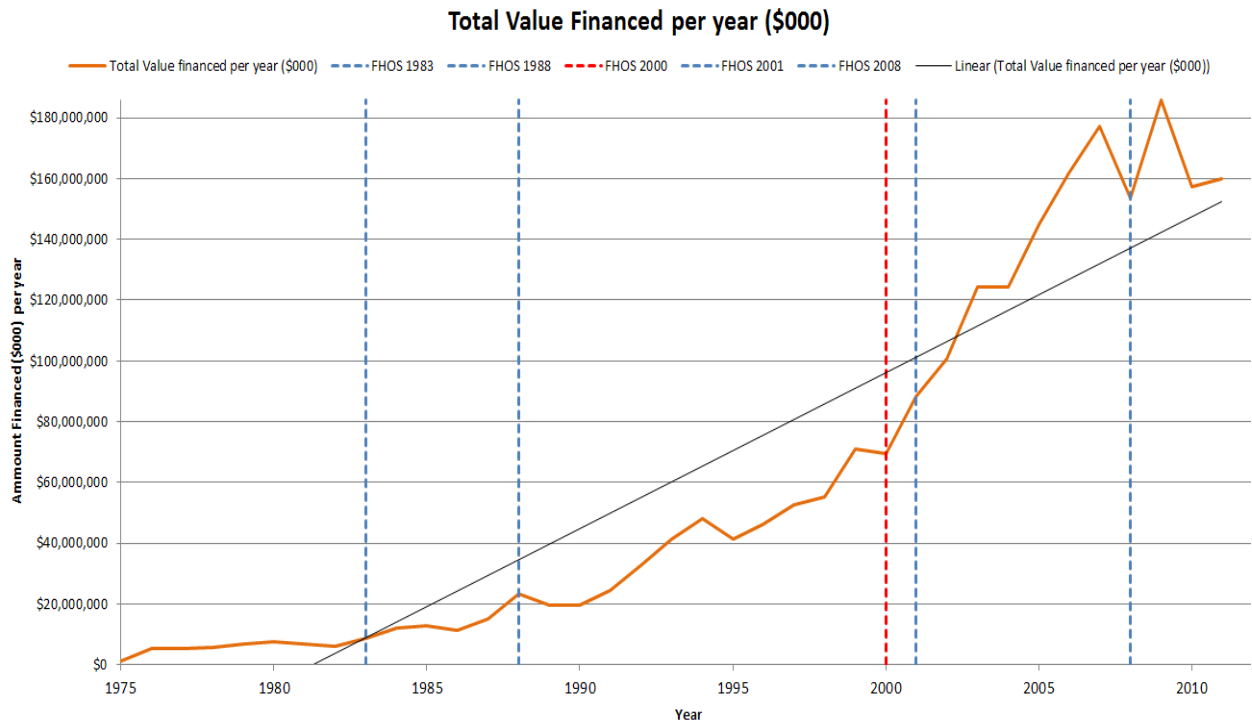
### 3. Growth in finance

During the period from 1980 onwards, there was much deregulation in the finance sector and growth in financial innovation developed quickly in the period from 2000 onwards. Interest rates were low in terms of the long term average (ABS, 2010) and banks were keen to lend for housing up until the GFC (Keen, 2010). There is anecdotal evidence that this borrowing increased demand in housing as expectations grew for high capital gains, and were in many cases delivered, as suggested by Keen. However, for that to occur, borrowers must have increased deposits to be able to purchase.

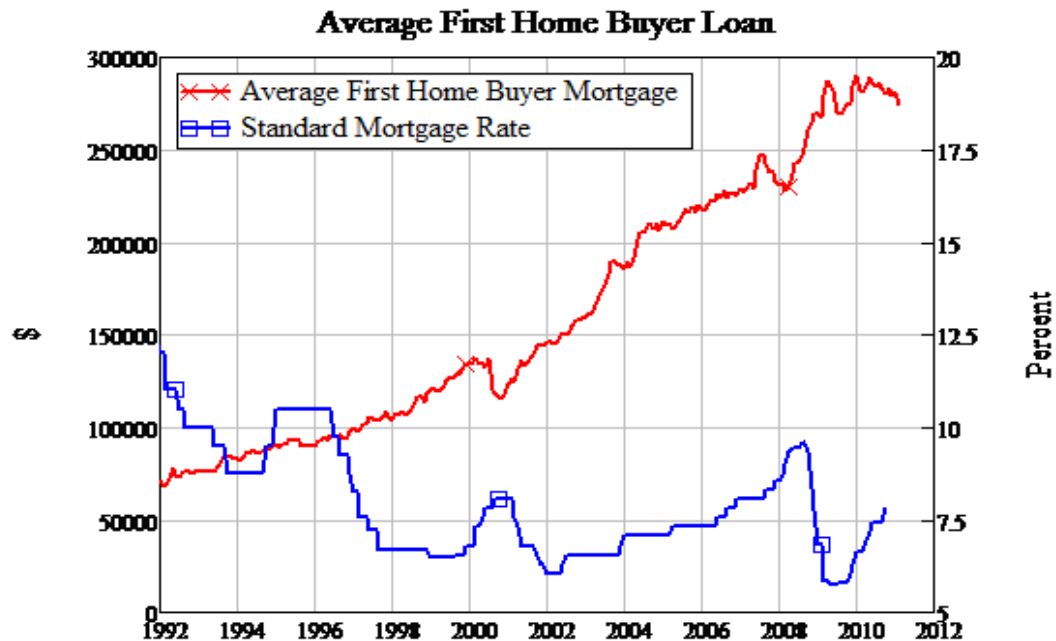
In Figure 1 it can be seen there is an injection of additional finance after each FHBG is announced and continues to sustain that growth in finance. Even though there seems to be a delay in amounts financed from the timing of the grants, this can be attributed the time in building a home, thus the timing of the required finance. This assumption that the FHBG simulated additional finance is supported again in Figure 2, below, in 2001 and in 2008, showing increasing first home owner loan values.

To maintain growth in average mortgages and the price of median house prices, there must be an additional ability to borrow in order to afford increasing house prices. Considering all first home buyers will use the grant as deposit, and based on lending policies where banks were financing 90% of the house price in debt, every \$7,000 grant gave the purchaser a \$63,000 in additional loan funds, as long as they could demonstrate their capacity to meet repayments. Many of those loans were interest only and required no repayment of any principle debt, thereby increasing the supply of finance that was otherwise previously not available. In addition, during this period, interest rates were at historically low rates (RBA, 2010) and wages growth maintained an average of 3 – 4 % increase (ABS, 2010), therefore allowing borrowers to effectively borrow more money as the servicing costs remain the same. These two factors combined to effect the growth of the loans taken out by FHBs during this time.

**Figure 1: Amount financed and the corresponding FHBGs.**



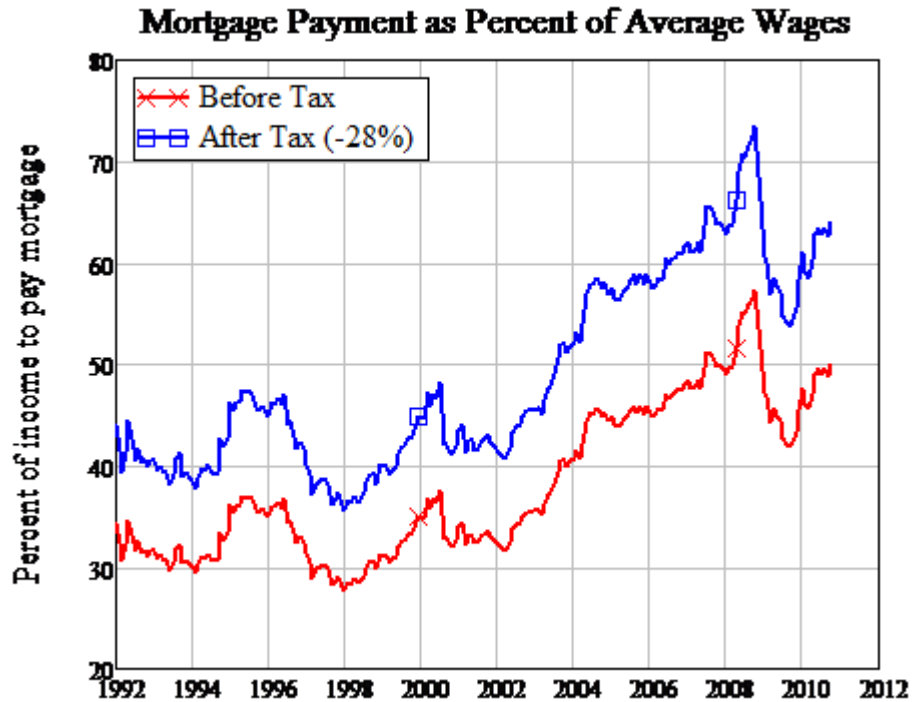
(Source : [www.debtdeflation.com/blogs](http://www.debtdeflation.com/blogs))

*Figure 2: Average First Home Buyer Loan*

Source: ABS 560909a, Column D; RBA Table F05 Column K.

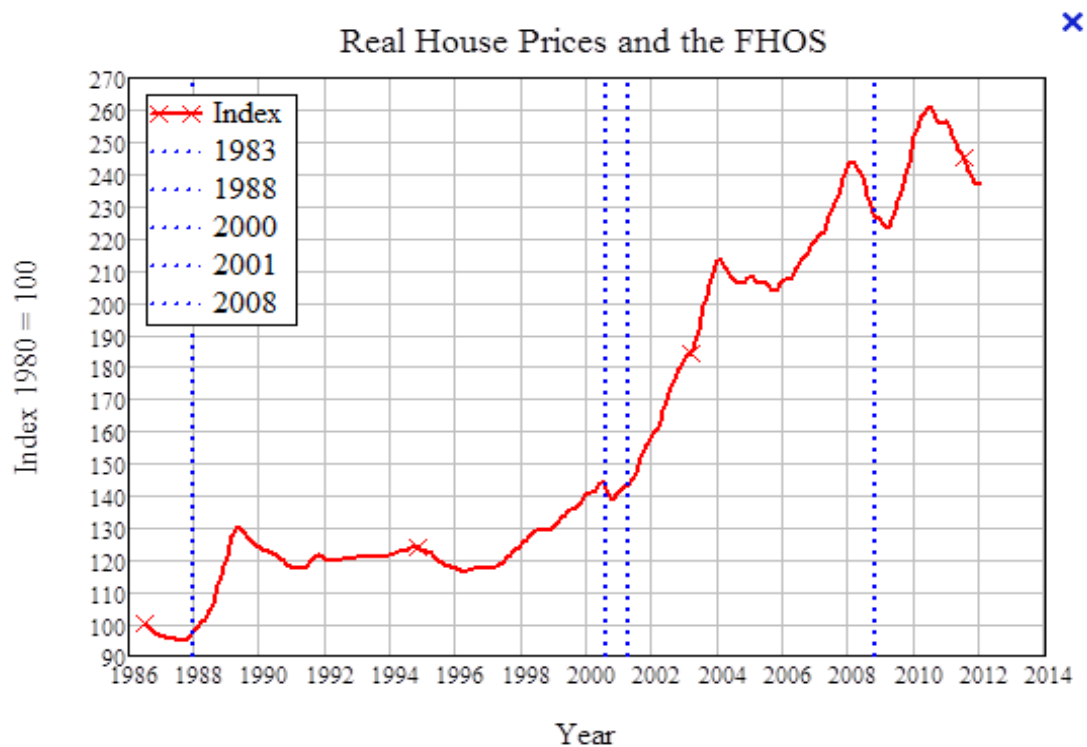
Figure 3 below shows that the percentage of income required to pay a mortgage increased during this period, suggesting that borrowers increased the amount borrowed throughout the FHBG period. This increase in servicing of the loans correlates with lower interest rates but also the issuing of FHBGs, the associated boost to those FHBGS, and house prices. Drops in the years 2000 and 2009 can be attributed to the incoming GST and in 2009 the effects of the GFC.

*Figure 3: Mortgage payments as a percentage of average wages*



(Source : [www.debtdeflation.com/blogs](http://www.debtdeflation.com/blogs))

Figure 4 shows the link between house price index pricing at the time of the issuing of the FHBGs. Each time a FHBG is offered, there is a corresponding increase in the real house price index over the following period.

*Figure 4: Real House Price Index and FHBG*

(Source : [www.debtdeflation.com/blogs](http://www.debtdeflation.com/blogs))

#### 4. Supply and demand of housing

Supply of housing is effectively inelastic in the short and medium term (Dungey et al, 2011). The HIA stated in 2009 that loans for new houses increased by 66% in the period March to December 2001 (HIA, 2009) and the permits from local government for new home



construction grew at a rate of 20%. The rate of growth in FHBG loans ratio to new permits to build to the growth in loan applications clearly shows an increase in the demand side with a lower corresponding increase in supply in new house construction. This excess demand for housing went into existing houses, as first home buyers needed to purchase within a set time to qualify for the grant, effectively pushing up the housing price.

Adding additional demand in the form of finance to buyers as noted above only increases the first home buyer's ability to buy therefore increasing pressure on prices for existing houses.

## 5. How much did it affect house prices?

OLS Regression was used to investigate the relationship between median house prices (dependant variable) and the FHBG. Median house price data from September 1996 to December 2011 was used together with a dummy variable for periods when the FHBG was operating.

From our previous figures and analysis, there is evidence that suggest the FHBG did affect the price of housing in Australia. What is harder to conclude is by how much. Regression analysis suggests that in periods when a grant was in operation, the price of a house increased by \$57,321, as shown in Table 1 below.

*Table 1: Single regression FHBG On housing prices*

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	ower 95.0%	pper 95.0%
Intercept	-1149226.877	575964.2918	-1.995309246	0.0505560	-2301326.995	2873.242	-2301327	2873.242
FHBG	57321.4597	2756.423064	20.79559573	0.0000000	51807.79265	62835.13	51807.79	62835.13

## 6. Conclusion: is it effective government policy?

We conclude from the above analysis that the FHBG has a direct and indirect effect on median house prices. The FHBG has, on each occurrence or boost, resulted in an increase in the median house price over the period from 2000 to 2010, and we conclude that during this period the FHBG has increased the house price by approximately \$57,321. This conclusion is reached through the following points:

- There is a positive correlation between the granting of the FHBG and the increase in house prices.
- There is a positive correlation between the FHBG and the growth in finance for FHB and the amount financed. The FHBG in this instance increased finance into the housing industry in both terms of number of loans and amount financed by FHB.
- The supply of new and existing housing is effectively inelastic. Therefore demand increases would increase price by a larger portion.

The current median price for housing in Australia according to the HIA is \$360,000. This research suggests that the FHBG has increased house prices by 18.8%.

It could be argued that the FHBG has been effective in driving home sales and construction to meet that demand, however if the success or effectiveness of the policy is to assist new home buyers into the market this policy may have resulted in the opposite effect. Many buyers are now not able to afford to buy as the \$7,000 grant has effectively increased the house price by \$57,000 and left many out of the market. There are plenty of commentators in the market, including Professor Steven Keen who suggests this has created a bubble in the housing market and will result in negative equity when the FHBG and associated schemes come to an end.

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