



Inquiry into Microeconomic Reform in Western Australia

Keystart

ISSUE

Keystart is a Western Australian Government program designed to help Western Australians buy a home when they are unable to secure financing from the private sector.

Home buyers are provided with low deposit loans that allow them to purchase homes they would ordinarily not be able to. In doing so, Keystart attempts to maximise the benefits to society associated with home ownership.

Since it commenced in 1989, Keystart has issued loans to more than 80,000 Western Australians.

As of October 2013, Keystart's loan book consisted of over 16,000 loans, with a total value of almost \$3.5 billion.

The ERA has two main concerns about Keystart:

1. it is not achieving its intended objective of increasing the rate of home ownership in Western Australia; and
2. it is potentially exposing the Western Australian Government, and ultimately taxpayers, to considerable financial risk.

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WHAT WE RECOMMENDED

Keystart maintains that the risk Government is exposed to by its lending activities is compensated for in the interest rate that it charges.

The ERA considers that the best way to verify the claims of Keystart is to attempt to sell Keystart to the private sector. If Keystart is indeed earning an appropriate commercial return then there is no compelling reason that the private sector would be unwilling to purchase the company.

Consequently, we recommended that the Government explore options for divesting Keystart to the private sector.

WHY WE RECOMMENDED THIS

KEYSTART'S MINIMAL EFFECT ON RATES OF HOME OWNERSHIP

One of the aims of Keystart is to transition people into home ownership, freeing up housing options for others.

This aim is based upon the concept of a housing continuum, which assumes that relationships exist between the various forms of housing available to households.

Changes that effect the ability of a household to access one form of housing (for example, home ownership) can have flow on effects that make it difficult for other households to access other forms of housing (for example, rental accommodation).

ENCOURAGING PROGRESSION ALONG THE HOUSING CONTINUUM

Ideally, households progress upwards along the housing continuum towards outright home ownership.

As a household transitions along the continuum, the improved stability of their housing results in a number of social benefits. For this reason, governments have an interest in progressing households along the housing continuum.

Proponents of Keystart believe that assisting more people into home ownership reduces pressure on the private rental market, and reduces the reliance on government rental subsidies and public housing, thereby freeing up government funds for use elsewhere.

However, the ERA considers that constraints on the supply of housing are likely to limit the ability of demand-side policies (such as Keystart) to assist the broader population along the housing continuum.

If the housing supply is constrained, a policy that facilitates one household making the transition into home-ownership is likely to prevent another household from making the same transition.

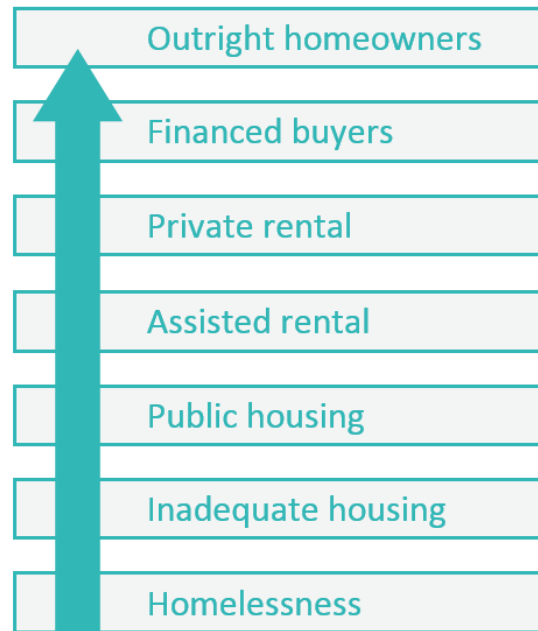
HOUSING SUPPLY IN WESTERN AUSTRALIA

The housing market is slow to respond to increasing demand. The reasons for this include the length and cost of the building approval process, and issues relating to the funding of infrastructure provision. This is seen in the figure to the right, which shows how housing growth has not kept pace with population growth in the State.

If the housing market did respond to increases in demand, then policies such as Keystart that increase the demand for housing would increase rates of home ownership.

However, this does not appear to be the case. Because of supply constraints, any increase in demand creates more competition for housing and simply drives up prices.

The Housing Continuum



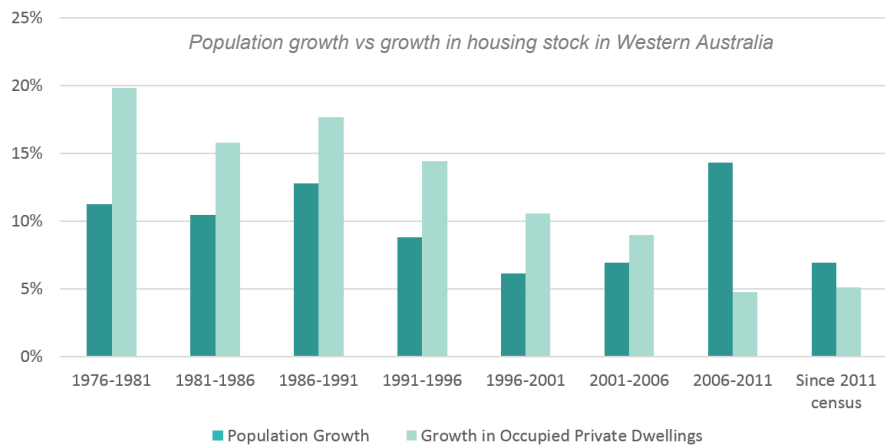
THE RISK TO GOVERNMENT

The ERA is also concerned that Keystart may be exposing the State Government to considerable financial risk.

Keystart clients are inherently riskier than clients serviced by the private sector.

Keystart offers low deposit loans, requiring only a 2 per cent deposit. In contrast, private lenders require a minimum of 5 per cent. Therefore Keystart clients have less equity in their homes.

Compounding this issue, Keystart does not require borrowers to take out lenders mortgage insurance, which would protect the Government in the event of default.



Private lenders manage this risk by requiring low deposit borrowers to pay for lenders mortgage insurance that protects the lender in the event that the borrower defaults.

The risks posed by Keystart's activities are exacerbated by the fact that it effectively increases lending during economic downturns, when economic conditions are poor, and defaults are more likely to occur.

The ERA noted that Keystart clients had considerable trouble meeting their mortgage repayments in the period from 1989 (Keystart's inception) to early 1993, a period that included a recession.

During this time, 214 clients (3.9 per cent) sold their homes for less than the outstanding balance on their mortgages, and a further 958 (16.7 per cent) had interest payments totalling \$7 million written off to prevent default.

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INCREASING RISK OVER TIME

Because Keystart charges a higher interest rate, its clients tend to move on to private sector lenders once they have a proven credit history.

This means that only the higher risk clients remain with Keystart and the quality of Keystart's loan book continues to deteriorate.

This fact sheet is part of a series on the ERA's 2014 Inquiry into Microeconomic Reform in Western Australia

The full report and additional fact sheets are available at erawa.com.au

CONTACT US

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