TITLE OF PAPER:
The OTHER Sub-prime Lending Crisis: the NSW Homefund Lending Scheme
By Shauna Ferris (Macquarie University)

PURPOSE OF THE PAPER: At present the global economy is suffering through the effects of ill-conceived lending to sub-prime borrowers. Many of the features of this disaster are remarkably similar to the problems experienced by the NSW Homefund Scheme, which was set up in the late 1980s to lend to low income people who would normally be ineligible for a home loan. This scheme was the first securitisation program for mortgage-backed securities in Australia. This paper describes the problems which arose in Homefund, which ended in significant losses.

Synopsis: The objectives for Homefund were admirable: the NSW government wanted to give low income people (who were unable to obtain funding from bank lenders) the opportunity to buy their own homes. However, the results were disastrous: for the borrowers; for the NSW Government; for the investors who provided the funds via mortgage-backed securities; and for the wider community which suffered from the economic fallout from the failure of this scheme. [However, the intermediaries who set up the securitisation program did very well, e.g. Salomon Brothers.]

Homefund may be used as a case study on How-Not-to-do-Risk-Management. The scheme suffered from poor product design, ineffective underwriting, mis-marketing (agency risk), contractual breaches, questionable accounting practices, poor financial and economic modelling, overly-optimistic credit risk assessment, inadequate capital management, politically motivated decision-making, conflicts of interest, inter-agency bickering, poor corporate governance, and simple fraud. Twenty years later, we can see that the same mistakes have been made, on a larger scale, in the US subprime debt markets.