

The Treasury

2015 Loan-to-Value Ratios/Macroprudential Policy Information Release

Release Document

June 2015

www.treasury.govt.nz/publications/informationreleases/financialsector/lvr

www.rbnz.govt.nz/research_and_publications/official_information/lvr-restrictions

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Briefing for Gabs Makhoul

Finance and Expenditure Select Committee June 2015

RBNZ Loan to Value Restrictions (LVRs)

Key messages

- **RBNZ are launching an industry consultation on changes to the existing LVR restrictions this week. The proposals were announced in the May Financial Stability Report, and are that:**
 - **Restrict loans to investors in residential property in Auckland for LVRs of over 70% to virtually zero (a speed limit of 2%)**
 - **Maintain restrictions on Auckland owner occupier loans for LVRs of over 80% within a speed limit of 10% of new commitments**
 - **Relaxation of the speed limit to 15% (from 10%) on non-Auckland owner loans for LVRs of over 80%**
- The RBNZ cite that the previous LVR policy imposed in October 2013 helped to slow the rate of house price growth through 2014, and has improved the resilience of the banking system by reducing the proportion of high LVR loans on the balance sheet.
- The RBNZ's rationale for these changes is based on the resurgence in house price pressures in the Auckland market since October 2014, and the increase in the investor share of the Auckland market combined with the evidence that suggests investor loans are more likely to default in a downturn.

Financial Stability Report

- The latest Financial Stability Report (FSR) was published on 13 May 2015. Overall, the RBNZ find that financial stability is relatively robust, with the banking system operating effectively and supporting growth. Nevertheless, the RBNZ judge that financial risks have increased since the November 2014 FSR, with the key risks to resilience identified as:
 - The probability of a sharp correction in house prices;
 - The elevated debt levels of the dairy sector and decline in rural incomes
 - The extremely benign conditions in global financial markets that may not be sustained

Key policy issues

Policy proposal characteristics

- Proposed changes to the LVR restrictions are to be introduced on 1 October 2015. A banking sector consultation will be announced in early June.
- Restrictions are still a speed limit and not an outright ban, requiring banks to continue restricting high LVR lending to no more than 10% of new mortgage lending for owner occupiers. Investors are hit harder, with a proposed 2% speed limit, effectively a ban but with a margin for error for banks.

- **Auckland.** The Auckland housing market is rebounding strongly, with house prices in March 16.9% higher than a year earlier (compared with 3.2% for the rest of the country). The RBNZ consider these valuations stretched and therefore at risk of a potentially substantial downward correction.
- **Investors.** The RBNZ note that the investor share of transactions in Auckland increased from around 36 percent pre-October 2013, to over 40 percent.
 - Around 17% of all mortgage lending in Auckland is to investors with LVRs of over 70 percent, and investor lending at these higher LVRs represents a greater default risk. The RBNZ estimates that this lending finances around 13 percent of Auckland property transactions
 - RBNZ will also use the new investor asset class to increase the capital banks hold for these loans, which will attract a higher capital weighting
- The current exemptions will still apply for Welcome Home Loans and bridging finance. The RBNZ introduced an additional exemption for new residential construction to aid growth in the supply of housing on 28 March 2014.

Policy impacts from existing macroprudential settings and current market dynamics

- National house price inflation slowed from 9.3 percent to 4.9 percent between September 2013 and September 2014. In the same period, Auckland house price inflation slowed from 16.5 percent to 8.5 percent. This agreed with the RBNZ estimates of the likely impact the policy would have.
- However, Auckland house prices increased by 12 percent in the four months to May, driven by record net immigration and a reduction in fixed mortgage rates.
- The RBNZ point to elevated levels of gross credit formation as a stability concern, due to new lending driving asset market movements and the increased likelihood of default of new loans.

Estimated policy impacts of policy proposals (from consultation document, not yet released)

- RBNZ estimates that the tighter LVR restrictions on Auckland investors will **reduce house price growth by 2-4 percentage points** in the region over the first year, and Auckland housing market transaction by around 7 percent.
- RBNZ expect a marginal reduction in owner occupier activity in Auckland, and a reduction in high-LVR lending to owner occupiers by around 2 percentage points.
- Outside of Auckland, the RBNZ expects that the LVR relaxation could **increase house price growth by around 1 percent**, and an additional stimulation if Auckland investors look outside of the region.
- On credit, the RBNZ expects a 1 percent fall in net credit growth, given the offsetting effects inside and outside of Auckland. By reducing the resilience of household balance sheets, the RBNZ suggest the policy would minimise damage to the wider macroeconomy should house prices fall.
- The RBNZ estimate that the unintended consequences on rental property supply, new build, and market distortion will be limited.
- The relaxation of the speed limit outside of Auckland is designed to allow the market impact to be assessed, and further easing is envisaged if house price pressures remain subdued.

Governance and accountability arrangements

- The RBNZ already had powers to use the LVR tools under the existing RBNZ Act, but an MOU has been signed by the Minister of Finance to improve public transparency.
- The Reserve Bank continues to be accountable to the Board, Minister and Parliament for its advice and actions, under the normal conventions outlined in the Reserve Bank Act.
- The MoU does recognise that that the RBNZ's macro-prudential policy framework will evolve over time, and that a full review of the macro-prudential framework shall be conducted after five years.
- The RBNZ is also required to review and assess its macro-prudential policy decisions and to report the results of that assessment in its Financial Stability Report.

Financial stability concerns from Auckland house prices

Treasury supports the RBNZ's view that recent developments in the Auckland housing market could potentially pose a threat to financial stability over the medium term and although there may not be signs that a nasty correction may be imminent, there is cause for vigilance. Given the consequences of doing too little too late, we support the case for intervention at this stage on financial stability grounds on the basis of the available data.

However, Treasury has been engaging with the RBNZ to suggest that although we accept that house price changes can have macroeconomic implications, the RBNZ's mandate is focused on promoting financial stability, and therefore the policy proposals should be reframed to focus more clearly on reducing systemic risk rather than asset prices.

Treasury is concerned that the original LVR policy may have supported the increase in investor activity. The RBNZ note that some of the increase in the investor share is due to falling participation by first home buyers following the introduction of LVR restrictions, and note that the level of sales to investors is around 12 percent higher now than immediately prior to the introduction of LVR speed limits and has been strong recently. We will be working with the RBNZ to unpick these concerns.

The RBNZ do not examine the impact on first time buyers, apart from noting that banks are known to preference lending to owner occupiers, especially first home buyers, in allocating high-LVR lending within the existing national speed limit.

Charts from RBNZ FSR May 2015

Table 2.2
LVR policy indicators

Indicator	September 2013	September 2014	Latest
House price inflation - national (annual 3-month moving average)	9.4	5.0	7.7
House price inflation - Auckland (annual 3-month moving average)	16.4	8.6	16.9
Housing credit growth (annual growth, %)	5.8	4.7	4.8
New lending with LVR > 80% (% of mortgage commitments)	24.4	7.3	6.1
Mortgage debt with LVR > 80% (% of mortgage debt)	20.5	15.8	15.1

Source: Registered banks' *Disclosure Statements*, RBNZ *New Residential Mortgage Commitments Survey*, RBNZ SSR, REINZ.

