



TE TAI ŌHANGA
THE TREASURY

Reference: 20210522

2 December 2021



Dear

Thank you for your Official Information Act request, received on 4 November 2021. You requested the following documents:

- *Aide Memoire T2021/2222: Further information on LVR consultation paper*
- *Joint Report by the Treasury and Reserve Bank of New Zealand T2021/1506: Amending the MOU on macroprudential policy.*

Information being released

Please find enclosed the following document:

Item	Date	Document Description	Decision
1.	1/09/21	Aide memoire T2021/2222: Further information on the Reserve Bank's Loan-to-Value Ratio (LVR) consultation paper	Release in part

I have decided to release the document listed above, subject to information being withheld under the following section of the Official Information Act:

- direct dial phone numbers of officials, under section 9(2)(k) – to prevent the disclosure of information for improper gain or improper advantage.

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<https://treasury.govt.nz>

Information publicly available

The second document you have requested is available on the Treasury's website:

Item	Date	Document Description	Website Address
2.	6/07/21	Joint report T2021/1506: Amending the MOU on macroprudential policy	https://www.treasury.govt.nz/sites/default/files/2021-11/oia-20210364.pdf

Accordingly, I have refused your request for this document under section 18(d) of the Official Information Act as the information requested is publicly available.

Some relevant information has been redacted from the documents listed in the above table and we believe this information should continue to be withheld under the Official Information Act, on the grounds described in the document.

In making my decision, I have considered the public interest considerations in section 9(1) of the Official Information Act.

Please note that this letter (with your personal details removed) and enclosed documents may be published on the Treasury's website.

This reply addresses the information you requested. You have the right to ask the Ombudsman to investigate and review my decision.

Yours sincerely

Mary Llewellyn-Fowler
Team Leader, Financial Markets

Reference: T2021/2222 SH-11-4-3-7

Date: 1 September 2021

To: Minister of Finance (Hon Grant Robertson)

Deadline: None
(if any)

Further information on the Reserve Bank's Loan-to-Value Ratio (LVR) consultation paper

Purpose

This aide memoire provides further information on the Reserve Bank's LVR proposal, in response to your feedback on the Reserve Bank's draft consultation paper seeking further consideration of the impact on section 68B, particularly on affordability for first-home buyers, and analysis of the high-LVR lending data.

Background

This aide memoire has been prepared by the Treasury with input from the Reserve Bank. The Reserve Bank will also be providing more information in the final consultation paper on how the LVR proposal may impact on first-home buyers, having regard to the section 68B direction.

High-DTI vs High-LVR lending

In May 2021, the Reserve Bank advised you that adding a debt serviceability restriction would be preferable to further tightening LVR limits. The Reserve Bank's analysis then indicated that investors as a group borrow at the highest debt-to-income ratio (DTI) multiples on average, followed by existing owner-occupiers, while first-home buyers borrow at the lowest DTIs.

Both high-DTI and high-LVR lending are a source of financial stability risk and the combination of the two is particularly risky. The Reserve Bank's concerns over high-DTI lending have not changed since May, therefore it is planning to consult in October on debt serviceability restrictions, but notes that DTI caps will take some time to implement. DTI tools address a different dimension of housing risk (likelihood of default) to LVR restrictions (size of losses in the event of default).

In the meantime, the Reserve Bank is becoming more concerned about the increasing levels of high-LVR lending to owner-occupiers in recent months, particularly first-home buyers, alongside the rising risks of a house price correction. The work that the Reserve Bank is doing on sustainable house prices is now indicating that house prices are above their sustainable levels.

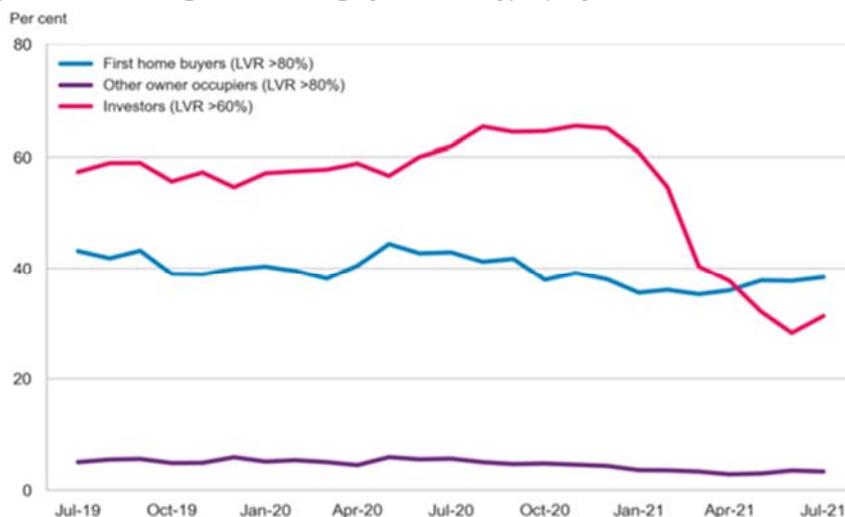
Figure 1 Share of new mortgage lending at high-LVR and high-DTI, by buyer type



Share of high-LVR lending to first-home buyers

The share of high-LVR lending as a proportion of all lending to first-home buyers has decreased since the reintroduction of LVR restrictions in May 2020, but is starting to trend up again since March 2021 (Figure 2). This is consistent with the Reserve Bank’s analysis on the risks of high-LVR lending noted above.

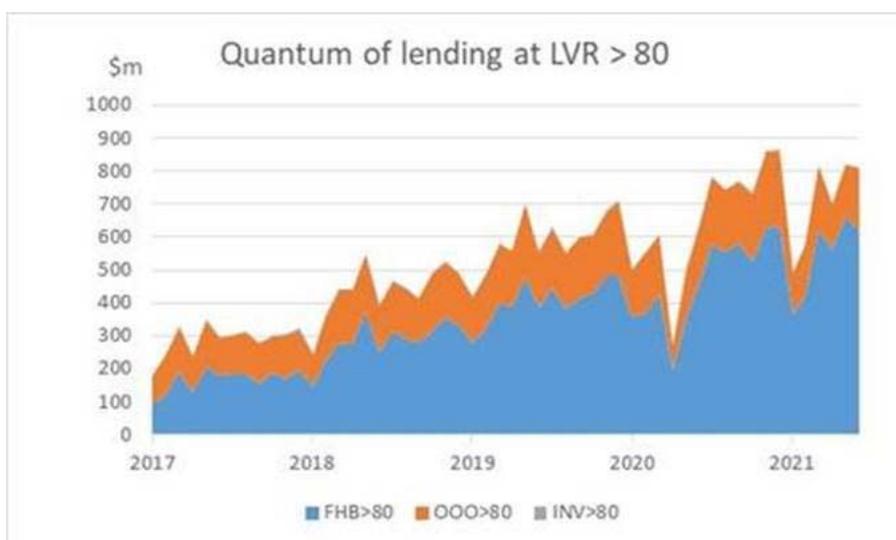
Figure 2 Share of high-LVR lending by borrower type (July 2021 LVR data – before exemptions)



The share of lending trends will depend on which comparison periods and groups we are looking at, but the Reserve Bank notes it is more important to look at the quantity (\$) of high-LVR lending, which it notes is increasing due to high house prices and sales activity, thereby raising financial stability concerns.

The Reserve Bank will also add the following chart to the LVR consultation paper (Figure 3), which demonstrates the quantity of high-LVR lending (i.e. the loan is over 80% of the value of the property) to different groups of borrowers (first-home buyers, owner-occupiers and investors).

Figure 3 Quantity of high-LVR lending (\$m)



Potential impacts of LVR proposal on sustainable house prices and first-home buyers

The Treasury considers that the current proposals may have much smaller impact on house prices, compared to the previous LVR changes in March 2021 (i.e. reinstating LVR restrictions, which was estimated to slow annual house price inflation by 1-2%, against the counterfactual), though we have not seen updated modelling on this.

The Reserve Bank has also noted in the consultation paper that the full impact of recent tax policy changes may not yet have flowed through. The Treasury's assessment is that the tax changes will only lead to a small reduction in house price inflation, due to the in-principle decision to allow a 20-year new-build exemption to the interest deductibility rule change. This is a change from the Treasury's previous assessment, which assumed a 10-year new-build exemption.

The LVR proposal could reduce the scope for first-home buyers with low deposits to enter the market (as most of the speed limit is currently allocated to first-home buyers), but as the Reserve Bank notes, there are some mitigations to support affordability for first-home buyers (i.e. new build exemptions from the LVR restrictions and Kāinga Ora First Home Loans). If the tighter LVR restrictions succeed in dampening house price inflation, this would also benefit those first home buyers who do enter the market in the

future. The Reserve Bank also notes that first home buyers are at greatest risk of entering negative equity if house prices fall from their current levels.

The Reserve Bank has also now done some initial estimates of how many borrowers could be impacted by the restrictions based on July 2021 figures (Figure 4). Figure 4 indicates that currently 1,028 first-home buyers do not meet the deposit requirements under current LVR settings, but could get a loan within the 20% speed limit allocation (based on July 2021 data). Under Option 1 (the preferred option), half of those 1,028 buyers (i.e. 514 buyers) could be prevented from obtaining a loan for an equivalent property because they are outside the new 10% speed limit. Under Option 2 (not preferred), there could be 1,161 first-home buyers (as well as a significant number of other owner-occupiers) prevented from obtaining a loan because they are unable to meet the 75% LVR and also don't fall within the 20% speed limit.

Figure 4: Estimated impacts of LVR restrictions

Estimated number of FHBs impacted by LVR restrictions			
	Current (20/80)	Option 1 (10/80)	Option 2 (20/75)
Not restricted	1897	1897	736
Speed limit	1028	514	1028
Affected by restrictions	0	514	1161

Estimated number of other OO impacted by LVR restrictions			
	Current (20/80)	Option 1 (10/80)	Option 2 (20/75)
Not restricted	19821	19821	17054
Speed limit	354	177	354
Affected by restrictions	0	177	2767

Next steps

The Reserve Bank intends to publish the LVR consultation paper on 3 September, for feedback by 17 September in anticipation of implementation from 1 October 2021. The Reserve Bank does not currently anticipate delays to the timeline due to the current COVID-19 outbreak, but will update you and the Treasury if this changes. The Reserve Bank will also inform you and the Treasury before it makes final decisions (expected in late September), in line with the MOU on macroprudential policy.

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