



Date 19 June 2013

To: Minister of Finance

## Work Programme on Loan to Value Restrictions

1. The housing market in Auckland and Canterbury continues to strengthen, based on a tight supply situation and easy credit conditions resulting from low mortgage interest rates and high loan to value ratio (LVR) lending. As you are aware, we are giving serious consideration to the use of macro-prudential policy – specifically LVR speed limits – to help contain housing demand relative to the limited supply and manage the growing risk to financial stability. We are concerned that, unabated, the housing market could also become an issue for price stability. In the last housing cycle, the OCR was raised by 325bp and we are keen to avoid the need for a similar response given the likely adverse exchange rate implications.

We consider that LVR restrictions are the only macro-prudential policy tool that could have a material effect on housing market conditions and the financial risks they pose in the current environment. Capital or liquidity overlays would make the banking system more resilient but would be unlikely to have any significant moderating effect on the housing cycle. Even with LVR restrictions, the impact would be uncertain and diluted by efforts on the part of affected borrowers to obtain finance from other sources, such as from family members or non-bank lenders.

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2. The Reserve Bank is currently consulting with the banks on a draft chapter to our Banking Supervision Handbook, which sets out a template for the conditions of registration that would be used to implement any LVR restrictions. The consultation closes on 3 July and we would expect to have an assessment and summary of submissions prepared by mid-July. On that basis, a decision to implement LVR restrictions could potentially be taken, at the earliest, in late July or early August.
3. In terms of the likely form of an LVR speed limit, we would expect this to apply to LVRs in excess of 80 percent with relatively few exemption categories. The areas we would expect to exempt would include Housing New Zealand's Welcome Home Loans, the refinancing of existing high LVR loans or the transfer of an existing high LVR loan to another property or lender. We have been examining other countries'

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LVR policies and, with the exception of Canada, they do not provide exemptions for first home buyers (for example: Sweden, Norway, Korea, Israel, Hong Kong).

4. By its nature, a LVR speed limit would continue to provide banks with the capacity to continue to undertake some high LVR lending, albeit at a reduced pace. We would expect that first home buyers, who make up a large proportion of high LVR lending, would thus continue to have some access to high LVR lending from banks, albeit on somewhat stricter terms and conditions.
5. On 27 June, I will be giving an on-the-record speech to clarify the role of macro-prudential policy and to elaborate the case for LVR speed limits. Although no decision on an LVR speed limit will be made before our market consultation is completed in July, the speech will indicate that LVR restrictions could be deployed in the near future. The speech will be carefully drafted. We will of course share the speech with you ahead of its release.
6. We are keen to meet with you on your return to discuss this issue and to seek to achieve a more consistent public message. In the mean time we have met with Treasury and will continue to discuss with them our thinking in this area, including the likely impact of the policy options that we are considering.

Grant Spencer  
Deputy Governor

CC: Girol Karacaoglu, Deputy Secretary, Macroeconomics, International and Research  
Cameron Burrows, Economic Advisor, Office of Hon Bill English