RESERVE BANK COVER SHEET

REPORT NUMBER	4890
DATE	16 August 2013
SUBJECT	**REGULATORY IMPACT ASSESSMENT: RESTRICTIONS ON HIGH-LVR RESIDENTIAL MORTGAGE LENDING**
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ACTION SOUGHT	Information
TIMEFRAME	Routine
SECURITY CLEARANCE	Confidential

16 August 2013

MEMORANDUM TO THE MINISTER OF FINANCE

Regulatory impact assessment: Restrictions on high-LVR residential mortgage lending

Purpose

1 The purpose of this memorandum is to provide a brief overview of the regulatory impact assessment (RIA) of restrictions on high loan-to-value (LVR) residential mortgage lending. This RIA has been prepared by the Reserve Bank in accordance with section 162AB of the Reserve Bank of New Zealand Act 1989 (Act). A draft copy of the RIA has been provided with this memorandum.

Timeline

2 As noted in the memorandum to you of 29 July 2013, an announcement on restrictions on high-LVR residential mortgage lending, to take effect from 1 October 2013, will be made by the Bank on 20 August 2013. The Bank proposes to publish this RIA, as per the requirement in section 162AB(4) of the Act, at the time of this announcement.

Regulatory impact assessment

3 As discussed with you, the Bank is concerned that risks in the New Zealand financial system are increasing, due to the current escalation of house prices and a rise in residential mortgage lending with high LVRs, against a backdrop of high and rising household indebtedness. These risks increase the probability and potential impact of a significant downward house price adjustment. Current imbalances in the housing market could increase over time, resulting in a significant disorderly correction to the financial system in the event of a future economic or financial shock.

4 The Bank considers that the recent increase in the share of high-LVR residential mortgage lending is likely to be contributing to house price inflation, and is increasing the risk of a sharp correction in house prices, which would have damaging effects on the financial system and wider economy.

5 The RIA considers three options for addressing housing market imbalances:

i. maintaining existing micro-prudential policy settings (including the changes arising from the Bank's review of capital adequacy requirements for residential mortgage lending);

ii. imposing temporary additional capital requirements for residential mortgage lending; and

iii. imposing temporary restrictions on high-LVR residential mortgage lending.

6 The RIA establishes that the Bank's primary motivation for taking action in the current environment is to dampen house price and credit growth to promote future financial stability, consistent with section 1A of the Act, which requires the Reserve Bank to promote the maintenance of a sound and efficient financial system.

7 The RIA concludes that imposing LVR restrictions is the most effective option for achieving this objective. The Bank believes LVR restrictions can help to dampen excessive house price growth arising from growth in bank credit that boosts housing demand beyond housing supply.

8 The restriction will require banks to temporarily restrict their new residential mortgage lending at LVRs over 80 percent to 10 percent of total new residential mortgage lending (referred to as a high- LVR speed limit). The Bank's modelling suggests that, as a result, house price inflation could be 1-4 percentage points lower over the first year the restriction is in place. Once in place, the Bank will monitor developments in the market to determine the effect of the restriction, and to assess whether systemic risks have dissipated sufficiently to allow the restriction to be removed.

9 The RIA sets out the costs that the restrictions will impose. Some potential high-LVR borrowers will be temporarily shut out of the credit and housing markets. Since LVR restrictions will potentially capture most categories of high-LVR residential mortgage borrowers, the groups affected will include first-home buyers, existing home-owners seeking to top-up their mortgages, investors, and small-to-medium enterprises borrowing against residential property. The effect on any one group of high-LVR borrowers will depend on how banks choose to ration their lending within the capacity provided by the speed limit.

10 The RIA concludes that, on balance, the long run aggregate welfare gain of reducing the risks of subsequent economic and financial instability often associated with rapid corrections in house prices, outweigh the short run individual welfare costs of temporarily excluding some borrowers from the market. In the long run, these borrowers are likely to benefit to the extent house price inflation is checked.

Recommendation:

11 It is recommended that you:

(a) **note** the contents of this memorandum, and the attached draft regulatory impact assessment; and

(b) **note** that the Reserve Bank will be publicly releasing the final regulatory impact assessment on 20 August 2013.

Bernard Hodgetts

Head of Macro-Financial Department

Reserve Bank of New Zealand

Noted:

Hon Bill English

Minister of Finance

Date signed:

When signed, please phone Ms Georgie Fraser, Reserve Bank of New Zealand, on 471 3607 to arrange collection.

Copies to: Gabriel Makhlouf, Secretary, The Treasury
Cameron Burrows, Economic Advisor, Office of Hon Bill English