MEMORANDUM FOR	Macro Financial Committee
FROM	Macro Financial Policy / Daniel Wills
DATE	29.01.2016
SUBJECT	**LVR effectiveness monitoring report: revised LVR restrictions**
FOR YOUR	Discussion

Summary

- Major banks are meeting the three new speed limits two months into their first (six month) compliance window.
- LVR restrictions have been coincident with a significant decline in Auckland housing market momentum.
- Bank balance sheet resilience has continued to increase since revised LVR restrictions were introduced.
- There is little evidence to date of major distributional impacts (beyond those envisaged) or policy leakage.
- We plan to develop counterfactual estimates of housing market variables in the absence of recent changes to LVR restrictions[1], utilising a similar modelling methodology to that used for initial LVR restrictions[2].

Compliance

- Major New Zealand banks are already meeting all three new speed limits, two months into the first six month compliance period (figure 1)[3]. Banks were allowed to delay the new reporting until later in that first 6 month period while systems were being constructed, but all respondents apart from Withheld OIA s18(c)(i) ref RBNZ Act s105

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[1] Tighter tax rules were implemented in the month prior to LVR restrictions. The relative impact of the tax vs. LVR restriction changes is unknown and will complicate impact analysis somewhat.

[2] See Price, G (2014). *How has the LVR restriction affected the housing market: a counterfactual analysis*. Reserve Bank of New Zealand Analytical note, May 2014.

[3] Current available data (November – December 2015) covers four of the five large banks in New Zealand.

have already supplied data.[4].

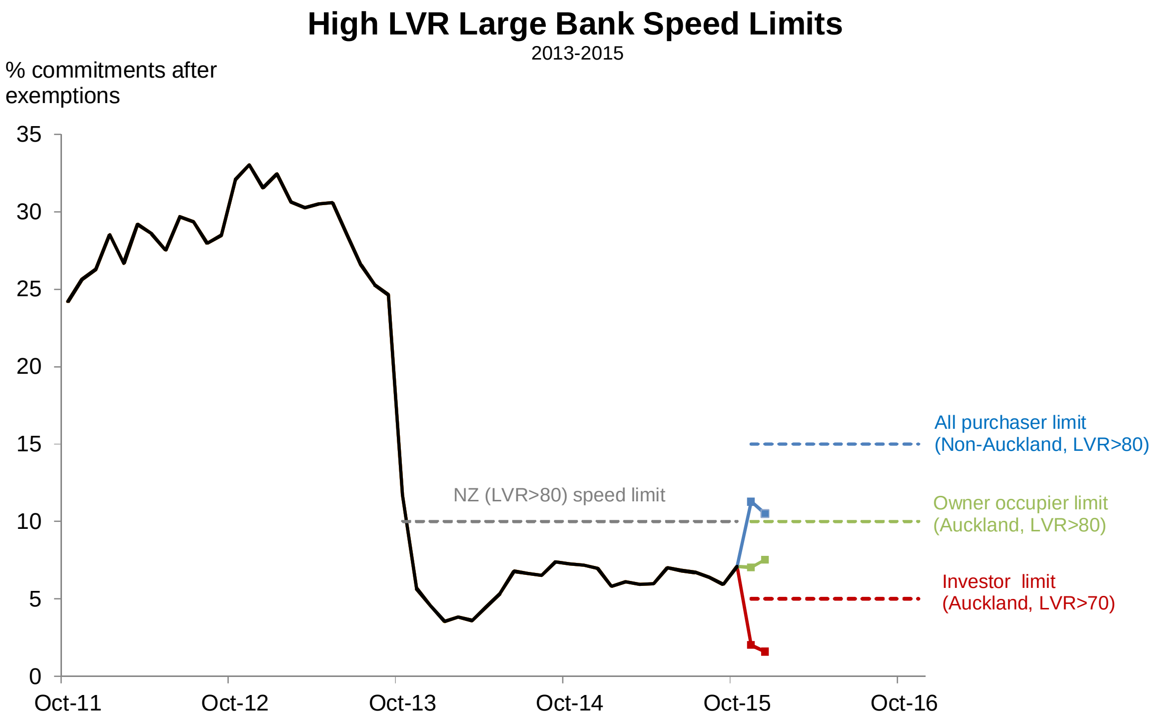
- System high-LVR lending appears to be low for Auckland investors (around 2%), but looks to have risen surprisingly rapidly for Non-Auckland lending (above 10%).

- High LVR lending shares are relatively similar across most banks and speed limits (figure 2). [redacted] Withheld OIA s18(c)(i) ref RBNZ Act [redacted]

- The combined collateral exemption is being utilised extensively by banks to meet their Auckland investor high LVR speed limit (figure 3). This exemption category accounts for around 75% of exemptions, and around 15-20% of total Auckland investor lending in the large banks. This means there are a lot of investors who are borrowing 70% against their Auckland rentals and 80% or less against other collateral (with a weighted average LVR>70). We don't consider this to be of concern as the rules allow investors to borrow up to 80 percent against any owner-occupied or non-Auckland property included as collateral in the loan.

- Broad measures of avoidance activity suggest that policy avoidance/leakage remains relatively low, in line with the findings from initial LVR restrictions (Wills, #5861575). For example, recent Macro-prudential Indicator Reports indicate that the share of housing lending by non-banks (outside LVR restrictions) remains low, at less than 4.5% of mortgages outstanding (MPI chartpack November 2015, #6423754).

Figure 1: High LVR limits – residential mortgage new commitments*



[4] [redacted] Withheld OIA s18(c)(i) ref RBNZ Act s105

*LVR>80% unless otherwise stated for lending across ANZ, ASB, BNZ, Westpac and Kiwibank. Data pre-August 2014 from private reporting returns. Data for November and December 2015 based off returns from [redacted] Withheld OIA s18(c)(i) ref RBNZ Act s105

Figure 2: Lending by loan type* (November - December 2015)

[redacted] Withheld OIA s18(c)(i) ref RBNZ Act s105

Figure 3: Auckland property investor exemptions (November - December 2015)

[redacted] Withheld OIA s18(c)(i) ref RBNZ Act s105

Impact on financial system resilience

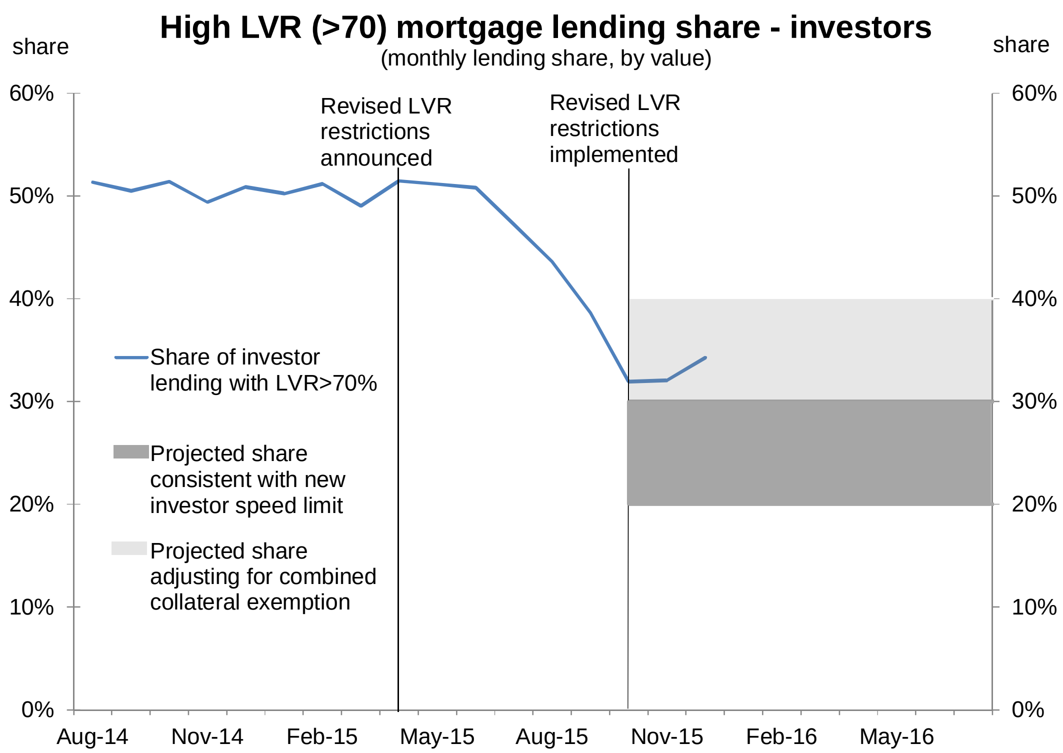
- The high-LVR share of new investor lending (including instances where the combined collateral exemption has been used) has dropped from around 50% prior to restrictions to around 33% in the two months following revised restrictions, increasing the resilience of banks' mortgage portfolios (figure 4).

- The share of high LVR mortgage lending to investors is slightly above the upper-end of initial projections for around 30% of lending (figure 4). Adjusting for the impact of the combined exemption[5] suggests that high LVR investor lending share is tracking close to projections.

- The policy seems to have led to most Auckland investors borrowing using the combined collateral exemption (~15-20% of loans) or using LVRs of 60 to 70% (~40% of loans). This will reduce average LVRs in the Auckland investor book over time.

- Lower LVRs on Auckland investor lending are expected to increase financial system resilience in a severe downturn in Auckland house prices. International evidence suggests investors are more likely to default during such events, as discussed in previous MFC papers such as Wills (#6013682).

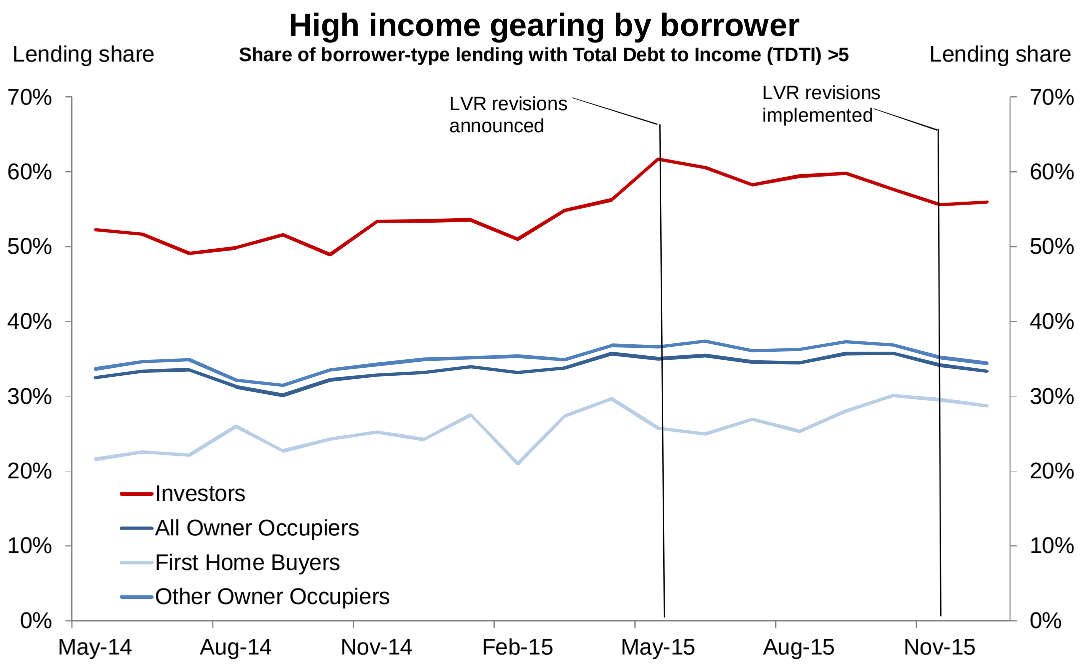
Figure 4: New Zealand high LVR investor lending share – expected vs. actual



[5] Initial projections for high-LVR investor lending (post LVR revisions) were finalised before the combined collateral exemption was proposed. In the absence of this exemption, some investors were expected to split their portfolio regionally amongst banks, resulting in a higher amount of low-LVR lending.

- The loan to income measures for investors and other buyer types have not changed dramatically since the investor LVR policy has come into force (figure 5). Investors seem to be getting loans at similar loan to income ratios, but lower LVRs ((table 1, appendix).

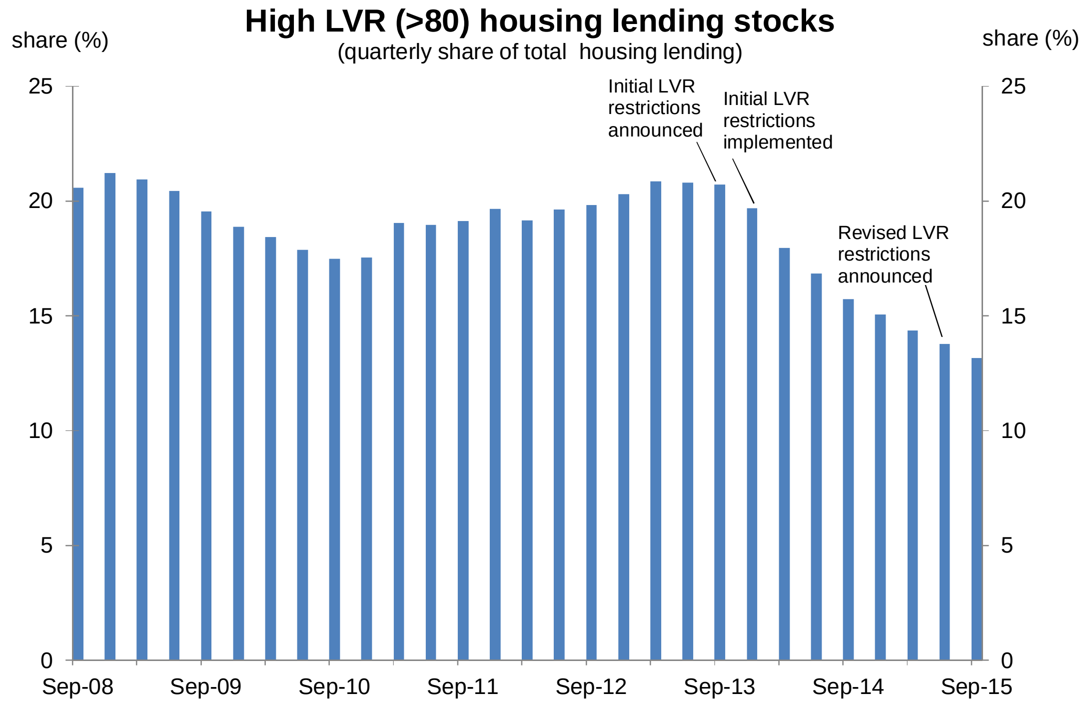
Figure 5: High income gearing share – new commitments



- The initial speed limit on high-LVR lending has seen a significant reduction in the overall stock of high-LVR loans since late 2013, increasing the resilience of banks mortgage portfolios (figure 6).

- The recent increase in high-LVR lending outside of Auckland (see figures 1, 18, 19) appendix) is likely to see the downtrend in the stock of high-LVR lending slow. The stock of investor mortgages with an LVR of above 70 is expected to reduce, although there is no data available to quantify this trend.

Figure 6: Stock of high LVR (>80%) housing lending



Impact on credit cycle and housing market

- The new speed limit measures are expected to improve financial stability by dampening rapid increases in Auckland house prices.

- Auckland house sales levels have fallen since the tightening of Auckland investor LVR restrictions, stalling the 2015 rebound in the market (figure 7). Auckland house price inflation has likewise decelerated sharply post the new LVR restrictions, ending the rapid acceleration in price growth (figure 8).

- Ex-Auckland sales activity has been trending up since late 2014 (figure 7). The easing of LVR restrictions ex-Auckland appears to have supported this uptrend. The Waikato and Bay of Plenty regions have driven much of this upswing (figure 12). Ex-Auckland house price inflation has bounced back sharply since eased LVR restrictions were announced (figure 8). However the level of price growth, and price-to-income ratios, remain much lower than in Auckland.

- Gross housing lending has started to slow since the new restrictions came into force, and may slow further in line with the reduction in the value of house sales in December (figure 9). Growth in net housing credit has been edging down in the recent months (figure 10).

- We have an older measure of 'investor' lending which shows loans where the purpose is to buy or improve an investment property. Slowing mortgage lending was initially associated with a sharp drop in this lending, although this share has recovered over the past two months (figure 23, appendix).

- The slowdown in the housing market could be driven by other policies or simply fading momentum. However, the fading of Auckland strength and increasing strength outside Auckland (where LVR policies were eased) suggests the LVR restrictions have had an impact. We will attempt to quantify this more formally in the future.

Figure 7: New Zealand house sales by region

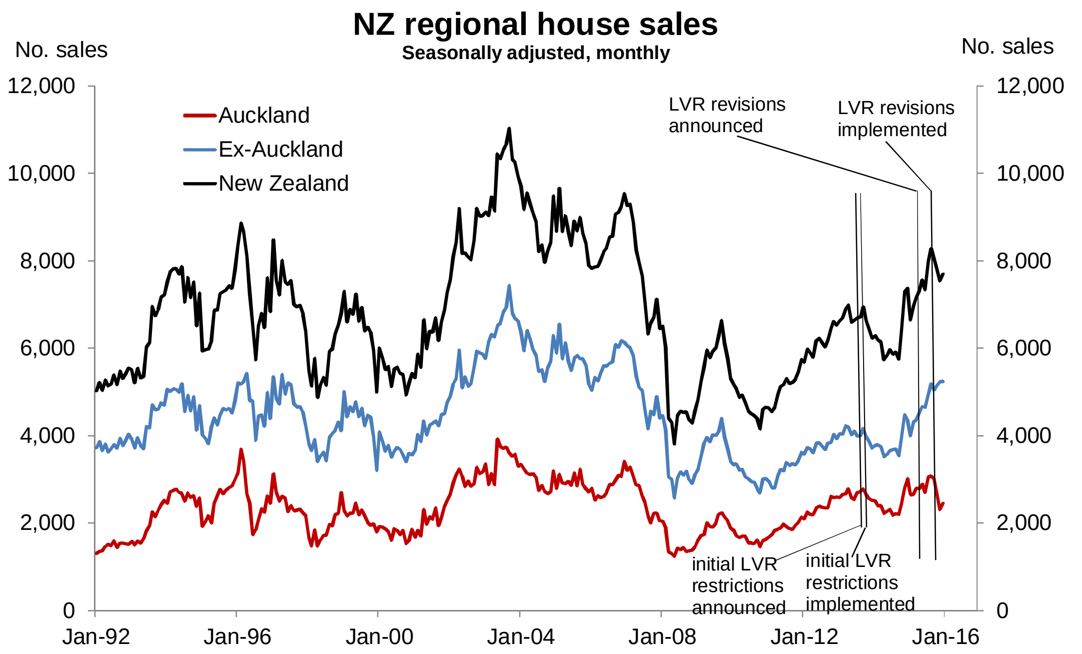


Figure 8: New Zealand house price inflation by region

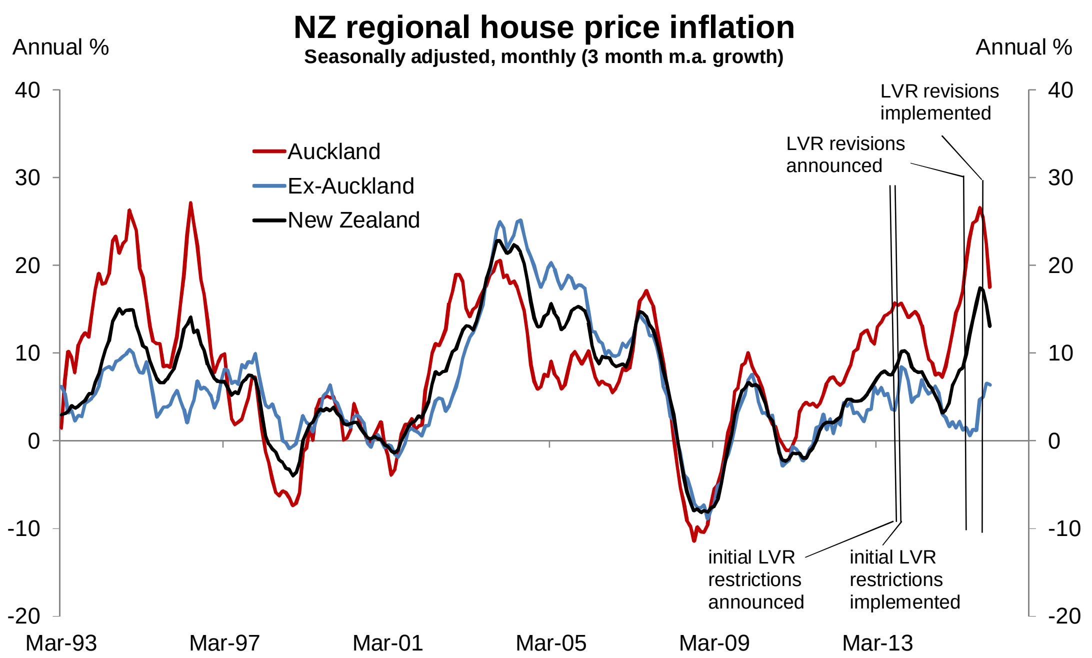


Figure 9: New Zealand housing lending

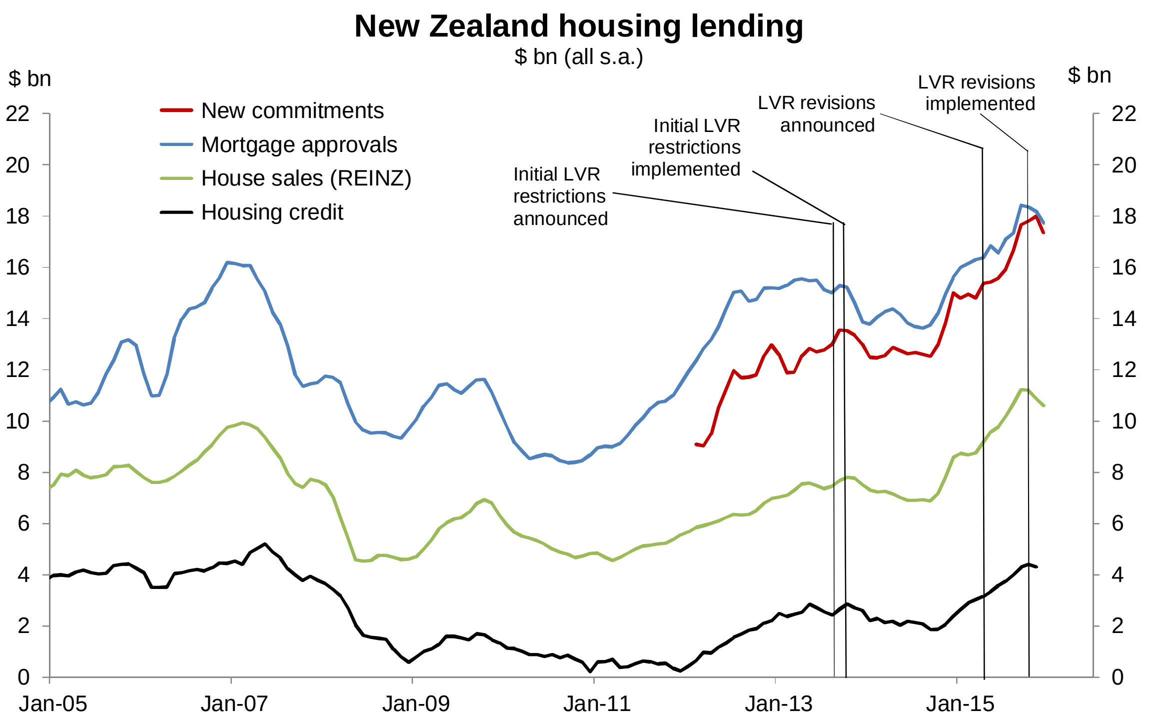
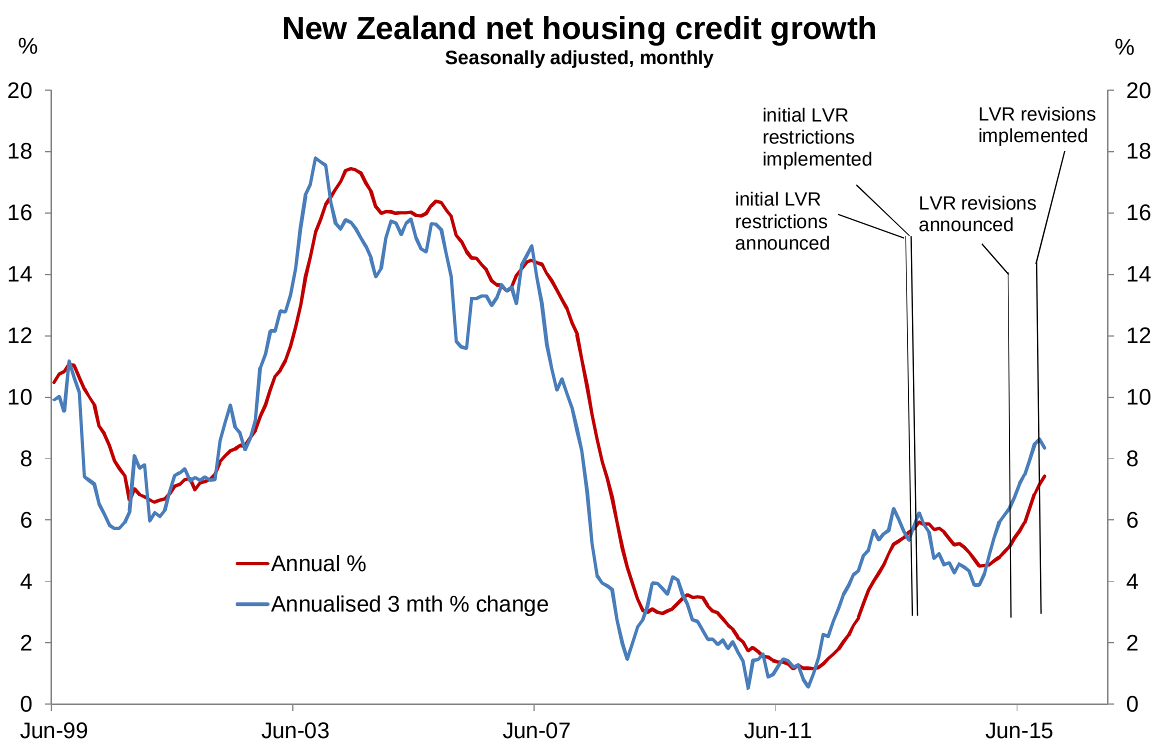


Figure 10: New Zealand net housing lending growth



Unintended consequences/distributional impacts

- The investor sales share (using Corelogic data) has dropped slightly in Auckland, but remains above pre-LVR restriction levels (figure 11). The nationwide investor mortgage lending share has been largely unaffected by new restrictions, with the exception of a short-lived drop just prior to their implementation (figure 23, appendix).

- Most other buyer type shares have increased modestly in Auckland (figure 11), with the exception of new-to-market buyers (possibly a reflection of new tax requirements for foreign buyers). The first home buyer share has increased modestly ex-Auckland, reflecting marginal declines in investor and mover shares in these regions (figure 21, appendix).

- The Auckland house sales share has dropped back towards its long run (20 year average) following revised LVR restrictions, to around one-third of sales (figure 12). The Waikato/Bay of Plenty share is growing steadily, a trend seen since late 2014.

- The distribution of sales by value in Auckland has been relatively static around the time of new LVR restrictions (figure 13). The high-value sales share in the region continues to trend up, reflecting the region's rapid house price inflation. In the Rest of New Zealand, the mid-priced sales share is growing slowly (figure 22, appendix).

- Auckland rental rate growth has dropped modestly following revised LVR restrictions, against speculation that Auckland investor LVR restrictions would boost rental rates (figure 14). Rental growth in the region is less than half on previous cyclical peaks in the 2000s and 1990s.

Figure 11: Auckland house sales share by purchaser type

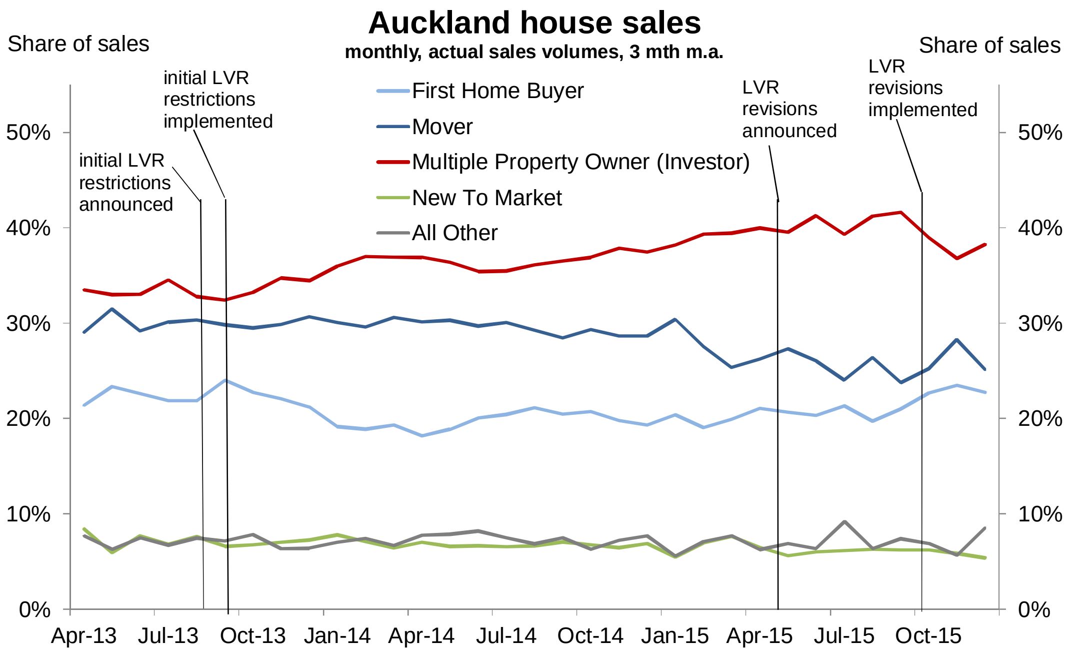


Figure 12: New Zealand house sales share

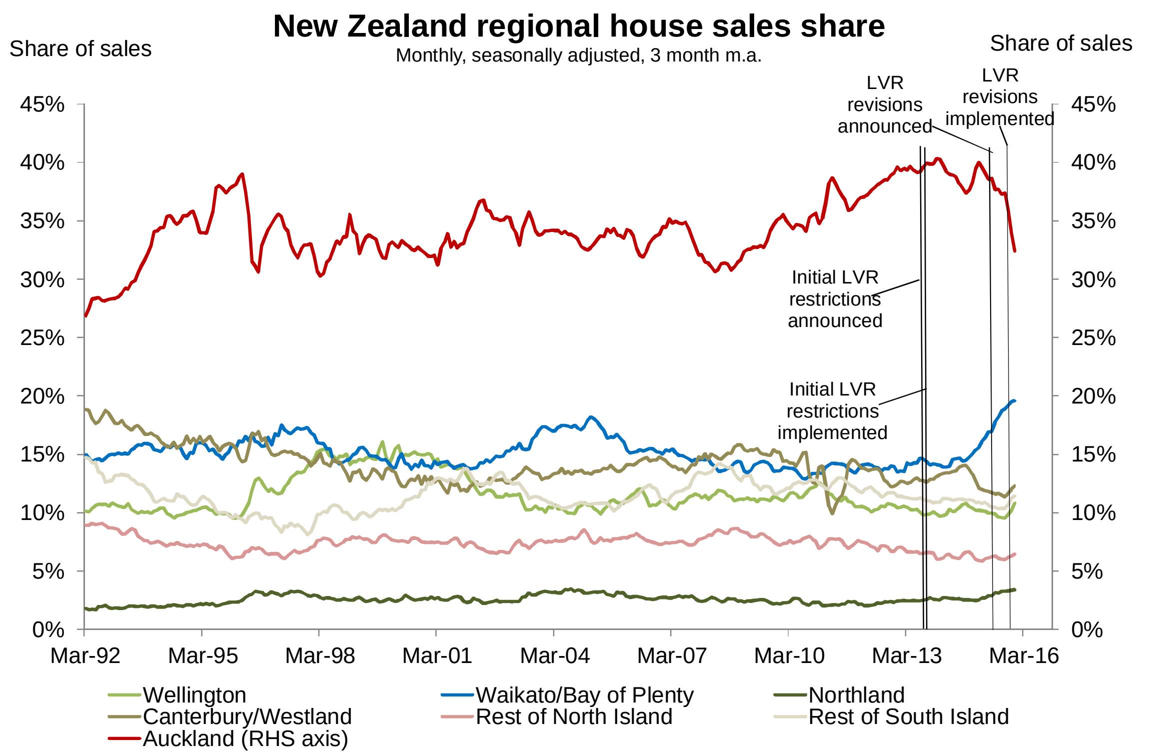


Figure 13: Auckland house sales share by value

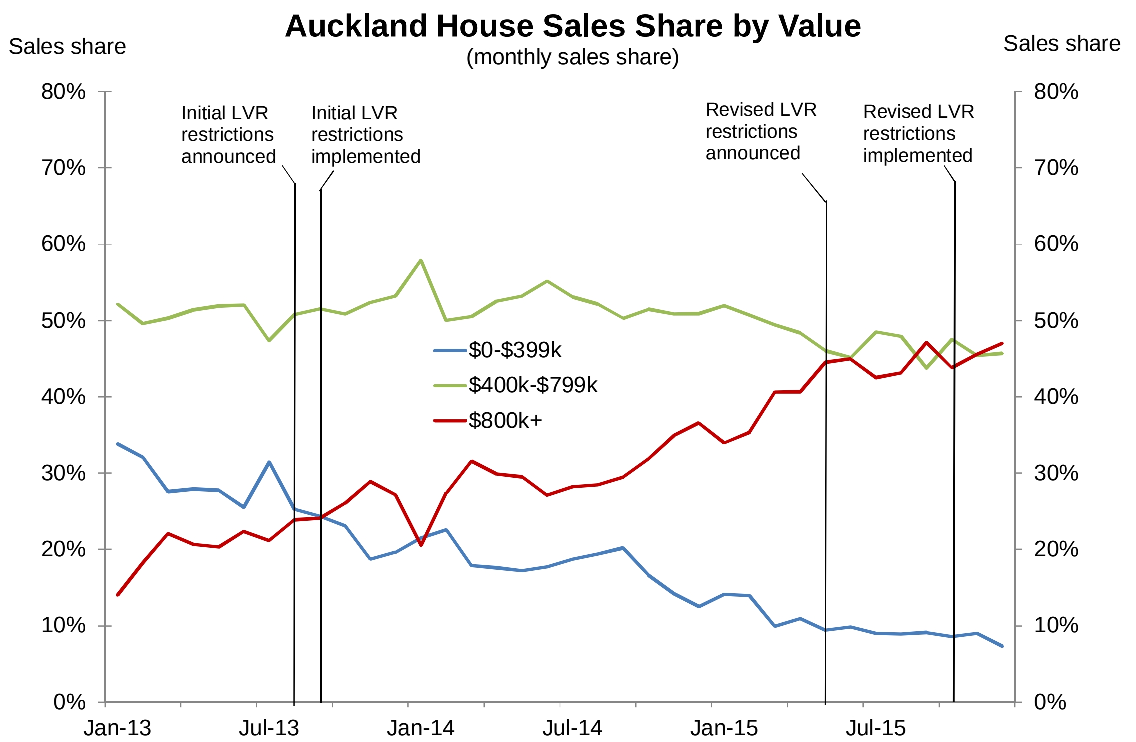
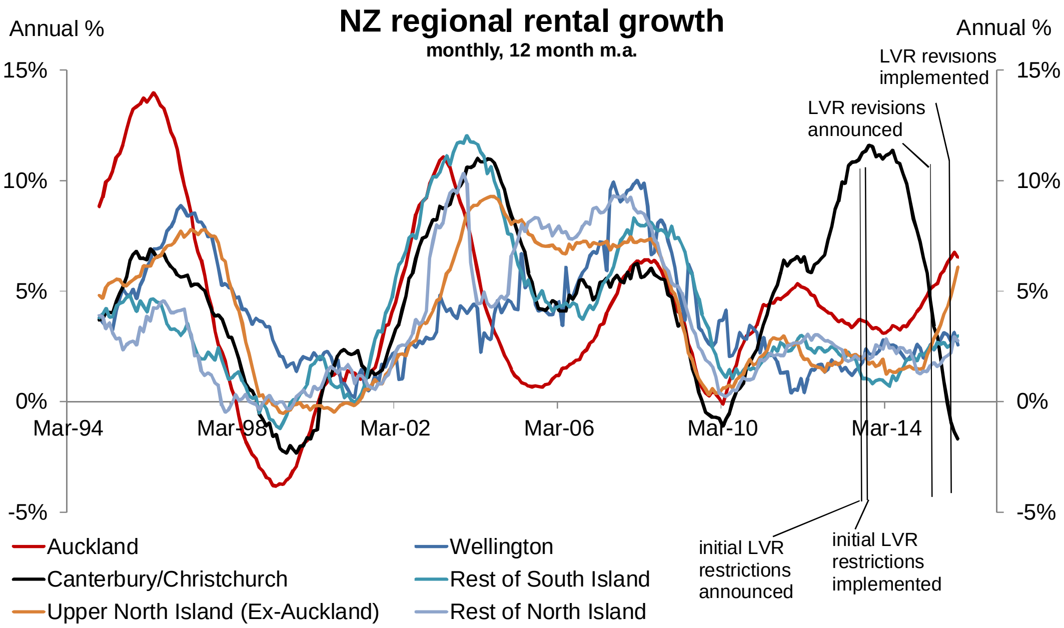


Figure 14: New Zealand rental rate growth



Appendix graphs

Figure 15: Auckland property investor lending by LVR (November - December 2015)

Withheld OIA s18(c)(i) ref RBNZ Act s105

Figure 16: Auckland non property investor (owner occupier) lending by LVR (November - December 2015)

Withheld OIA s18(c)(i) ref RBNZ Act s105

Figure 17: Non-Auckland property investor lending by LVR (November - December 2015)

[redacted]

Withheld OIA s18(c)(i) ref RBNZ Act s105

Figure 18: Non-Auckland non property investor (owner occupier) lending by LVR (November - December 2015)

[redacted]

Withheld OIA s18(c)(i) ref RBNZ Act s105

Figure 19: Non-Auckland lending by LVR

[redacted]

Withheld OIA s18(c)(i) ref RBNZ Act s105

Figure 20: LVR of new commitments – mean above median

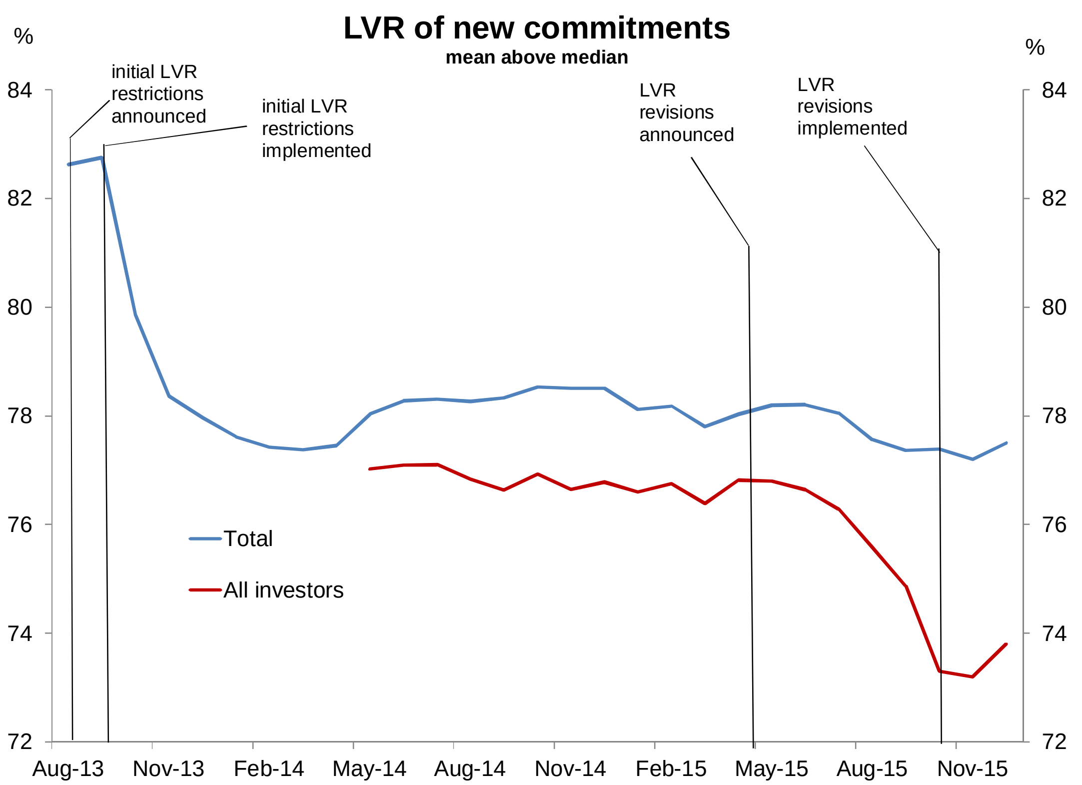


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Figure 21: Ex-Auckland house sales share by purchaser

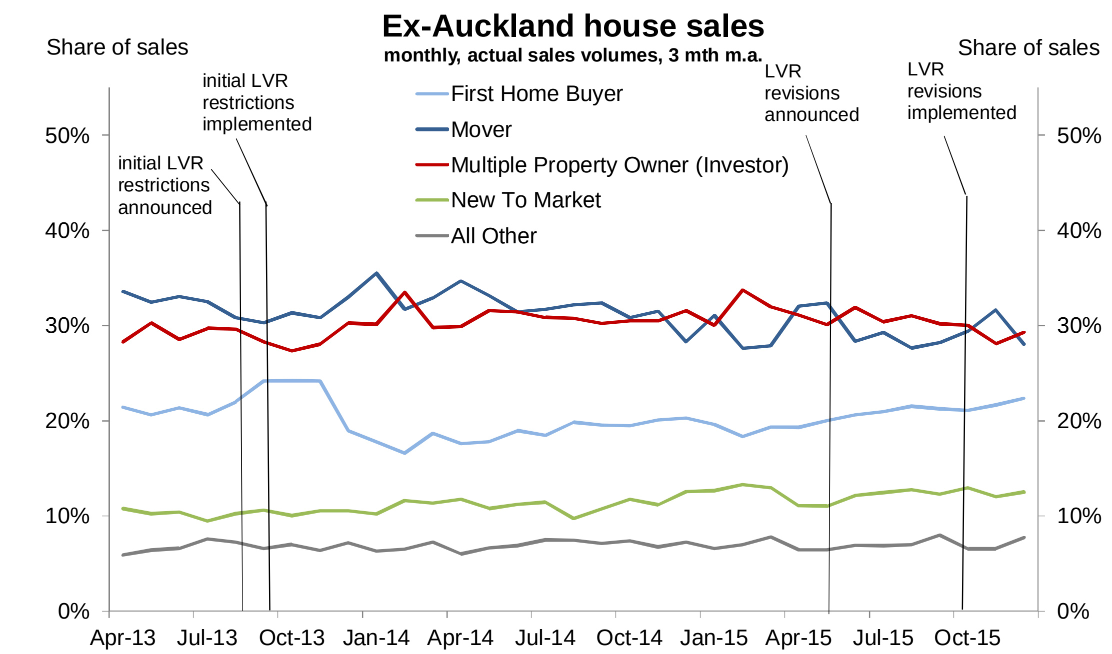

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Figure 22: Ex-Auckland house sales share by value

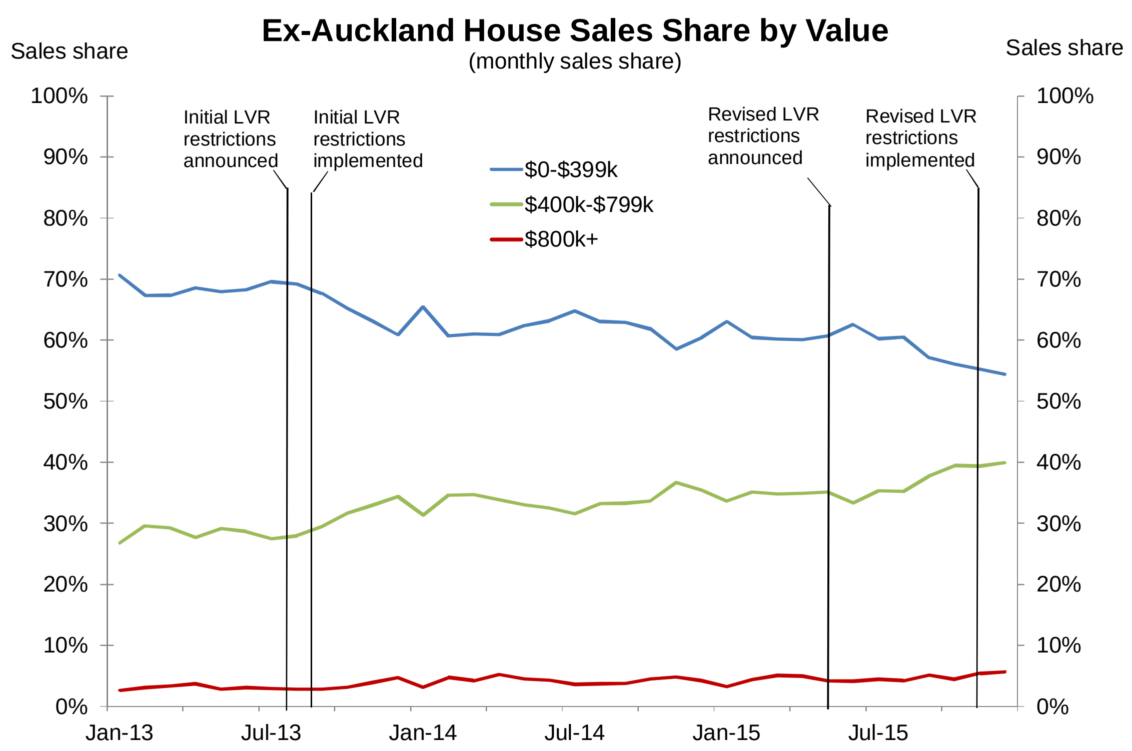

Figure 23: Investor mortgage lending share by value and number