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MEMORANDUM FOR	Macro-Financial Committee
COPIED TO	
FROM	Macro Financial Policy (Principal authors: Chris Bloor and David Hargreaves)
DATE	21/04/2015
SUBJECT	**PROPOSED CHANGES TO THE LVR POLICY**
FOR YOUR	Decision

At the request of the Governing Committee, this paper outlines proposals for an amendment to the LVR policy to address financial stability risks arising from rapid house price growth in the Auckland housing market. Macro Financial Policy is working on the assumption that a policy package along these lines will be announced at the release of the May Financial Stability Report on May 13. **MFC is invited to recommend to the Governing Committee that the policy be adopted, and identify any remaining caveats or concerns.**

The proposed changes are to:

- Introduce a new speed limit at near-zero on investor lending in Auckland at LVRs above 70 percent.
- Retain the 10 percent speed limit on all other residential mortgage lending in Auckland at LVRs above 80 percent.
- Increase the speed limit to 15 percent for mortgage lending outside of Auckland at LVRs above 80 percent.

This paper discusses the rationale for the proposed policy, the expected policy impact and technical considerations in relation to implementation.

1. Problem definition

Since September 2014, there has been a significant increase in both housing market activity and house price inflation in the Auckland region. Auckland house prices have increased by 12 percent in the past four months, taking annual growth to almost 17 percent. Increased housing demand has been driven by a combination of record net immigration into the region and a reduction in fixed mortgage rates, particularly at longer terms. There is relatively little evidence that a loosening in lending standards has played a substantial role in stimulating demand, but credit conditions are generally fairly loose and banks have readily accommodated increased demand. Gross lending flows are relatively strong and have been increasing rapidly in recent months.

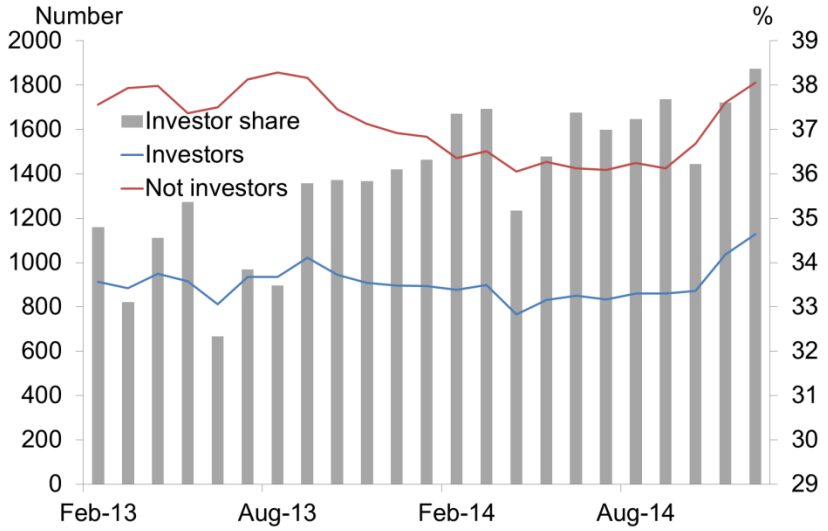
This increased demand to purchase property is being exacerbated by existing shortages of housing in Auckland, along with significant supply constraints, resulting in significant pressure on house prices.

At the same time that pressures in the Auckland housing market have increased, the Canterbury housing market has eased, and the rest of the country has remained more subdued. As a result, the case for specifically targeting policy measures to the Auckland

market is significantly stronger than it was at the time when we first implemented the LVR policy.

There is evidence that investors are playing a growing role in the market, and an increase in investor demand is likely to be one factor contributing to stronger market conditions. The investor share of transactions in Auckland has increased from around 34 percent prior to the introduction of LVR restrictions to over 37 percent now, and the level of sales to investors is significantly higher than it was in 2013.

Figure 1: Auckland house sales



Current strong growth in Auckland house prices is adding to the existing 'stretch' in the level of house prices. Demographia rank Auckland as the 14th least affordable housing market out of 368 markets sampled.[1] Overall, it appears unlikely that supply constraints will be materially alleviated in the near term, and there is no obvious immediate trigger for a softening in housing demand. Therefore, there is a significant risk that housing market pressures will persist for a number of years, exacerbating existing imbalances.

Our principal concern is that the more stretched the Auckland housing market becomes, the more likely that there will be a nasty correction at a later date. Such a correction could threaten the stability of the banking system if the resulting credit losses were sufficiently large. While it is often remarked that the international evidence suggests housing credit losses have rarely been the sole source of financial crises, it is worth noting that housing has become a much larger share of banks' lending portfolios over recent decades. Thus the potential for damage to bank balance sheets may be larger than in the past. Moreover, it is highly likely that the sorts of factors triggering a housing market downturn would also weigh heavily on other sectors, such as commercial property, the general business sector or agriculture, adding to pressure on bank lending portfolios. A large correction could also generate a significant period of macroeconomic weakness, particularly if a large number of households ended up in a position of debt overhang following a market correction. Such a scenario would further exacerbate stress on bank balance sheets.

Given these risks, there are two primary objectives for the proposed changes to the LVR policy outlined in this note, which we consider can be linked directly to the Reserve Bank's statutory role of promoting a sound and efficient financial system. The first would be to reduce the rate of growth in Auckland house prices in order to limit the probability and magnitude of a significant correction. However, we are aware that the tools that we have at

[1] This is based on September 2014 data. With Auckland house prices having increased by 15 percent since then, Auckland is likely to be ranked somewhere between 4th and 9th least affordable now. This is around the level of San Francisco, but less affordable than greater London or Melbourne.

our disposal can only have a moderate effect on house price growth, and that this impact tends to wane over time. Given the size of the imbalances in the Auckland housing market, house price growth is likely to remain unsustainably high even with the proposed policy changes.

The second objective is to improve the resilience of bank balance sheets to a housing market correction, by reducing the sector's exposure to riskier loans and by reducing the magnitude and probability of a housing correction.

This resilience of bank balance sheets is directly addressed primarily through permanent prudential settings. Stress test results suggest that banks should generally be well placed to absorb credit losses from a severe downturn. Nevertheless, the extent of imbalances in the Auckland housing market may warrant further buffers being built up. But given a planned review of capital settings will be able to address some of these risks, we have placed less emphasis on directly increasing the capital buffers on bank balance sheets in this paper. Instead, this proposed policy reduces average customer LVRs, particularly with respect to Auckland lending. This should make the banks more resilient for any given level of capital. This is achieved partly by making households more resilient but this is not an intrinsic aim of the policy.

The policy will also tend to promote the resilience of household balance sheets, thereby helping to minimise damage to the wider macroeconomy should the Auckland housing market fall materially. Weak household balance sheets cause two significant problems in a severe downturn. First, it would tend to exacerbate the extent of the downturn, as firesales can arise when a significant proportion of borrowers are pushed into a forced sale situation. Second, the ability of the economy to recover from the initial shock can be significantly constrained if debt overhang exists, depressing domestic demand. Reducing the risks of firesales directly enhances bank resilience. The policy acting to promote household financial resilience could also be seen as contributing to soundness and efficiency in a broader sense.

2. Policy advice

In recent months, a range of policy options have been presented to the Macro-Financial Committee to address the current build-up in risk in the Auckland property market. Following discussion with the Governing Committee, we have now narrowed down a preferred policy option, involving a recalibration of LVR restrictions to more tightly bind on property investors in Auckland. Specifically, we propose:

- Setting a speed limit of near-zero percent on residential property investment loans in the Auckland region with an LVR of greater than 70 percent.

- Retaining a speed limit of 10 percent on residential mortgages (excluding the new property investor asset class) in the Auckland region with an LVR of greater than 80 percent.

- Increasing the speed limit for both residential mortgages and residential property investment loans outside of the Auckland region to 15 percent for loans with an LVR of greater than 80 percent.

Other policy options discussed at MFC have included an increase in capital requirements for Auckland housing, and restrictions on high debt-to-income lending. Additional capital requirements would have a narrower effect than LVR restrictions, operating mainly to increase bank loan loss absorbency. We do not believe that they would significantly reduce Auckland house price growth or reduce the risk of substantial numbers of distressed households needing to sell in a downturn. Furthermore there are already measures underway that will bolster bank capital held for housing. The proposed new asset class treatment for mortgage loans to residential property investors, which is currently under

consultation, will help ensure that banks hold adequate capital for the risks that they face from investment property lending. Any residual concerns about capital are expected to be addressed through a review of bank capital settings that is planned for later this year.

Debt-to-income restrictions in some form remain another possible area for further action, should our investigations conclude that loans are being originated at DTIs that pose a prudential risk. This is an active area of MFD's work programme and we are currently assessing preliminary data provided by each of the major banks. We currently lack sufficient information to assess the appropriateness of a policy response and any measure would also take a significant period of time to implement.

As discussed in previous papers, international evidence suggests that loans to property investors tend to default more frequently than loans to owner occupiers once they reach a position of negative equity, and hence tend to have much worse performance in a severe housing market downturn. Around half of all loans to investors have an LVR of over 70 percent, predominantly in the 70-80 percent LVR range. When combined with a rising share of lending going to investors in Auckland, we believe that this lending could materially exacerbate the risk of severe firesales in the event of a significant market correction.

Outside of MFC, two other potential adjustments to the LVR policy have also been considered. The first has been the merits of reducing the speed limit to zero for all mortgage lending at LVRs of over 80 percent in Auckland. Given that non-exempt lending at LVRs of over 80 percent is only around 6 percent of total lending currently, our assessment of this option is that it would have only a limited effect on both resilience and the housing cycle. We also believe that banks should be provided with scope for at least some high-LVR lending, especially to owner occupiers, as there are a range of special circumstances in which such lending is desirable. Examples include remediation of leaky buildings, repair of uninsured earthquake damage, and temporary extensions of credit for hardship. It is difficult to write exemptions to cover off all of these eventualities, which was one of the initial motivations of a speed limit framework.

The second potential adjustment was to lower the LVR threshold at which the speed limit applies in Auckland to 75 percent. This would potentially have a powerful effect, given that 35 percent of lending is currently taking place in the 75-80 percent LVR bucket. However, we believe that there are stronger resilience benefits to targeting investor lending at LVRs of 70-80 percent than from targeting lending to owner-occupiers at 75-80 percent. We also believe that the efficiency costs of restricting lending to owner occupiers are larger than for investors. Investors will face constrained portfolio choices (i.e. they will choose to buy other assets, or keep their balance sheet smaller, rather than buy an Auckland property). But this seems like a less severe distortion than being unable to purchase a home to owner occupy.

3. Expected impact of policy

Impact on house prices, sales and credit

Previous papers have discussed the broad framework we use to assess the effects of changes to the LVR policy and produced estimates of the effect of an alternative policy option. An earlier paper suggested a central estimate of a 1.7 percent impact on national house price inflation and 2.1 percent impact on Auckland house price inflation if a 10 percent speed limit was imposed on all investor lending at LVRs of over 70 percent.

The proposed calibration in this paper will have a somewhat larger effect on Auckland house prices, given that the investor speed limit is being set at zero, rather than 10 percent (table 1). We estimate that around 34 percent of lending in Auckland is to property investors. At a national level, half of all investor lending is at LVRs of above 70 percent. Assuming this is representative of the situation in Auckland, the restriction will apply to around 17 percent of all housing lending in Auckland.

In addition, high-LVR lending to owner occupiers will have to slow somewhat. Nationally and before exemptions, around 10 percent of lending to owner occupiers is at LVRs above 80 percent. After exemptions this is likely to be 8-8.5 percent. It is plausible that this lending has been disproportionately taking place in Auckland, in which case the Auckland share could be higher than this. Banks appear to be comfortable operating with high-LVR lending at 3-4 percentage points below the speed limit, so the high-LVR share of Auckland owner occupied lending may well fall by at least 2 percentage points to maintain this buffer.

We estimate that the effect of restricting investor lending and a more binding requirement on Auckland owner occupiers would reduce Auckland house prices by 2.9 percent relative to the counter-factual. Previous experience suggests that this is likely to be front-loaded in the first six month period. House sales would be expected to be 9.2 percent lower in Auckland.

Table 1: Modelled impact of policy adjustments

	Assumptions					Modelled impact		
	Affected lending (%)	Cash buyer share (%)	Effective speed limit (%)	Avoidance (%)	Replacement buyers (%)	House sale change (%)	House price change (%)	Impact on housing credit (national, %)
Impact on Auckland								
Tighter investor limit	17	20	0.4	25	25	-7.6	-2.4	-1.4
More binding limit on owner occupiers	2	20	0	0	0	-1.6	-0.5	-0.3
Total Auckland impact	**19**					**-9.2**	**-2.9**	**-1.7**
Ex-Auckland impact of relaxed speed limit	5	20	0	0	0	4.0	1.0	0.8
National impact						**-1.1**	**-0.5**	**-1.0**

Outside of Auckland, this policy package would allow the high-LVR share to rise by around 5 percentage points, possibly more if existing high-LVR lending has been weighted more heavily towards Auckland. We estimate that this could increase ex-Auckland house prices by around 1 percent. In addition, there could be an additional stimulatory effect if Auckland-based property investors start looking further afield to continue building property portfolios. We have not attempted to quantify this effect, which may be particularly concentrated in close proximity to Auckland – for example Hamilton. Outside of Auckland house sales are expected to increase by 4 percent.

Given offsetting effects inside and outside Auckland, we do not expect a dramatic effect on credit growth. We expect new commitments to fall by 3.4 percent, resulting in a 1.0 percent fall in net credit growth.

Impact on resilience

While residential property investment loans may have relatively low default rates during normal economic circumstances, the Reserve Bank has looked at evidence from extreme housing downturns during the GFC, and this clearly indicates that default rates can be higher for investor loans in severe downturns. For example, evidence from Ireland suggests that loss rates for investors were nearly twice as high as for owner-occupiers.

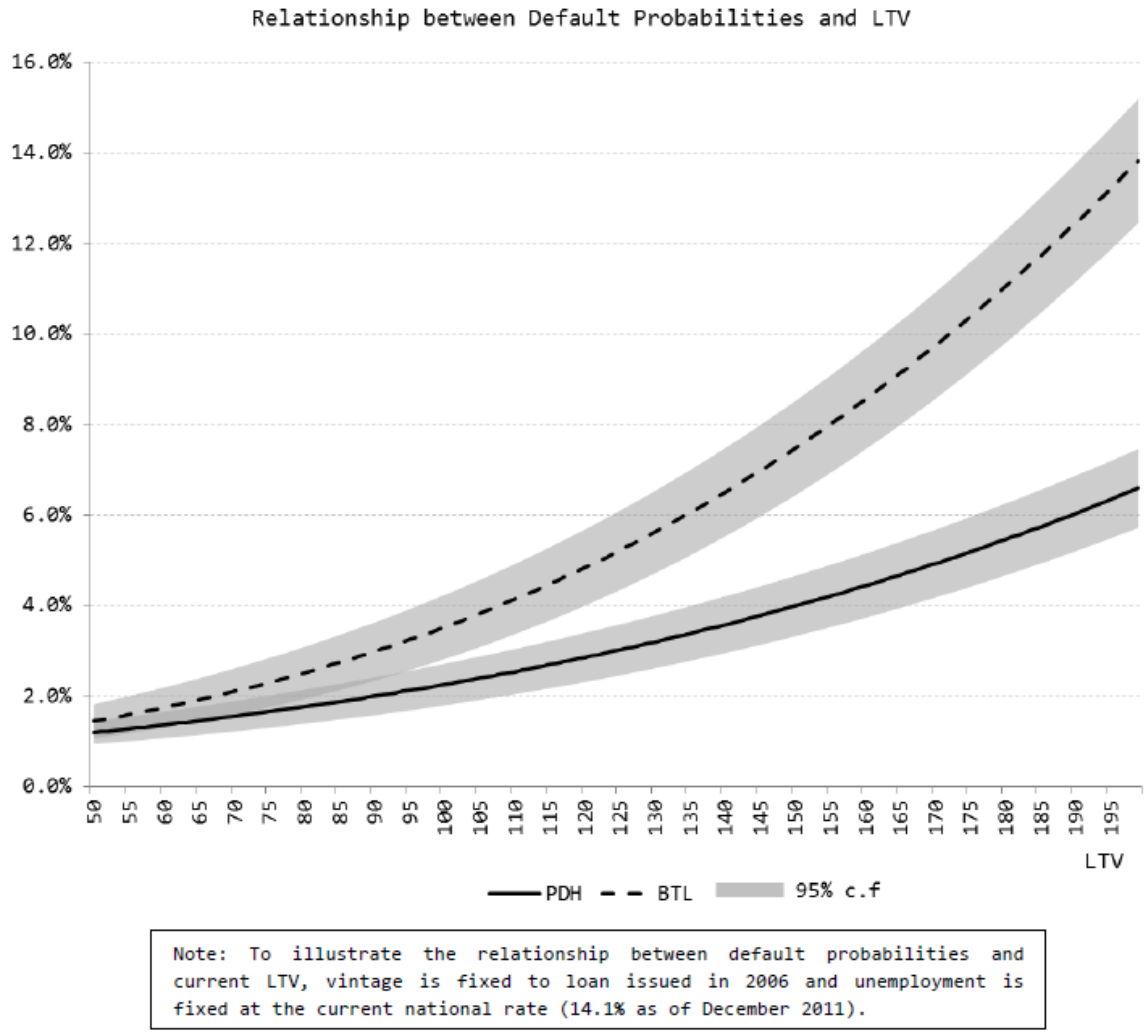
Table 2: Ireland residential loans - realised loss estimates, 2011-2013

	Owner Occupier	Investor	Total
Bank of Ireland	5.9%	10.7%	7.0%
Financial Measures Programme (BlackRock Solutions)	7.6%	14.3%	9.2%

Source: "Stress" scenario in The Good, *The Bad and The Impaired: A Credit Risk Model of the Irish Mortgage Market*. Kelly, Central Bank of Ireland, November 2011, pg 25.

Furthermore, studies which have separately estimated default rates by LVR separately for investor loans and owner occupancy loans suggest that investor loans are substantially riskier at any given loan to value ratio. The figure below is from Kelly (2012) and shows an estimate of default rate based on current loan to value ratio. For example, if a loan was initially written at a 70 percent LVR and then prices fell 30 percent, the loan would appear in

the chart below as LTV=100. This would have a mildly increased rate of default compared to a low LVR loan for an owner occupier. But for an investor, the rate of default would be higher, and have increased more sharply as a result of the decline in house prices.



Note: PDH is principal dwelling house, BTL is buy to let.

In the US case, it is also worth noting that the statistics distinguishing investors from owner occupiers may not always have been reliable. A New York Fed study found that investors were an obvious driver of downturn defaults if they were identified as investors on the basis of being owners of multiple properties. In contrast, investor's role was much harder to see if investors were identified using the borrower's declared intentions. Most studies of the US have data on declared intentions rather than actual occupancy status. Despite this issue, Palmer (2014) reports that default rates were increased in a multivariate regression as loan to value ratio rose and for loans that were to declared non-owner occupiers.

There are several structural factors which appear likely to make investor lending riskier at any given LVR.

First, for a typical investor that owns their own home and several others at (say) 80 percent LVR, their gearing relative to their labour income will be substantially higher than for a typical owner occupier at the same LVR. This means that a substantial fall in house prices would leave the investor much more heavily underwater relative to their labour income. This diminishes their incentive to continue to service the mortgage (relative to alternatives such as entering bankruptcy).

Second, some investors are likely to not own their own home directly (it may be in a trust and not used as security, or they may rent the home they live in). Again, this is likely to increase the incentive to stop servicing debt if it exceeds the value of their investment property portfolio. The Reserve Bank considers 'strategic default' to be unlikely for owner occupiers in most circumstances, but it is a more realistic prospect for investors in severe downturns.

Finally, investors may face additional income volatility related to the possibility that the rental market they are operating in weakens in a severe recession (if tenants are in arrears or are hard to replace when they leave, for example). Furthermore, this income volatility is more directly correlated with the valuation of the underlying asset, since it is harder to sell an investment property that can't find a tenant.

Investor lending can also be a strong driver of speculative rises in property markets, as the US and Irish experience indicates. While investors own a larger share of Auckland properties than non-Auckland properties, there is quite limited evidence of investors dominating the current market or buying for quick resale. But we still consider the investor loans being made are riskier than owner occupier loans for the structural reasons discussed above.

Over time, the proposed policy would reduce the number of investors with debt in excess of 70 percent secured on Auckland property. The focus on Auckland reflects the elevated level of house prices relative to incomes in Auckland, and the apparent speculative dynamic that has begun to develop recently. We judge that Auckland prices have diverged from the rest of the country sufficiently that the chance of a substantial correction in Auckland prices is higher than in the rest of the country.

In a low interest rate environment it is logical for house prices to rise and for the rise to be concentrated in regions where the future supply of housing is relatively constrained (such as central areas of Auckland). However, the same argument would apply in reverse when interest rates start to rise again. Furthermore, logical house price rises can sometimes lead to further, less logical, rises as the market develops its own momentum.

While investor lending appears riskier than owner-occupier lending at any given LVR, it is difficult to quantify exactly how much riskier, or the extent to which investor LVRs should be reduced to make them about as risky as an owner occupier loan. Banks have always been prepared to lend at somewhat higher LVRs to owner occupiers than investors, reflecting the issues discussed above. The Reserve Bank considers that it is reasonable to regard 70 percent as a high LVR for investor lending in a speculative market, and that a typical 70 percent origination LVR loan is riskier than a typical 80 percent owner occupier loan in a downturn. Kelly (2014)'s results are consistent with this. The Bank of Ireland has also used similar analysis of the Irish GFC experience to conclude that 70 percent is an appropriate level for calibrating their investor LVR speed limit.

The case for a speed limit on high-LVR lending related to the efficiency costs of an outright ban. If some 'special case' customers have a pressing need for finance (e.g. to repair the underlying collateral), the use of a speed limit makes these loans possible without the need for a complicated series of exemptions. More generally, the speed limit allowed banks to write a number of high LVR loans (mostly for owner occupiers including first home buyers). This allowed some customers to shift homes or become owner occupiers, while still dramatically cutting the total high LVR flow.

When considering investor lending, it seems possible there will be some 'special cases' that make a speed limit meritorious relative to an outright ban. But there is less of a case for a speed limit materially above zero, as this was designed to allow for first home acquisition and the like.

Unintended consequences

We expect that there will be fairly loud opposition to this policy from those connected with the property investment industry. Key complaints are likely to be that it will lead to an increase in rents, restrict the availability of rental property, and impede the supply of new housing.

We are not convinced that restricting the ability of investors to purchase additional properties significantly impacts on the underlying supply and demand position of the rental market. In the near term, the policy will not change the number of houses in the Auckland region. We do expect that the policy will result in a reduction in the share of sales going to investors, so over time this will lead to a marginal reduction in the supply of rental properties. Our estimates are that the investor share of purchases will drop by around 4 percentage points, resulting in the stock of rental properties falling by 0.75 percent in the first year. However, this will also be accompanied by a reduction in demand for rental properties given that the corollary of falling investor purchasers is an increase in the home ownership rate. There may thus be some upward pressure on rents, but this is likely to be fairly minimal.

Of more concern would be if the policy affected the supply of new housing. There is already an exemption for construction loans, and under the proposal this would continue to apply for property investors. The exemption requires the loan to be committed prior to commencement or at an early stage of the construction of the dwelling. It may therefore reduce the willingness of developers to commence construction without pre-selling, which may at the margin make it more difficult to develop apartment buildings. On the other hand, tighter LVR restrictions on investors will significantly enhance the attractiveness of investing in new builds. Investors may see the construction exemption as the only mechanism to increase their exposure to Auckland housing, so it is possible that there could actually be a boost to supply.

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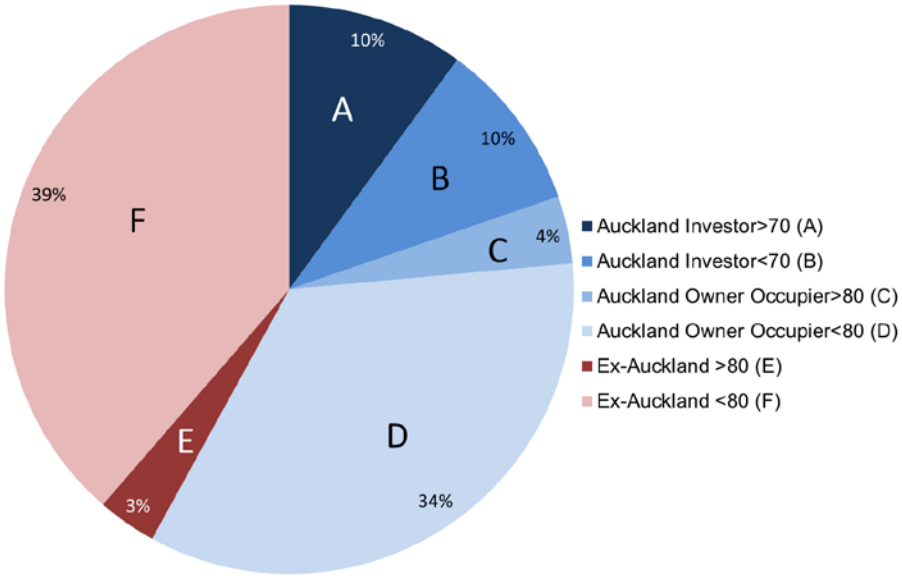
4. Policy issues that may need to be given thought

Within the broad policy calibration, there are a number of technical details that would need to be worked out.

How should the speed limits be calculated?

The proposed policy option requires three separate speed limits to be defined, but there are a few different options for how these can be defined. Figure 2 provides an approximate representation of current bank lending flows (the Auckland/non-Auckland split is the aspect we lack data on).

Figure 2: Rough composition of current lending flows



With a complete ban on Auckland investor lending at LVRs > 70 percent, the formula for calculating the speed limit could be seen as academic. However, we believe that there is merit in considering a very low limit rather than zero (see below), and it is likely that the eventual exit strategy may involve an increase in the speed limit over time. For this reason, it is worth considering the best speed limit definition now.

There are essentially two issues to consider.

1. Should the denominator of the speed limits be all lending to that sector, or should the denominator be total lending. For example, the Auckland investor speed limit could either be defined as A/(A+B) or as A/(A+B+C+D+E+F)?

2. Should we retain a national speed limit on lending at LVRs of over 80 percent or introduce an ex-Auckland speed limit (i.e. E/(E+F) or (C+E)/(A+B+C+D+E+F))?

On the first issue, the most logical approach is to set the denominator as lending to that particular sector. One counterpoint is that using the broader denominator may be easier for smaller banks with lumpier lending flows. This would particularly be the case if we set a very low speed limit for Auckland investor lending. On balance though, we favour the former option.

Likewise, the best option for the second issue is probably to impose a specific ex-Auckland speed limit. This will require further enhancement of our data collections. However, it would be difficult to recalibrate the national speed limit to reliably deliver the degree of easing in the rest of the country that we desire, and doing so would have differential impacts on banks depending on the extent of their Auckland lending.

Is zero the correct speed limit for Auckland investor housing?

Part of the philosophy of the speed limit approach is that it allows for banks to continue writing high-LVR loans in special cases, without having to provide a myriad of exemption options. This argument is probably more compelling for owner occupiers, but there are likely to be some special cases such as leaky buildings that also apply to investors.

Another issue with a hard limit is that we would need to allow a phase-in period to ensure that we did not frustrate existing contracts where lending has been approved, but has not yet reached the commitment stage. While most of these approvals would likely be committed during the announcement period, there could be a long tail and a single new commitment after the implementation date would constitute a breach of conditions of registration.

Finally, with a hard limit, any mistake by a frontline lending officer could result in a breach of conditions of registration, like the breach that occurred when ASB allowed a customer to register a second mortgage. These new rules will create additional complexity, and it is easy to imagine top-ups inadvertently being granted where Auckland investor collateral represents a small proportion of the collateral pool.

For these reasons, we believe it would be better to consider a small speed limit that allows a small safety margin and some capacity for high LVR loans to be approved in special cases. The difficulty would be to calibrate such a limit to achieve this goal. A 2 percent speed limit would probably be effective for the five largest banks, which would give capacity for [redacted] Withheld: OIA s18(c)(i) [redacted] lending to occur over a three month period outside of the restriction. However, such a low speed limit would not be sufficient for even a single loan over a six month period for many of the smaller banks. A higher limit could be considered for smaller banks, or else the limit could be expressed as 1 percent of total mortgage lending for them.

We do not believe any changes are required to exemptions

There are currently five exemption categories to the existing LVR policy: Welcome home loans, refinancing (switching banks), portability (moving house), bridging finance and construction loans. Welcome home loans, portability and bridging finance exemptions are all restricted to owner occupiers, so should not affect property investors.[2] The refinancing and construction exemptions will apply to investors, and we believe that this remains appropriate so as not to impede mortgage market competition or restrict the supply of new housing.

We should take a hard line on multiple collateral loans

As discussed in #6074258 we believe that Auckland should be defined on the basis of loan collateral falling in the administrative boundary of the Auckland City Council. We suggest leaving it to banks to find the most efficient method with which to identify such lending. However, where data limitations or ambiguity mean that a bank is unable to identify the location of collateral, that loan should be classified as an Auckland loan. If loans on multiple properties are grouped together in one collateral structure, the entire loan should be classified as an Auckland loan if any of the collateral is in Auckland.

[2] In some circumstances loans against a property investors own house may be captured in the property investor definition, and this lending would be able to take advantage of the portability and bridging exemptions.

Loans classified in the corporate asset class may present a problem

Some banks classify lending to larger property investors in the corporate asset class, and this lending is not currently subject to LVR restrictions. We have no information at this stage as to how much lending is treated in this way. Anecdotally banks prefer to keep LVRs below around 70 percent for this lending, but may in certain circumstances be prepared to go a little higher.

There are a few options we can consider:

1. We could set strong expectations on banks that they would not start classifying more lending in the corporate asset class, and that banks would not lend at LVRs of above 70 percent to Auckland based investors in the corporate asset class. This could be supplemented with a formal data requirement so that we could monitor the use of the corporate asset class as a possible avoidance channel for high-LVR lending to investors.

2. We could change the definition of the residential property investor asset class in order to encompass this lending. This has generally not been favoured previously, as doing so would likely result in more favourable capital treatment.

3. We could explicitly ban corporate loans that are secured on Auckland property with an LVR of 70 percent. However, we are concerned that this approach could have unintended consequences. Some loans in this asset class may include Auckland housing as a relatively minor part of a collateral package, and would be outside of the target of the restriction (e.g. $2m loan secured on a $2m commercial property and a $500k house).

Overall, we favour option 1, which could be codified through the anti-avoidance section of BS19. If we found evidence that banks were exploiting this loophole for avoidance purposes, we could reconsider a more proscriptive approach.

Is 15 percent the correct ex-Auckland speed limit?

A series of papers last year set out the framework to guide the easing of LVR restrictions (#5649461 and #5859135). Outside of Auckland, house price growth would receive a green light on our traffic light framework, and almost certainly housing credit growth would as well if we had the data. However, there remains some risk of resurgence, as mortgage interest rates remain very low, and even outside of Auckland migration is strong.

We believe that an easing of policy outside of Auckland is appropriate, but we should be cautious in doing so given the risk of resurgence. This is particularly the case given that some Auckland based investors may start looking further afield in response to tighter restrictions in the region.

We do not know the regional split of high-LVR lending, but we generally assume that the share may be a little higher in Auckland. Therefore, just moving to a separate ex-Auckland speed limit may represent a slight easing outside of Auckland, allowing 1-2 percent more high-LVR lending. If the speed limit was increased to 15 percent, banks would probably be comfortable with non-exempt high LVR shares of 11-12 percent. This would roughly double the flow of new high-LVR lending outside of Auckland. This would be a prudent first step towards removing the policy outside of Auckland. Further easing of policy could be considered if the housing market remains subdued outside of Auckland.

5. Roadmap and implementation issues

Table 1 sets out rough timelines for the implementation of policy assuming the intention were to implement it as quickly as practicable. We would envisage an announcement of intention to consult on the package in the FSR, consultation through May/June and implementation on 1 August.

Table 1: Indicative timeline for policy implementation

Announcement of policy package	FSR (May 13)
Release consultation paper and draft changes to BS19	Late May
Consultation period ends	Late June
Release final policy position and revised conditions of registration	Mid-July
Policy takes effect	1 August

Under the Memorandum of Understanding on macro-prudential policy we are required to consult with the Minister of Finance and Treasury from the point where macro-prudential intervention is under active consideration, and inform the Minister and the Treasury prior to making any decision on deployment of a macro-prudential policy instrument. Informal consultation has already started, and formal notification of our intention to act should be made prior to the May FSR (providing this paper or a summary would be one logical approach).

A key contingency is that this policy is reliant on the definition of residential property investment loans, which is the final stage of the housing capital review. The consultation period for this has closed, and the final policy position is due to be discussed at FSO on 15 May. An earlier decision on the definition would clear a key roadblock, and may allow for an earlier release of the macro-prudential consultation paper. We have discussed with PSD the benefits for this policy of having a relatively broad definition of residential investment loan, so that there are few or no investors who are able to be classified as standard residential mortgages after the asset class is in place.

Banks will find it challenging to implement the necessary system changes in order to meet a 1 August implementation date. It will therefore be preferable to release the full consultation paper as quickly as possible, to ensure that banks have adequate time to make these changes. The consultation paper could be delayed for a few weeks after the FSR without too much trouble. However, a substantially longer delay may make it difficult to implement policy by the 1st of August as desired.

A key concern is that there will be an incentive for Auckland property investors to try to rush in to secure lending prior to the implementation date. So while we are aware that banks will find this timeline difficult, we do not want to provide a longer notice period. There was some evidence of a surge in sales during the six week notice period prior to the introduction of LVR restrictions. Where investors have available equity in existing facilities, they may try to top these up in order to finance future purchases. Investors may also be less picky than owner occupiers, so may be more inclined to make a rush purchase to beat the restrictions. It would be helpful to provide strong messages to banks to stop new lending to Auckland investors with LVRs of over 70 percent during the notice period. This should probably be done as soon as the policy is in the public domain.

Concurrently with the consultation process, we will need to make some additions to the new commitments survey in order to measure compliance with the three new speed limits. Table 2 is an example of how we could amend the survey to obtain the necessary compliance data. We would expect to provide banks with an updated template soon after announcement, with first reporting required for the August month.

Table 2: Example addition to new commitments survey

		Auckland Investor lending			Auckland ex-investor lending			Ex-Auckland lending		
		Number of commitments	Value of commitments	Exempt lending	Number of commitments	Value of commitments	Exempt lending	Number of commitments	Value of commitments	Exempt lending
(a)	LVR >100									
(b)	LVR > 95 ≤ 100									
(c)	LVR > 90 ≤ 95									
(d)	LVR > 85 ≤ 90									
(e)	LVR > 80 ≤ 85									
(f)	LVR > 75 ≤ 80									
(g)	LVR > 70 ≤ 75									
(h)	LVR > 65 ≤ 70									
(i)	LVR > 60 ≤ 65									
(j)	LVR ≤ 60									
(k)	LVR unknown									
	Total	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**	**0.000**
	Monthly speed limit		**0.000**			**0.000**			**0.000**	