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REINZ REAL ESTATE INSTITUTE OF NEW ZEALAND

28 June 2015

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Dear Sirs

Submission on Adjustments to restrictions on high-LVR residential mortgage lending

The Real Estate Institute of New Zealand (REINZ) welcomes the opportunity to submit on the Reserve Bank's consultation paper on adjustments to restrictions on high-LVR residential mortgage lending (the Consultation Paper).

REINZ has previously submitted on the policy framework around LVR in April 2013 and is pleased to see that the Consultation Paper takes into account our concerns previously expressed in relation to applying a blanket high LVR limit across the country, given the wide variation in price movements between Auckland and the rest of the country.[1]

The Reserve Bank's analysis and the rationale

In general, REINZ agrees that there has been a significant increase in Auckland house prices since the introduction of LVR in October 2013 to date and it is unlikely to be subdued anytime soon.

Figure 1 below shows that the median price for Auckland has increased by 28.7% or 17.3% per annum on a compound annual growth rate basis since the LVR was introduced. In contrast, the median price for the rest of New Zealand has increased only by 5.4% or 3.4% per annum on a compound annual growth rate basis over the same time period. These results are not clearly indicative of how effective the LVR has been in slowing down the rate of house price growth in response to rising financial stability risks.

The Consultation Paper states that the LVR policy had a significant impact by slowing down national house price inflation by 4.4% between September 2013 and September 2014, after which time there has been a significant increase in housing market activity and house price inflation in the Auckland region.[2] In our view this trend is consistent with the temporary effect of LVR predicted in the recent OECD report. The report states that the effectiveness of LVR may tend to fall through time as lenders circumvent the restrictions.[3]

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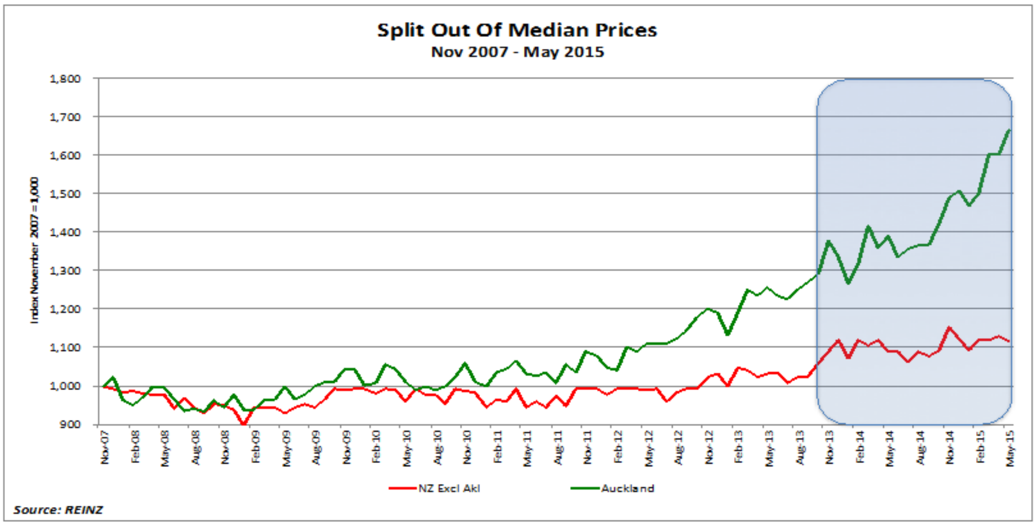
[1] *REINZ submission: Macro-prudential Policy Instruments and Framework for New Zealand, 9 April 2013.*
[2] *Reserve Bank's Consultation Paper, p3.*
[3] *OECD Economic Surveys: New Zealand 2015, OECD, p90.*

"For instance, there is a possibility of leakage to non-institutional lenders (such as lending from family members), offshore creditors or non-deposit-taking institutions, as the restrictions apply only to registered banks."

REINZ had previously shared similar concerns on the limited effect of the LVR associated with increased number of family borrowings and using family-owned properties to achieve lower LVR. Our members are indeed evidencing such methods adopted by property purchasers to lower the LVR, particularly in Auckland.

Figure 1



REINZ also generally agrees with the analysis that the upward pressure on Auckland house prices has been significantly contributed by increased demand to purchase property, accompanied by existing shortages of housing in Auckland and significant supply constraints. REINZ believes that the ultimate solution to this problem lies with increasing the supply, rather than constraining the property market transactions.

The Treasury has recently expressed its reservations regarding the effectiveness of the LVR as follows:[4]

"However, Treasury has been engaging with the RBNZ to suggest that although we accept that house price changes can have macroeconomic implications, the RBNZ's mandate is focused on promoting financial stability, and therefore the policy proposals should be reframed to focus more clearly on reducing systemic risk rather than asset price."

One of the Reserve Bank's objectives with the LVR 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.[5] REINZ has previously submitted that capital-based measures will better achieve this objective and notes that the Reserve Bank has already consulted on a new asset class for property investment loans which will result in higher capital requirements for this class of lending. [6]

[4] *2015 Loan-to-Value Ratios/Macroprudential Policy Information Release Document, the Treasury, June 2015, p4.*

[5] *Reserve Bank's Consultation Paper, p9.*

[6] *Reserve Bank's Consultation Paper, p9.*

The proposed speed limits

The Consultation Paper proposes the following:[7]

- Restrict property investment residential mortgage loans in the Auckland region at LVRs of greater than 70% to 2% of total property investment residential mortgage commitments in Auckland.

- Retain the existing speed limit of 10% for other residential mortgage lending, as a proportion of total non-property investment residential mortgage commitments, in the Auckland region at LVRs above 80%.

- Increase the speed limit on residential mortgage lending at LVRs above 80% outside of Auckland to 15% of residential mortgage commitments outside Auckland.

Based on the data relied on by the Reserve Bank in the Consultation Paper, REINZ understands the need to specifically target investors in Auckland properties as default rates can be higher for investor loans than for owner occupiers in severe economic downturns. The expected efficiency of the proposed policy would be difficult to measure due to a number of factors, however. For example:

- On-selling activities by investors are not captured as mortgage is not required.
- Cash buyers predominantly investing in high-priced Auckland properties are not captured.
- Most investors are well capitalised to fund the deposit to meet the new LVR restrictions.
- Any decrease in the investment activities for Auckland properties or a fall in Auckland property price may be a result of the introduction of the new property tax rules coming into force from October and not necessarily associated with the LVR.

In the view of REINZ, to retain the existing speed limit for non-investment loans for Auckland properties will continue to negatively impact first home buyers in Auckland. According to our data, only 18% of residential sales in Auckland were under $500,000 in May 2015. *Table 1* below shows that first home buyers are barely active in the Auckland market, with only 5 out of 221 suburbs in Auckland recording a majority of their sales under $500,000.

Table 1

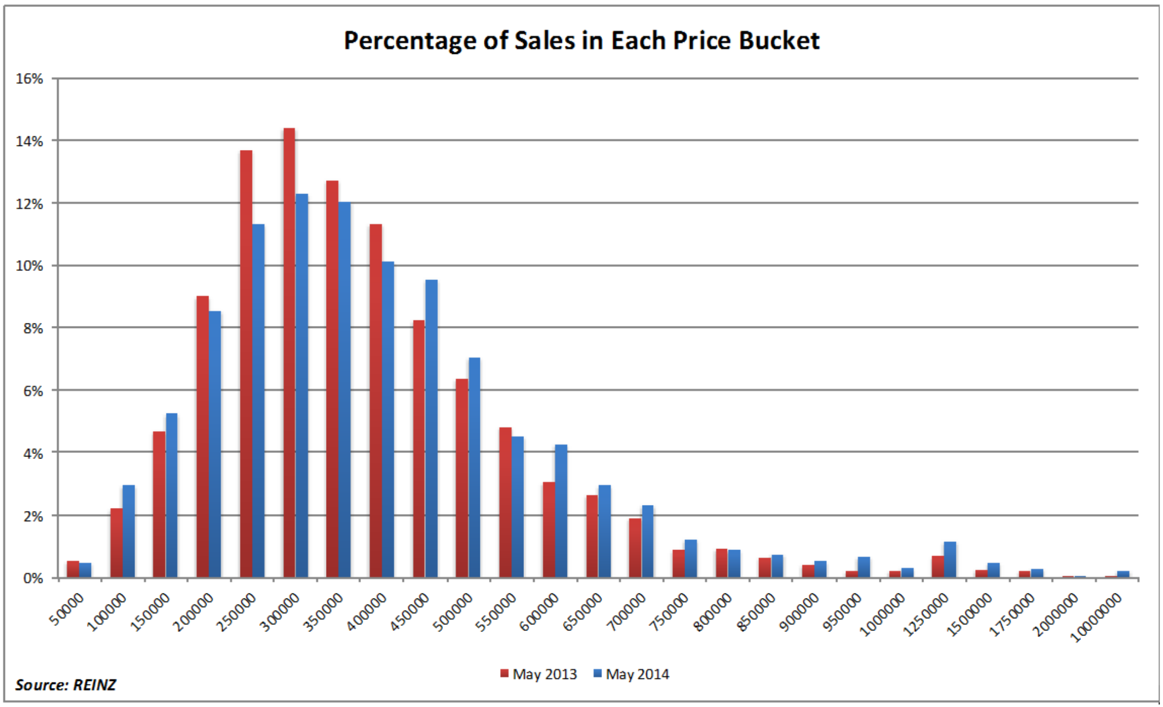
Ranking of Sales under $500,000 by Suburb for May 2015 (Source: REINZ)

Rank	Suburb	Total Sales	Sales under $500k	% under $500k	Median Price
1	Auckland Central	151	110	73%	365,000
2	Manurewa	73	36	49%	500,000
3	Papakura	59	34	58%	482,500
4	Papatoetoe	84	25	30%	587,500
5	Pukekohe	52	22	42%	535,000
6	Tuakau	21	17	81%	401,000
7	Clendon Park	19	15	79%	412,000
8	Randwick Park	17	14	82%	388,000
9	Mangere East	27	14	52%	485,000
10	Henderson	72	13	18%	694,000
11	Waikuku	26	13	50%	495,000
12	New Lynn	42	12	29%	625,000
13	Waymouth	21	11	52%	490,000
14	Takanini	29	9	31%	579,000
15	Otara	14	9	64%	447,500
Totals		**707**	**354**	**50%**	**490,000**

[7] *Reserve Bank's Consultation Paper, p2.*

Figure 2 below shows that sales in the $450,000-$750,000 range increased noticeably between May 2013 and May 2014 resulting in a general increase in sales above $450,000 and a decrease in sales below $450,000.[8]

Figure 2



Our concern that the LVR restrictions will disadvantage first time buyers is also shared by the New Zealand Treasury.[9]

> *"Treasury is concerned that the original LVR policy may have supported the increase in investor activity. The RBNZ note that some of the increase in the investor share is due to falling participation by first home buyers following the introduction of LVR restrictions, and note that the level of sales to investors is around 12 % higher now than immediately prior to the introduction of LVR speed limits and has been strong recently. We will be working with the RBNZ to unpick these concerns. The RBNZ do not examine the impact on first time buyers, apart from noting that banks are known to preference lending to owner occupiers, especially first home buyers, in allocating high-LVR lending within the existing national speed limit."*

The OECD report also predicts that the burden of the LVR restrictions falls disproportionately on first-time home buyers and poorer individuals and additional policy measures to offset some of these distributional consequences may act to reduce the effectiveness of the LVR.[10]

The Reserve Bank's concern is with the risk of a substantial correction in the Auckland house prices triggered by a sharp economic downturn which could threaten the stability of the banking system in the event of a large increase in mortgage default rates and credit losses.

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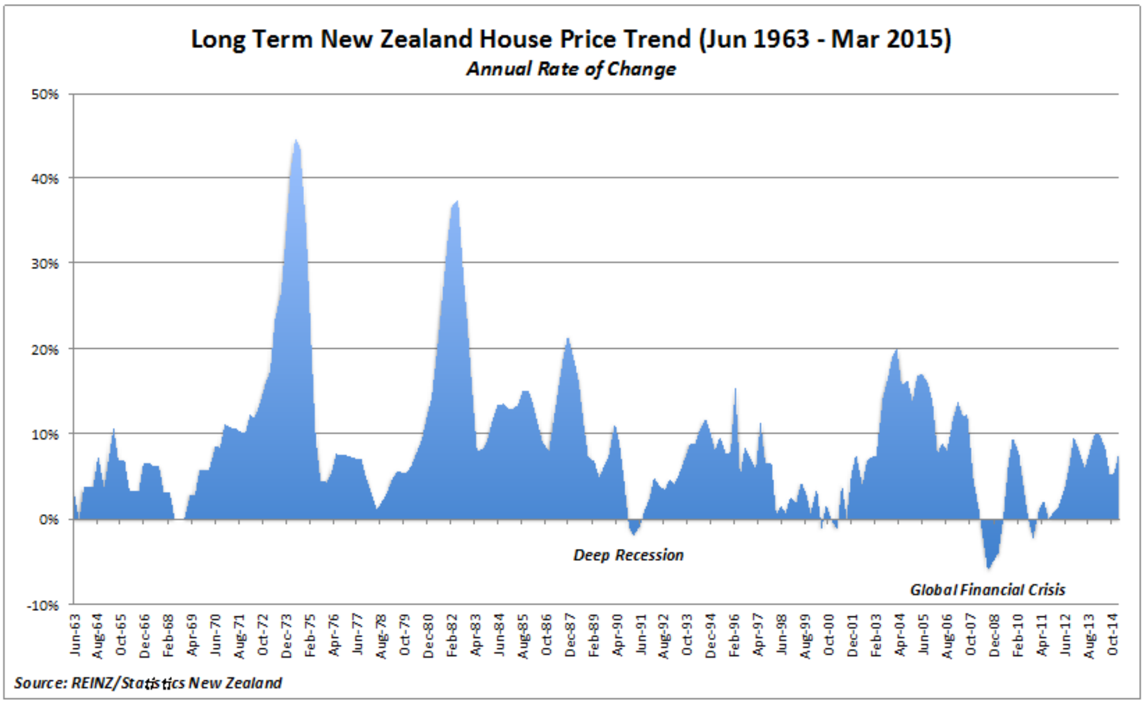
[8] *Note that the selected period covers several months before and after the LVR introduction as opposed to showing only the immediate effects before and after of the LVR introduction.*
[9] *2015 Loan-to-Value Ratios/Macroprudential Policy Information Release Document, the Treasury, June 2015, p4.*
[10] *OECD Economic Surveys: New Zealand 2015, OECD, p90.*

This concern was supported by the "stress test" undertaken by the Reserve Bank in conjunction with the Australian Prudential Regulation Authority, which has featured a significant housing market downturn concentrated in the Auckland region.[11]

Figure 3 below outlines the long-term rate of change in New Zealand house prices from June 1963 to March 2015, with the three periods of negative price changes noted which could be identified as the 'significant housing market downturn'. It can be seen that the periods of these downturns have been for a short period of time with relatively quick recoveries. It may be an overstatement to presume that future downturns of this shallow nature will create any significant risks for the banking system.

Figure 3



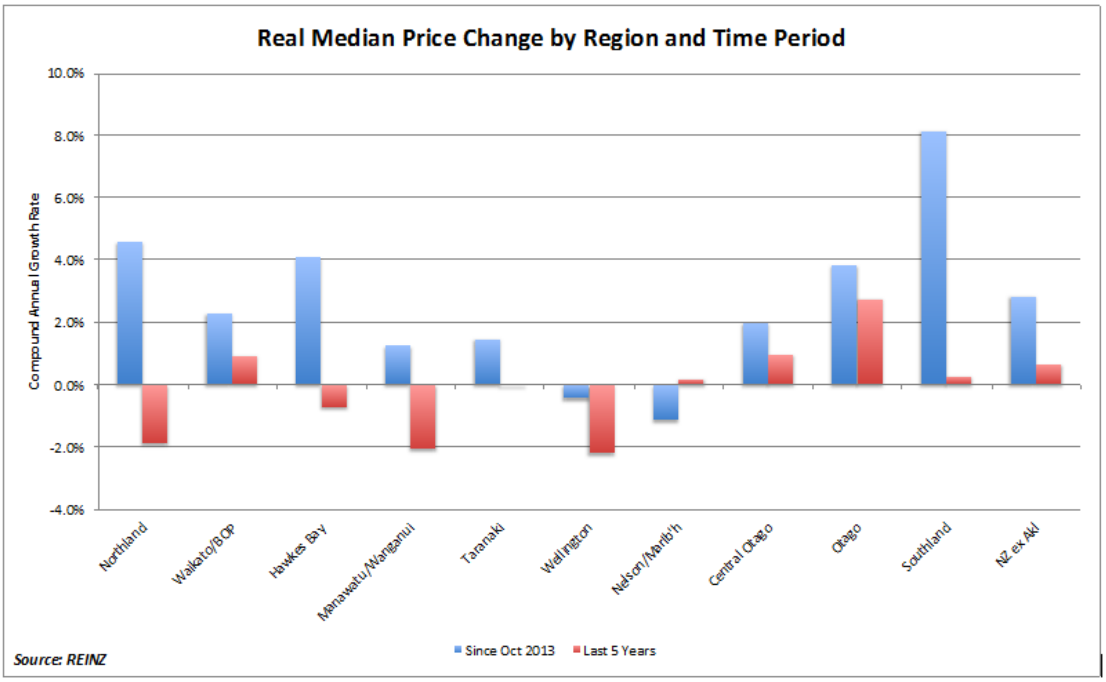
The Reserve Bank estimates that the tighter LVR restrictions on Auckland investors will reduce house price growth by 2-4 percentage points in the region over the first year, and Auckland housing market transaction by around 7%.[12] If these targets remain as the objectives of the Reserve Bank following this consultation, REINZ submits that they could be better achieved by applying LVR restrictions to Auckland region above a certain price. For example, imposing LVR restrictions for residential borrowing for Auckland properties that are priced over $500,000 would help to mitigate the negative impact of the LVR on first home buyers in Auckland.

As for the proposed speed limit for outside Auckland, there is a general lack of discussion throughout the Consultation Paper justifying the need to impose any speed limit at all. In fact, the Consultation Paper notes that there is little evidence of exuberance in property markets outside of Auckland.[13] REINZ concurs with that observation.

[11] *Reserve Bank's Consultation Paper, p6.*
[12] *Reserve Bank's Consultation Paper, p 9-11.*
[13] *Reserve Bank's Consultation Paper, p14.*

Figure 4 below shows the real price change on a regional basis excluding Auckland and Canterbury/Westland.[14] This shows that over the past five years there has been very little real price growth in the regions outside Auckland, with Northland, Manawatu/Wanganui and Wellington showing annual real price decline of 2% per annum. Since October 2013, the real price increase in the majority of the regions has been less than 3%. There are five regions with price movements of less than 2% per annum since the introduction of the LVR with two of these showing negative returns. Overall, the rate of change in the real median price for properties outside Auckland has been minimal.

Figure 4



Our regional members have expressed concerns on many occasions that their clients and customers are bearing the brunt of a policy designed principally to address the Auckland market. Based on the relative house price movements and the significantly different supply/demand balances between Auckland and the rest of the country, REINZ considers that a speed limit for outside Auckland is unnecessary. REINZ submits that the Reserve Bank should seriously consider a removal or a greater relaxation of the speed limit imposed on regions outside Auckland.

<u>Impact on rental market</u>

In REINZ's view, there is a real possibility that the rental price will increase as a result of the proposed changes. Provided that the Reserve Bank's objectives are met and that this results in the proportion of investor owners decreasing, this could lead to less rental properties becoming available. The Consultation Paper predicts that the demand for rental properties

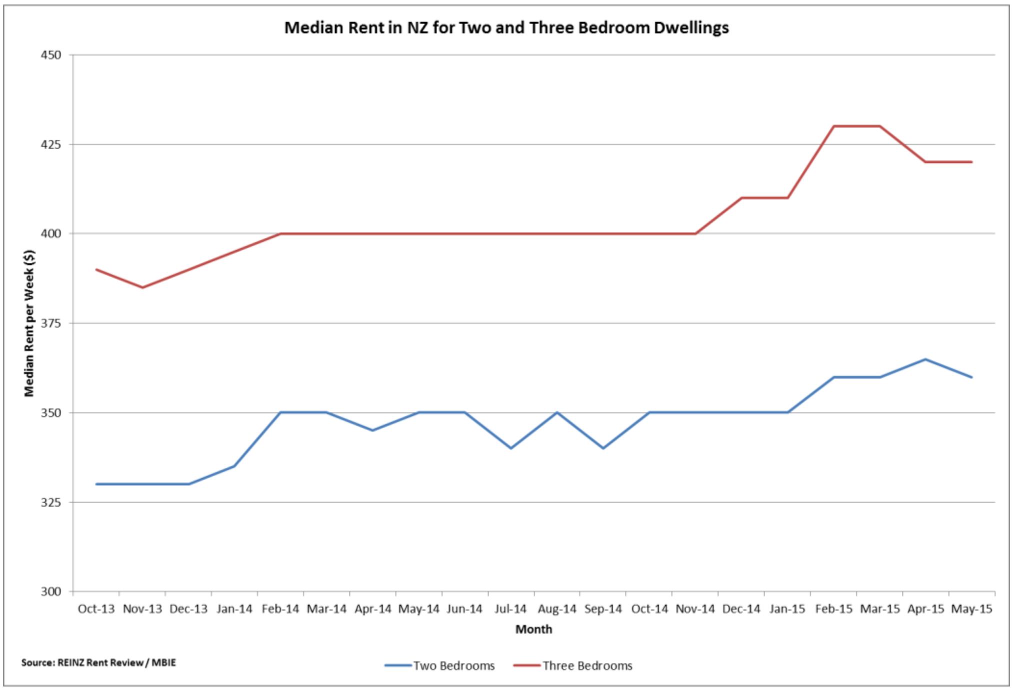
[14] *Canterbury/Westland has been excluded due to the isolated impact of the 2011 earthquake on the market dynamics for the region.*

will reduce to alleviate the decreased supply presumably since there will be a general shift from investor to owner occupier purchases.[15]

Figure 5 below shows that since the introduction of the LVR, the rental price across the country has increased by 9.1% for two bedroom dwellings and 7.7% for three bedroom dwellings.

According to the May 2015 Financial Stability Report the annual net immigration currently stands at an all-time high of more than 56,000, around half of which represents inflows into Auckland.[16] Based on such findings, any decline in the demand for rental properties is unlikely, particularly in Auckland, and the burden can fall disproportionately on low-income households. The rising burden of housing costs on low-income households has contributed significantly to the increase in poverty rates since the late 1980s.[17]

Figure 5



In summary, REINZ submits that:

1. LVR restrictions should only be imposed on a temporary basis as its impact will wane over time and, in any event, will only have moderate effect on house price growth as already predicted by the Reserve Bank.[18]

2. The Reserve Bank should seriously consider a removal or a greater relaxation of the speed limit imposed on regions outside Auckland.

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[15] *Reserve Bank's Consultation Paper, p12.*
[16] *Financial Stability Report, Reserve Bank, May 2015, p26.*
[17] *OECD Economic Surveys: New Zealand 2015, OECD, p116.*
[18] *Reserve Bank's Consultation Paper, p9.*

REINZ would be more than happy to meet with you to discuss our comments further at your convenience.

Yours sincerely

Colleen Milne
Chief Executive Officer