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Principal:
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16 August 2016

The Governor
Reserve Bank of New Zealand
PO Box 2498
WELLINGTON 6140

Dear Sir,

**Re: RESTRICTIONS ON HIGH LVR RESIDENTIAL LENDING AND
UNINTENDED ADVERSE CONSEQUENCES FOR HOUSE
CONSTRUCTION**

We refer to the recent proposed adjustments to restrictions on high LVR residential mortgage lending. We refer specifically to the proposed new regulations to restrict investor borrowing to 60% of LVR for property investment.

We observe that there are two possibly unforeseen adverse consequences which are not addressed in the consultation paper on the proposed new regulations.

Our concerns relate to the following:

- a. The restrictions apply to loans for the construction of some new dwellings, which would ordinarily be exempt from the regulations, specifically where the security properties provided includes a property currently used as an investment or rental property; and
- b. The exclusion of relocated or repurposed buildings from the definition of new construction.

We will address the two concerns separately, as follows:

Limitation on Loans for Construction of New Dwellings Where Property Security Includes a Rental or Investment Property

It is clear that the intention of the proposed regulations is to restrict the availability of funds to property investors who wish to purchase an existing building for rental purposes. The policy reasoning for this is clear. Property investors are not adding to the housing stock if they are buying existing property, and demand from investors is one of the reasons for excessive house price inflation.

LVR Restrictions.docx

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In addition, the government wishes bank funds to be applied to the construction of new dwellings, not to inflationary speculation in the existing property market.

The proposed new LVR rules are expressly not intended to restrict the supply of funds for the construction of new buildings, or to limit other measures intended to increase the supply of housing, particularly in Auckland.

However, we believe that this is precisely the likely consequence of the proposed regulations, for the following reasons:

1. The classical transaction which would be restricted by the regulations would be an investor borrowing more than 60% of the value of an existing house with the intention of using that property as a rental. The proposed purchase does not add to the supply of housing (though it may increase the supply of rental accommodation, at the expense of owner occupied dwellings).
2. However, a prospective purchaser may wish to borrow for the purpose of constructing a new dwelling. This would ordinarily not be affected by the proposed regulations. However, if the borrower requires security over properties in addition to the section on which the house is to be built (which would be the usual scenario) the proposed loan may well be prevented by the regulations.
3. The following is an actual scenario where precisely this situation has arisen.
 - a. The intending borrower wished to purchase a section and erect a house thereon;
 - b. As the loan required was well in excess of the current value of the land, the borrower's bank required additional security;
 - c. The only security available, in this particular case, was a property which is currently being used as a residential rental investment. There was more than sufficient equity in the existing property to provide the bank, in the ordinary course of events, with adequate security; and
 - d. However, although the purpose of the new loan was to buy a section and erect a new house, the bank was obliged to apply the 60% lending cap on the current rental property. This had the effect of significantly reducing the available security. The loan was declined.

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4. We believe that the fundamental purpose behind the proposed regulations is to discourage the purchase of existing properties, and to encourage the construction of new properties.
5. Consequently, the purpose of the loan must in every case be paramount, not the nature of the security being offered.
6. A property investor may have a large portfolio of properties, and be wishing to add to that portfolio by purchasing bare land and erecting new dwellings, not by buying existing houses. Under the proposed regulations, this would not be possible unless the level of borrowing across his or her entire portfolio was less than 60%. We believe that this defeats the purpose of the regulations.
7. In summary, we recommend that the regulations be drafted or amended to provide that it is the purpose of the loan which determines whether the 60% lending cap applies, and that if the security property, or one of the security properties provided, is an investment property this does not result in an artificial position of a lending cap on the proposed borrowing.

Relocated and repurposed houses should be treated as new dwellings

We understand that the Reserve Bank does not currently accept that the relocation of an existing house to a bare site is the construction of a new dwelling for the purposes of the LVR restrictions. We believe that this approach is incorrect.

We understand from discussions with Reserve Bank representatives that the Reserve Bank does not regard a relocated house as contributing to the housing supply. We believe that this false.

1. The majority of relocated and repurposed dwellings are houses which have been removed from their original site during the subdivision or development of the land. Typically, this would mean that the house which had been removed would make way for two or more replacement dwellings. With the new Auckland Unitary Plan the removed house may be replaced by four or five new houses.
2. A usual scenario would involve the removal of a house from one section, and its relocation on a bare section, combined with the construction of a new dwelling on the first section. The removal of the house from one lot and its relocation on a new site has contributed to the supply of housing. The house

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could simply have been demolished, in which case only one house would be added to the supply of housing, rather than two as would be the case if the relocated house was retained.

3. We believe that relocated houses should be treated as a new build for the purposes of the regulations. To not do so discourages developers from retaining existing housing stock, and would potentially result in these houses being demolished, thereby reducing the housing stock.
4. We are also aware of many buildings which have been repurposed and relocated as new “houses”. These include buildings erected as show homes and former dormitories from boarding schools. It is an efficient mechanism to add to the housing supply if these buildings are relocated and upgraded to function as new dwellings.
5. If the regulations exclude such buildings from the definition of new construction, there will be a reduced demand for such buildings with the likely consequence that many will be demolished, and builders will be obliged, due to funding constraints imposed by the new regulations, to erect new dwellings instead. This will add to the cost of new housing, reduce the housing stock, and given constraints within the building industry, result in a reduction in the supply of dwellings.
6. We also observe that a relocated second-hand house, or repurposed building is generally significantly less expensive than a new construction. It is much less costly for an existing house or building to be re-located on bare land, and utilised as a house, than for an entirely new house to be built. One new dwelling would on average cost at least five times the amount of a re-located dwelling.
7. As one of the purposes of the Reserve Bank restrictions is to increase the supply of affordable housing, we believe that such inexpensive relocated housing should specifically be encouraged, rather than discouraged by the proposed new regulations.
8. In conclusion, we request that the Reserve Bank gives serious consideration to:
 - a. Amending the proposed regulations to ensure that the restrictions apply based on the intended purpose of the loan, not the nature of the security provided; and

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- b. To ensuring that relocated dwellings, and repurposed buildings intended for housing, be treated the same as a new construction for the purposes of the LVR restrictions (i.e. excluded from the new restrictions).

We are happy to provide additional information in support of these submissions, if required.

Yours faithfully
BLOMKAMP COX

Per John Cox LLB

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