Grant Burson
Withheld OIA s9(2)(a)
[redacted]

25 July 2016

Head, Macro Financial Department
Reserve Bank of New Zealand
PO Box 2498
Wellington 6140

By e-mail: macroprudential@rbnz.govt.nz

To whom it may concern

Adjustment to restriction on high-LVR residential mortgage lending

This submission is in relation to the Consultation Paper dated July 2016 headed Adjustment to restriction on high-LVR residential mortgage lending. I am responding as a concerned New Zealand individual.

Your consultation paper was in regard the RBNZ moving the restriction on high LVR residential mortgage lending rules to all of New Zealand and the change in the investment ratio from 70% to 60%.

I submit that the overall objectives of this policy is sound however may benefit by a slight adjust as follows:

<u>Recommendation - Policy Adjustment</u>
The construction exemption should only be allowed in the Auckland market.

The reasoning for the recommendation is twofold:

1. Make the market (including the NZ registered Banks) aware of the exemption.
2. Reduce the risk of oversupply and investment in areas other than Auckland.

<u>General Comment</u>
The major contributor for the rise in residential house prices in Auckland is the lack of existing product and also the lack of supply which is being exaggerated by migration. This has resulted in Auckland house prices rising over recent years with this now flowing on to other areas of New Zealand as this price increase has driven investors out of the Auckland market.

It would appear from the briefing paper that the issues around the New Zealand residential property market is the rise in these values. Recent rises have been achieved at a higher rate outside of Auckland due in part to Auckland investors and speculators refocusing outside of Auckland due to affordability and equity issues.

A concern a present is that certain media are indicating that the only solution is a reduction in the price of housing and are also not fully reporting the policy, especially exemptions available. Most media reports advise that all investors now need a minimum of 40% equity.

Grant Burson
[redacted]

House Price Reduction – Is this the solution?
An economic value is that supply / demand will correct itself if given time. If demand increases without an increase in supply, or an alternative is not possible, then the price will rise and continue to rise until an affordable price is reached. This affordable price point for housing is an unknown as it is an essential supply. Therefore this will continue to be an issue but will self-correct once there is a supply / demand balance or oversupply. How severe this correction will be is a concern but unknown until it arrives. What we do know is that there is a shortage as well as a lack of supply in the short to medium term.

A reduction in value is a concern as if you can buy something tomorrow cheaper than today then you will delay the purchase. Further to this is if a product sale price is decreasing then a supplier will only continue to produce the product if they can still make an adequate profit / margin or else the cost to manufacture this product is also reducing.

Hence if we see a fall off / reduction in house prices in the market, investors, owner-occupiers and first home buyers will not enter the market given they will be able to purchase that same house cheaper next year. It will not matter if there is a shortage of product as confidence in the market will have been removed. This was highlighted in October 2015 when the RBNZ and Central Government put in place new policies and there was a slight adjustment downwards but turned upwards again in April 2016 once the policies were understood and confidence was restored. During this period there was no correction to the lack of supply.

The introduction of the recent adjustment to the High-LVR on residential mortgage lending and the reporting around it may create a reduction in confidence as the media continue to focus on investors now requiring a 40% deposit to finance a house purchase and that house prices need to reduce. Note that should house prices start to reduce over a medium term (say 4 to 6 months) then the Banking system will exaggerate the position through tighter lending restrictions.

The effect of a reduction in house prices will affect the supply due to:
- Residential developments becoming unprofitable;
- Developers risk increasing on residential development through an increase in the likelihood of purchaser's not wanting to or not having the ability to settle. Purchasers will be reluctant to settle if the asset they are buying is worth less than they are required to pay for it and Bank's will require higher equity to maintain an acceptable LVR;
- Developer's inability to achieve pre-sales to meet development finance requirements required by Banks;
- Main trading Bank's unwillingness to finance residential property development due to the lack of pre-sales, higher settlement risk and too low a development margin.
- Given the above developers will be unwilling to supply or build residential house and instead land bank pending the market returning.

As above a decrease in house prices will be followed by a reduction in supply. Problem solved for now.

However migration numbers are not expected to change overnight and we would have to have a significant reduction in population in Auckland to resolve the current housing supply shortfall. The most likely cause of a reduction in population in Auckland would be a recession which is likely to create greater financial instability than the present issues.

Grant Burson

Withheld OIA s9(2)(a)

[redacted]

The likely outcome of a reduction in house prices is continued population growth in Auckland against a back drop of a reducing supply. This will only create a further shortage in Auckland housing. At some stage in the future (and this could be a year or several years away) housing confidence will return resulting in a rise in house prices. Given that the shortage of housing will be higher than is currently held, it will result in a significant rise in house price again and most likely above the current prices seen.

It would also take, as it has in the current cycle, several years for the consent, infrastructure and resources to be put in place to enable the supply to increase. Effectively all that would be achieved is a short term correction in the current housing values in Auckland and or New Zealand which would then only result is a greater rise down the track. Or else simply - just kicking the can further down the road.

<u>Restrict / market the Construction Exemption?</u>

Maybe one solution would be for the Reserve Bank to encourage the use or even market to NZ Trading Banks and the media / public the exemption under Construction allowed within the policy. This would divert interested property purchasers with less equity to purchase properties to be constructed rather than existing houses. Any finance approved would of course still need to meet Trading Bank's debt serving and other requirements.

Note that I have struck several instances of parties who have purchased residential houses that meet the requirement of the Construction Exemption however main trading banks have required 30% and one in the last week at 40% (under the new announcement) deposits / equity as they understood this was required. Note that in all cases, on the purchasers going back to the Trading Bank and providing them with the details of the exemption, finance has been approved with a deposit required at only 20%. Hence I am concerned that as the media and the RBNZ have not mentioned this exemption both investors and the NZ Trading Banks are not adequately aware of it.

To also refocus the investment supply onto the Auckland market it may be prudent to restrict the Construction Exemption to the Auckland area only. The risk of leaving it nationwide is that supply may commence in areas where there is no shortage resulting in an oversupply. Also given the price point outside of Auckland is lower, a larger deposit is more affordable.

The advantages with the above is:

- Likely to result in the continuation of supply in the Auckland market.
- Purchasers are likely to refocus on the residential new builds in the Auckland residential market as under the Construction Exemption there is no LVR restrictions. First home buyers and investors could obtain 100% if the Banks are willing to provide it.
- Demand for the purchase of existing houses is likely to reduce as parties focus on new builds which may result in more supply of existing product as there are less purchasers. This may well result in prices stabilising.
- Investors and speculators are likely to refocus on the Auckland market as a 40% deposit in the non-Auckland market is likely to be sufficient to enable an Auckland property to be purchased with a 20% deposit.
- The market price of houses is reported / recorded on settlement. Therefore should there be any increase in the value of completed products this will not show statistically for 6 to 24 months as there will be a delay between the purchase and settlement as construction works have to be completed. Hence indicate to the market more price stability.

Grant Burson

Withheld OIA s9(2)(a)

[redacted]

- Encourage the NZ Trading Banks to finance new builds as the settlement risk on these is likely to reduce. It may also encourage the NZ Trading banks to finance the settlement of new builds are they are comfortable that the RBNZ will not take any action against them for this.
- Allows the RBNZ to further adjust the LVR policy to focus on Auckland's supply as required.

I am aware that this action will result in media, economists and Politician negative comments as it will not cater for the first home purchaser. However if the market values of houses start to reduce, first home buyers will be unwilling to invest now and as seen in the last cycle they were also too slow to get back into the market when it started to rise. Hence whichever way you decide the first home buyer is disadvantaged.

Finally if you believes that some of the above has merit then I would recommend that the definition of the Construction Exemption is tightened up as I believe there are several loopholes that parties could exploit.