CREATING Communities

8 August, 2016

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

Attention: Head of Macro Financial Department

By email: macroprudential@rbnz.govt.nz

RE: Submission to the Reserve Bank's Consultation Paper: Adjustments to restrictions on High LVR residential mortgage lending.

Creating Communities Ltd is grateful for the opportunity to submit in response to the Reserve Bank's consultation paper regards new high LVR lending limits for residential mortgages.

1. About Creating Communities

Creating Communities Ltd (CCL) is a syndicate representing 4 private Auckland development companies who collectively have been operating in the Auckland market for greater than 100 years. The CCL syndicate is building 350 new homes in Glen Innes, Auckland. 83 of the new homes will be for Social Housing, and 34 of the new homes will be for Affordable Housing, the balance will be sold into the private market.

2. CCL Experience regards LVR limits and the Development of New Build Homes

Since 2013 CCL has experienced the impact of progressively tightened LVR limits. With each tightening we have experience a 4-6 month lull in demand for new homes. The negative impact on sales of new homes has had a detrimental impact on CCL's relationship with Bank funders due to the impact on performance ratios within our Bank Funding covenants.

The current LVR Limits are designed to cool the housing market while supply has an opportunity to catch up with demand. In recognizing that the LVR limits would be a failure if they limited supply, the Reserve Bank has an exemption for mortgage lending to fund the construction of new dwellings. In practice this exemption supports the sale of Land and Build Packages which are typically offered by group builders whereby the retail purchaser funds the building activity. In the Auckland Market, land and build packages are a relatively small component of the supply of new housing (arguably less than 10%).

Clause 51 of the Reserve Bank consultation document out on the LVR Limits outlines the nature of the current exemption;

> 51. The LVR policy already includes an exemption for mortgage lending to fund the construction of new dwellings, which is designed to mitigate any negative effect of the policy on housing supply. This exemption will continue to apply under the proposed policy settings, and is available for both investors and owner occupiers.

Unfortunately, the majority of new supply in Auckland is supplied by developers who fund construction through a debt facility with a major trading bank, and therefore the new homes that they are building fall outside of the exemption. This is particularly the case in brownfield subdivision.

Appendix A: (following) constitutes a table that details some of the general characteristics of the two different means of generating supply of newly built homes.

The practical effects of the tightening LVR restrictions are illustrated by the following experience;

Creating Communities Ltd (CCL) is currently building 350 new houses to supply the Auckland market. In the 2016 year to date we have been selling approximately 2 homes per week, with an increased sales rate limited by availability. The homes have overwhelmingly been purchased by owner occupiers.

In the 3 weeks since the 19th of July announcement of LVR restrictions, CCL have made no sales, and furthermore, received no offers, on any of the seven 2, 3 and 4 bedroom homes currently listed for sale.

CCL believe that in the interests of protecting and encouraging new supply;

1. the Reserve Bank should not differentiate between different sources of new build supply, and

2. there should be consistency across Government and quasi-Government agencies, with regard to how policy is scoped and defined, particularly with respect to the definition of what is a newly built home.

3. Relief Sought

CCL believe that the exemption in Clause 51 of the Consultation Document should be widened such that;

1. **all new builds are exempted from LVR limits, and**

2. **that the definition adopted by the Kiwisaver HomeStart Grant Policy[1] be adopted as a means of defining what constitutes a "Newly Built Home" for the purpose of being exempt from the LVR restrictions.**

4. Concluding Comments

CCL's experience has been that the current settings do not cause the market to differentiate strongly between new housing supply and old housing supply. This is despite the increased costs and performance associated with the production of new housing.

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[1] The KiwiSaver HomeStart definition for a newly built home is as follows;

> A home which received its building code compliance certificate fewer than six months before Housing New Zealand receives a KiwiSaver HomeStart grant application is considered a new home. The certificate must relate to the home as a whole and not only some building work on the home. Buying a vacant residential section and planning to relocate an existing/older house on the site does not constitute a new build property and will only be eligible for a HomeStart grant of between $3,000 and $5,000.

The clearest example of this has been CCL's sale of a 240sqm Silverton Ave home on a 500sqm section just 60m from the coastal reserve, with sea views, for $1.2m. The purchaser was unable to pay more as $1.2m was what he had been paid by a speculator for his 96sqm ex state house on 800sqm on Wimbledon Crescent, one of the less desireable parts of Glen Innes.

This example shows that the focus of speculation is on land with prospects of increased density. Ironically this increased price competition is undermining the financial case for the redevelopment of this same brownfield land, therefore it is desireable that Reserve Bank Policy suppress this speculation. However this suppression should not come at the cost of limiting new supply, which ultimately is the solution to the current demand supply imbalance in the housing market.

CCL is aware that The Property Council and RAWA Limited are also proposing to submit on this topic, and we wish to record our support for those submissions.

Best regards

Murdoch Dryden
Director: Creating Communities Ltd

APPENDIX A

Nature of Sale	Land & Build Package (mortgage lending to fund the construction of new dwellings)	Developer Pre-sale of buildings under development.
Typical Timing	Upon completion of subdivision prior to commencement of any building works	Typically occurs once building consent has been received, but can be at any stage in the build process.
Finance	The Bank will finance the Purchaser to purchase/finance the building works. The funding will come via the banks retail funding department, and will be for a single dwelling.	The Bank will finance the developer, typically wholesale funding via the Property Finance department at the bank. Typically funding multiple dwellings.
Payments	The finance is usually tied to milestone payments such deposit upon agreeing building plan, payments on pouring floor slab, completing roof, closing in building, code of compliance.	The finance is usually drawn down monthly against a development funding facility to meet progress claims from the builder.
Purchaser Risk	Purchaser has greater exposure to the project performance and financial viability of the builder. This was seen in the recent receivership of Stonewood Homes, and in a number of small ChCh residential build companies who have not performed.	The purchaser will pay a deposit to a stakeholder. The purchaser will usually have a sunset clause wherby they can cancel the contract and recover the deposit if the developer is not performing.
Vendor/Developer Risk	The developer is usually limiting their exposure to the subdivision works, and some vendor financing of the land component of the transaction (builders terms), the builder/vendor is exposing themselves to a transaction with a counterparty where there is often a greater degree of design personalization and therefore management required.	The developer is exposed to some settlement risk upon completion, but does have the security of the deposit which is usually set at 10% of the sale price.
Reserve Bank LVR Treatment	Lending can be made at 90% LVR with such lending falling outside the Reserve Bank LVR Limits	Lending is subject to LVR speed limits meaning that there is a shallower pool of buyers for this product.