Property Council New Zealand

2 August 2016

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

Attention: Head, Macro Financial Department

By email: macroprudential@rbnz.govt.nz

Re: Submission on the Reserve Bank's Consultation Paper: Adjustments to restrictions on high-LVR residential mortgage lending

Property Council New Zealand (Property Council) welcomes this opportunity to submit on the Reserve Bank's above consultation paper.

1. About Property Council

Property Council is a member-led, not-for-profit organisation offering a collective voice for the commercial property industry and the residential sector. Our members include owners, investors, managers, and developers of office, retail, industrial and residential properties, central and local government agencies and other property professionals. Our branches throughout the country represent some of the largest commercial property portfolios in Auckland, Waikato, the Bay of Plenty, Wellington, Hawkes Bay, the South Island and Otago, the value of which exceeds billions of dollars. We promote sound policies and requirements to achieve our primary goal of the creation and retention of well-designed, functional and sustainable (including economically) built environments which contribute to New Zealand's overall prosperity. Over the years, Property Council has built a rapport of being an advocacy organisation that can be relied upon for impartial, objective, relevant, and high quality advice.

2. General remarks

Property Council recognises the importance of the Reserve Bank's role, and acknowledges the increasing pressure it has been under in the last couple of years to help cool New Zealand's housing market whilst bringing inflation back within the target range of 1-3% on average over the medium term.

Property Council also acknowledges the Reserve Bank's decision to price some prospective buyers out of the market as a short term measure.

Property Council is encouraged to note the exemption for construction loans is proposed to be retained as part of the proposed adjustments to restrictions on high loan-to-value ratio (LVR) bank lending. Property Council understands this includes buying a property off the plan, as well as buying land to build a new house on.

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We do, however, submit against the Reserve Bank's proposal **not** to exempt the purchase of a newly built house for the reasons outlined below.

3. How the industry operates and construction lending

Once developers have got sections available, they are able to offer them to the market. Many developers favour selling several sections at once to builders/contractors who construct dwellings with a view of offering a land and house package (newly constructed houses) to the general public.

Needless to say, we are seeing some bigger companies play the role of developer and builder. These companies are able to facilitate construction lending with ease as they already own the section and then build once contracted by an owner-occupier or investor. There are not that many companies in New Zealand that are able to play this dual role.

The various stages, costs and challenges of, and the time and costs involved in, the build process can be very draining. These, combined with developers mostly preferring to sell a number of sections at once, is probably why only a small segment of the market comprises of construction lending. Also, banks and the KiwiSaver Home Start package have additional requirements where construction lending is involved.

The Reserve Bank's current proposal to exclude construction lending anywhere in New Zealand means that where a builder decides to build a number of houses (without all being sold off-the-plan) to achieve economies of scale, then those that have not been sold off-the-plan will become subject to LVR requirements.

Not excluding newly built houses would be counterintuitive to what the policy is actually aiming to do (recognised by the Reserve Bank exempting construction loans).

Property Council does not expect there to be a significant increase in constructing lending as a result of the Reserve Bank's current proposals. We submit that the current proposals would do very little to improve housing affordability.

4. Risk of distortions and unintended consequences

The benefits of buying a new house over a dwelling built 20-30 years ago are many (built to current standards, insulation, carpets, no asbestos, et cetera.). The difference in the selling price between the two, however, is not significant at the moment, particularly in Auckland (and especially where the older house sits on a big section). This is a direct result of the speculative market.

In regards to the new-build component of the housing market, there is only so much profits builders can make due to the following costs which can be substantial:

- making a section 'ready to go' (that is, getting the necessary operative zoning, and provision of/connection to all the necessary infrastructure)
- development contributions and, in Auckland, Watercare's infrastructure growth charges
- fees incurred to secure resource and building consents
- construction costs.

Further, in order to secure funding to finance a project, builders (as do developers) need to be able to demonstrate that the project will not fail – if banks are not satisfied that the project will be financially viable (and that unforeseen events may not be able to be covered for), they might decide against advancing finances, or only finance a portion of the needed sum. This leads to mezzanine funding being involved, which increases the project's costs.

It can therefore be deduced that bulk of the speculation is occurring in the existing dwellings sector, which needs to be the Reserve Bank's main focus.

By exempting newly built houses from LVR restrictions, buyers will continue to be able to buy new houses, which should see the demand for new houses being sustained.

The LVR restrictions would then have a direct impact on existing houses that are for sale. As less buyers would be able to buy them, their demand would naturally fall – the consultation paper discusses in detail the benefits reduced availability of high-LVR loans have brought about (such as around $20b in lending at an LVR of above 80 not having taken place). A fall in the sale of existing houses will subsequently result in a fall in their asking prices. Not only will this affect speculation and volatility, it will also make brownfield developments commercially feasible for developers, which the proposed National Policy Statement on Urban Development Capacity(NPS-UDC) is about.

5. Housing shortage versus the risk of an oversupply

The Auckland Unitary Plan Independent Hearings Panel has stated that Auckland needs 400,000 dwellings over the long term (to 2041). In its recommendations, it has stated:
"A reasonable estimate of residential demand over the next seven years includes a current shortfall of around 40,000 dwellings and annual demand in the order of 13,000 dwellings or 91,000 over the seven years."

It is clear from the IHP's recommendations that Auckland has a housing shortage. There is not a likelihood of overbuilding in the near future, which the Reserve Bank says is a risk. The flow on effect of Auckland's housing crisis is common knowledge and there is anecdotal evidence of owner-occupiers relocating from Auckland to other areas in order to be able to afford a house.

Also, the ensuing NPS-UDC will require councils to provide for additional capacity so that there is an oversupply for 'ready to go' land at all times.

Extending the LVR restrictions to newly built houses (and not exempting them) will hurt the supply side of the equation and will be contrary to complementing fiscal policy (NPS-UDC).

In summary:

- If the Reserve Bank's policies price buyers out of the newly built houses component of the housing market, their supply will simply stall, as opposed to a fall in their selling price. This will exacerbate the housing supply issue and work against fiscal policy measures.

- If the Reserve Bank's policies price buyers out of the existing houses component of the housing market, their asking price will fall.

6. Relief sought

The KiwiSaver Welcome Home Loan benefits are available to houses which have received their code compliance certificate less than six months before Housing New Zealand receives a HomeStart application. This is in addition to applications involving properties bought off the plans, and land to build new houses on.

Property Council requests that the LVR exemption be extended to newly built houses which have code compliance certificates that are less than six months and one day old.

The suggested change will:

- be consistent with the KiwiSaver Welcome Home Loan programme
- help address the housing supply and affordability issue
- help mitigate the effects of speculation for the reasons discussed above.

7. Conclusion

The consultation paper points out that New Zealand house prices have increased by around 50% since 2010, driven by strong immigration, low mortgage rates and sluggish housing supply. Unfortunately, LVR restrictions target the ability of a buyer to take out a mortgage, as opposed to placing sufficient weight on what they are buying. In essence, measures should be aimed at pricing speculation so that selling prices better reflect true value.

We would welcome the opportunity to discuss the issues raised in this submission further, and we look forward to assisting the Reserve Bank implement monetary policy tools that will benefit New Zealand's economy and help maintain its resilience.

We avail ourselves of this opportunity to convey our sincere desire to maintain and further develop our relationship with the Reserve Bank on matters of national importance.

Yours sincerely

Alex Voutratzis
Director of Policy & Advocacy

Cc: Hon Bill English, Minister of Finance