

Submission on Consultation Paper: Serviceability Restrictions as a Potential Macroprudential Tool in New Zealand - Property Institute of New Zealand

Executive Summary:

- The Property Institute of New Zealand (PINZ) opposes the addition of Debt-To-Income (DTI) ratios to the Reserve Bank of New Zealand's Macroprudential Toolbox.
- PINZ submits that the addition of DTI ratios will lead to a two-tier market, namely those with equity (such as those who already have houses) and those without.
- PINZ argues that DTI ratios will have a severe impact on first home buyers and those on low incomes attempting to get on the property ladder.
- PINZ fears the implementation of DTI ratios will further constrain new home building at a time when housing supply is a significant economic and political priority.
- PINZ believes that the Trading Banks have sufficient tools and processes in place to assess and manage risks of lending, and that the Reserve Bank should not attempt to superimpose another artificial constraint on the market.
- PINZ suggests that a further tightening of money supply may also lead to negative economic outcomes, as fewer homeowners will have the ability to access the capital in their properties to help finance new and productive business ventures.
- The Reserve Bank's introduction of Loan-To-Value Ratios (LVRs) coupled with tighter restrictions on foreign capital has already had the desired effect on the market – namely a slowdown in house price inflation. PINZ argues that further restrictions are unnecessary.
- The risk of a house price collapse is small, with historical data showing that in a New Zealand context this has not happened for more than 50 years, despite numerous global shocks.

General Comment:

The Property Institute of New Zealand (PINZ) is surprised by the tone of the consultation paper prepared by the Reserve Bank of New Zealand (RBNZ). The Institute's observation is that the RBNZ appears already to have concluded that DTI Ratios need to be added to its macroprudential toolkit, and PINZ fears this consultation exercise is little more than a political box ticking exercise.

PINZ makes this comment for two main reasons:

1. As it's presented - the research paints a glowing picture of DTI ratios. It appears to be a one-sided account, designed to skew the commentary/narrative.

2. The seven questions that submitters are asked to answer have been prepared with an outcome in mind, an exceedingly narrow scope – offering little opportunity for those fundamentally opposed to DTI ratios to express a view that does not fit with that of the authors of the consultation paper.

It's for the reasons outlined above that the Institute has chosen to make this non-standard submission.

Questions for feedback:

Q1: Do you have any comments on the evidence that high DTI borrowers are more susceptible to mortgage default and consumption stress? Are there other relevant studies, or other relevant channels through which a DTI policy would influence financial stability?

Because of the way this question is framed, the Property Institute of New Zealand has little choice but to agree that those who borrow more are indeed at higher risk in a financial crisis, (and that has always been the case in New Zealand), but PINZ argues that even during the Global Financial Crisis and credit crunch of 2008 the impacts within New Zealand were slight – because we have a robust market that Treasury figures show has not experienced a property price collapse in more than 50 years. PINZ does not believe this is likely to happen in the near term either.

Q2: Do you agree that the current levels of debt (relative to income) that some borrowers are able to borrow risk putting them under pressure, especially if interest rates rise? Why are the DTIs achievable in New Zealand apparently higher than in other markets like the UK?

Because of the way this question is framed, PINZ has little choice but to answer yes. However, comparisons with the UK are irrelevant. There is a different market there, different conditions, different rules and a totally different set of central Bank priorities. Furthermore, even with DTIs/uncertainty over Brexit and the general election, house price inflation continues to outpace wage growth, and housing undersupply is a growing concern. In other words, DTIs will simply stop more and more people from borrowing what they need to buy a house – as house prices continue to rise faster than wages.

Q3: Do you agree with our assessment of other possible policies that are under the Reserve Bank's control, or do you think one or more of them could be preferable to DTI limits? Are there other policy options under the Reserve Bank's control that we haven't listed that could be relevant?

It's unclear to the Property Institute what problem the Reserve Bank is trying to fix and why there is a current urgency to progress further constraints on money supply, at a time when a lack of capital is a handbrake to growth. Previous measures, such as Loan-To-Value Ratios and restrictions on foreign capital appear to have already had negative consequences for the housing market – particularly new builds and for first home buyers.

Q4: If a DTI policy was used, what would be the challenges and issues that could arise in the detailed rules and (for lenders and the Reserve Bank) monitoring compliance with the policy?

This is outside the Property Institute's sphere of expertise.

Q5: Do you agree that a DTI policy (if implemented) should be broadly as described above (a speed limit, with similar exemptions to the LVR policy)? Are there other design options or additional exemptions (besides the suggestion described above for relatively inexpensive owner occupied homes) that would be worth considering?

While PINZ opposes the introduction of Debt-To-Income ratios, PINZ believes that if implemented exemptions should be applied to new builds and first home buyers to avoid the negative social and economic consequences of establishing a two-tier market that entrenches those with equity (such as those already with homes) and locks out new entrants/low income earners from the property market.

Q6: Do you agree with our assessment of the impacts of a DTI policy as described on the housing market – in particular, that it would not materially affect construction, and would if anything tend to increase the home ownership rate? Are there other potential consequences of the policy for the housing market that we have not discussed?)

As above, the Institute is particularly fearful of the impact that a DTI policy will have on first home buyers, those on low incomes and new builds. PINZ is also concerned that a tightening of money supply in this area will further erode the capital base that Kiwi entrepreneurs have relied on for generations – namely using the equity built up in the family home to raise funds for new businesses. And PINZ also fears that those on low incomes who will be locked out of the housing market, will no longer have the ability to draw on the 'nest egg' they have amassed in their homes to help fund a comfortable retirement.

Q7: Please comment on the Reserve Bank's analysis of the potential costs and benefits of a DTI policy. Do you see other material costs or benefits, or have views about the magnitudes of the costs and benefits or the method used to derive them?

As above, and as previously stated, PINZ submits that the Reserve Bank has adopted a jaundiced view of DTIs, framing the questions and providing research that paints a 'best-case-scenario' without adequately presenting a 'worst-case-scenario' alternative. As previously stated, it remains unclear to the Institute what problem the Reserve Bank is trying to fix and whether or not a limited DTI will actually have any impact in a significant financial collapse. Those on fixed incomes with high equity in their property and small loans may find themselves in just as bad a position should interest rates rise. High Debt-To-Income ratios are not new and the Property Institute argues that while some economists might claim that DTI restrictions are good for the stability of our financial system, PINZ believes they will have severe negative consequences on our housing market into the future.

Summary

The Property Institute of New Zealand opposes the introduction of Debt-To-Income ratios and believes they are not necessary at this time as other macroprudential tools already in place have had a significant impact on slowing the property market.

PINZ believes DTI ratios would lead to a two-tier property market, entrenching the position of those who already have purchased a home, and locking out new home buyers and those on fixed and low incomes.

The Institute is also disappointed with the tone of the consultation paper which appears to presume DTI ratios are necessary – framing questions in a way which limits the ability of submitters to fully canvas their views. Rather than a ‘free-and-frank’ exchange of information the Reserve Bank of New Zealand seems to be orchestrating the answers that it wants/needs.

The Property Institute believes that should DTI ratios be introduced, exemptions should be made for first home buyers and for new builds, to ensure that an entire generation of young Kiwis are not locked out of the housing market forever, and to ensure housing supply does not fall further behind demand.
