Summary of Submissions: Reinstating Loan-to-Value Ratio Restrictions

February 2021

Contents

Background

1. In December 2020, the Reserve Bank opened consultation on a proposal to reinstate Loan-to-Value Ratio (LVR) restrictions. This followed observations of a rapid acceleration in the housing market combined with increases in the flows of lending to higher-risk borrowers (i.e. those with higher LVRs). LVR restrictions were removed on 29 April 2020 as part of our response to COVID-19, in order to remove a potential barrier to the flow of credit and ensure banks were not deterred from offering mortgage deferrals to their customers. The consultation proposed reinstating restrictions at the same level they had been prior to 29 April.

2. After considering submissions and undertaking further analysis (published as part of our Regulatory Impact Assessment (RIA)), we believe that the financial stability risks exceed the situation at the time of the Bank's December LVR consultation. We have therefore decided to put in place more stringent LVR restrictions. From 1 March 2021, the restrictions will be reinstated at the same level as prior to the onset of COVID-19, with a further tightening of restrictions on investors taking effect on 1 May.

3. This decision was driven by a concern about the risk that a sharp correction in the housing market poses for financial stability. There is evidence of a speculative dynamic emerging, with many buyers becoming highly leveraged. Highly leveraged property owners, in particular investors, are more prone to rapid 'fire sales' that potentially amplify any downturn.

4. The limits will be:

   From 1 March 2021:
   - Lenders can provide a maximum of 20 percent of new mortgage lending to owner-occupiers at LVRs greater than 80 percent (after exemptions); and
   - Lenders can provide a maximum of 5 percent of new mortgage lending to investors at LVRs greater than 70 percent (after exemptions).

   From 1 May 2021:
   - Lenders can provide a maximum of 20 percent of new mortgage lending to owner-occupiers at LVRs greater than 80 percent (after exemptions); and
   - Lenders can provide a maximum of 5 percent of new mortgage lending to investors at LVRs greater than 60 percent (after exemptions).

5. This document outlines the feedback received and the key themes emerging from the consultation process to reinstate the restrictions. The accompanying RIA provides an assessment of the costs and benefits of the decision to reinstate LVRs, and the tightening of restrictions on investors.

6. We will continue to monitor the situation closely over the coming year and review whether the LVR settings are appropriate.

Consultation Process

7. The consultation on the Reserve Bank's proposal to reinstate LVR restrictions opened on 8 December 2020, and closed on 22 January 2021. We received 23 submissions to the December consultation paper, comprising:

   - Four submissions from banks – ANZ, BNZ, ASB and Kiwibank.
   - Two submissions from stakeholder groups – Community Housing Aotearoa and FIRST Union (a private sector trade union with many members in the finance sector).

- 17 submissions from members of the public, of which three were originally sent to the Prime Minister and one to the Minister of Finance.

These submissions have been anonymised and uploaded to the Reserve Bank website.

8. This document provides a summary of the submissions received in response to our consultation, as well as a brief response to those submissions. Here, we focus on the common themes and views raised in the submissions. This document is not intended to be an exhaustive summary and response to all points raised. We direct readers to the RIA for our full analysis of the issues that led to the decision to reinstate LVR restrictions, and the subsequent tightening of restrictions on investors.

Summary of Submissions

Reinstatement and calibration of LVR restrictions

All respondents to the consultation supported reinstating LVR restrictions…

9. All respondents to the consultation supported reinstating LVR restrictions in some form (aside from one submitter whose view was unclear). The most common reason given for supporting the proposal was that it would help to control house price inflation and improve housing affordability, particularly for first home buyers (FHBs).

10. The banks, along with one member of the public, also noted that reinstating restrictions would be effective against financial stability risks arising from a sharp correction in house prices, arguing that the recent increase in high-LVR lending was driving increased financial risks.

…however over half of respondents thought that restrictions should be higher for investors, and/or eased for FHBs.

11. Although there was widespread support for reinstating LVR restrictions, around half of respondents considered that the restrictions on investors should be set at a stricter level than before they were removed in April 2020. Submitters also noted the growing share of investors in the housing market since the restrictions were removed in April.

12. Some submitters argued the restrictions should be tighter to support housing equality, while others considered that the investor behaviour was speculative and driving up house prices. Some submitters also noted the evidence published in the consultation paper that investors are more likely to deleverage in a downturn.

13. Recommendations for limits on investors ranged from a cap of 60 percent LVR to as low as 25 percent LVR (proposed by FIRST Union). One respondent argued for a dynamic LVR cap that would be progressively tightened on investors as the size of their property portfolio (by number or by value) increased. One submitter argued that investors should be incentivised to invest in new builds to increase the supply of housing – we note that the LVR policy has a construction exemption in place for that reason.

14. Conversely, several submitters called for setting looser restrictions on FHBs, or even exempting FHBs from LVR restrictions. They argued that this would help to ‘level the playing field’ between FHBs and other buyers, and enable creditworthy FHBs to enter the housing market. Some respondents noted that FHBs were disadvantaged as they needed to put down a cash deposit, whereas investors and existing owner-occupiers were able to borrow against home equity in a rapidly rising market. Two respondents suggested banning the use of existing home equity as a deposit on a new property altogether.

Banks expressed different views about the calibration of restrictions, particularly for investors.

15. Of the four banks who submitted, Kiwibank and ASB were both supportive of reinstating LVR limits at their previous levels, stating that they had already adjusted their policies for new loan applications. However, ASB noted that investor demand is strong and “may be persistent” following reinstatement of the restrictions. Kiwibank noted that if the restrictions were set more tightly than previously, they would need three months’ notice to manage their pipeline of loan applications.

16. ANZ argued that restrictions on investors need to be more stringent to address financial stability risks, and recommended a calibration of no more than 5 percent of new lending at LVRs above 60 percent. ANZ stated that it has already imposed this level of restriction, but that the restrictions need to be industry-wide to be effective.

17. By contrast, BNZ recommended relaxing the (non-exempt) investor LVR limit from 70 percent to 80 percent. BNZ noted that its investor portfolio has performed in line with or better than owner-occupier loans, and hence the relative risks do not justify more stringent restrictions on investors vs owner-occupiers.

Other issues raised

Some respondents argued for the introduction of Debt-to-Income (DTI) restrictions, while others disagreed that they would be an effective tool.

18. Four respondents noted the comment we made in the consultation paper on giving further consideration to DTI restrictions as an additional tool to manage financial stability risks. Two members of the public strongly supported the idea, while ASB also expressed some support and stated it would like to engage further with the Reserve Bank. By contrast, ANZ argued that DTI restrictions are a ‘blunt instrument’ and are likely to disproportionately impact on lower-income and younger New Zealanders, potentially widening the housing inequality gap.

Respondents also made a variety of points related to addressing housing affordability and housing supply in New Zealand...

19. Many respondents provided comments or policy ideas to control house price inflation and/or improve housing affordability, as well as how to address the supply of housing in New Zealand

20. This included policy measures that are within our control, such as banning interest only loans. Most other policy measures suggested were not within the our mandate and/or powers, including:

    - Changes to tax policy. For example, extending the brightline test, introducing a Capital Gains Tax, or land taxes.
    - Constraining investment in property by having a moratorium on the number of investment properties that investors can own.
    - Providing FHBs with more ability to get a deposit together for a house, for example by changing the criteria for loans provided by Kāinga Ora, or loosening restrictions on Kiwisaver withdrawals.

… and some requested we review our current capital adequacy settings and technical elements of our policies.

21. Community housing providers called for the Reserve Bank to provide guidance to banks on how loans for community housing and similar arrangements should be treated under capital adequacy rules (currently outlined in BS2 of the Banking Supervision Handbook).

22. One of the banks also asked for clarification on whether customers not planning to live in the property, or rent it out (e.g. buying for elderly parents) are classified as investors or owner occupiers under our capital adequacy rules (BS2) and the LVR policy (BS19).

Response to Submissions

Reinstatement of LVR restrictions

23. Our mandate is to promote the maintenance of a sound and efficient financial system. As noted above, a number of submitters cited rapid house price inflation as one reason to reinstate LVR restrictions. While house prices are not the target of LVR restrictions, we note that when a strong run-up in house prices occurs alongside growth in high-risk mortgage lending, this can pose risks to financial stability by increasing the risk of a sharp correction and consequent financial sector disruption.

24. These financial stability concerns – around the risk of a sharp correction in the housing market – in our view, are growing. There is evidence that a speculative dynamic is emerging in the housing market, with many buyers becoming highly leveraged. A growing number of highly indebted borrowers, especially investors, are now financially vulnerable to house price corrections and disruptions to their ability to service their debts.

25. As such, given the evidence base and support of submitters, we decided to reinstate restrictions on 1 March, as proposed in the consultation paper. We have also decided to tighten restrictions further on investors beginning from 1 May.

Calibration of LVR restrictions for investors

26. As pointed out in some submissions, international evidence generally suggests that highly leveraged investors present a greater financial stability risk than owner-occupiers, as they have greater potential to amplify any downturn in the housing market. This is because investors are more likely to seek to de-leverage and exit the market in a severe housing downturn, potentially driving a 'fire sale' dynamic that pushes prices down further. Some submitters, as discussed above, also pointed out the growing share of new lending to investors as a reason for growing financial stability risks.

27. For these reasons, we consider that the risks to financial stability of investors in particular exceeds our assessment at the time of the December consultation. In response to consultation feedback and further analysis in the RIA, we have decided to impose tougher limits on investors.

28. We do acknowledge that submitters expressed mixed views on whether investors are riskier at any given LVR in New Zealand – ANZ noted the growing share of investors in the market and risks to financial stability they pose, while BNZ stated in their submission that its investor portfolio has performed better than its owner-occupier portfolio over recent months. We consider the limited New Zealand evidence to be a natural consequence of the housing market having had no severe downturns in recent history (since the early 1990s at least). The absence of a severe housing market downturn in the last 30 years is not evidence that one could not occur, and the performance of investor loans during past shallow housing corrections is not necessarily a good guide to the dynamics that could arise in a severe downturn.

29. In regards to investment activity in new builds, 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 when the LVR policy is reinstated, and is available for both investors and owner occupiers.

LVR restrictions for first home buyers

30. We recognise submitters' concerns around access to housing for FHBs and their requests for exemptions or easier restrictions. However, while there is international evidence to suggest that owner-occupiers present marginally lower risks than investors, all highly leveraged borrowers present financial stability risks. LVRs are designed to protect households and banks from losses that would occur in a severe downturn.

31. While reasonably broad application is necessary to maximise effectiveness of the LVR policy, the framework incorporates two potential ways of mitigating potential efficiency costs/distortions. The first is through the use of speed limits rather than outright limits. The second is through the limited use of exemptions.

32. With regards to speed limits, banks will continue to have discretion to allow some first home buyer high-LVR lending as part of the 20 percent limit on high-LVR owner occupied lending. This speed limit is substantially larger than allowed for high-LVR investor lending (5 percent). Reserve Bank lending data shows that in the three months to end-November 2020, 39.5 percent of new lending to FHBs was at LVRs above 80 percent.[1] As banks have generally kept within the prior speed limits for owner-occupier lending since the LVR restrictions were removed, reinstating the restrictions is not expected to have a material impact on high-LVR lending to FHBs.

33. The exemptions mean that banks can lend above the LVR restrictions and this type of lending would not count towards the LVR speed limit. Exempted lending categories include:

    - A new build exemption where the borrower commits to the purchase at an early stage of construction or buys the residence (within six months of completion) from the developer;
    - Kāinga Ora's First Home Loans scheme (formerly Welcome Home Loans), for low deposit borrowers to buy their first home; and
    - Loans for remediation required to bring a residence up to new building codes, or to comply with new rental property standards (for example, installing insulation).

Timing of reinstatement of restrictions

34. As noted in the summary above one bank made the point that if the restrictions were set more tightly than previously, they would need three months' notice to manage their pipeline of loan applications. This is because banks need time to manage this pipeline of loans that have been approved but not yet settled.

35. Given that we consulted on the option of reinstating the existing limits on 1 March, we need to account for these practical limitations for banks in implementing the new threshold for investor LVR restrictions. As such, we see that it is practical that the existing limits are reinstated on 1 March, and the threshold for investor LVRs will move from 70 percent to 60 percent from 1 May 2021. Banks are expected to apply the tighter rules on all new loan approvals from 1 March.

Other issues raised

36. Along with many submitters, we note that there are a number of complex and multifaceted drivers of the housing market in New Zealand. On 24 November 2020 the Reserve Bank received a letter from

[1] https://www.rbnz.govt.nz/statistics/c31

the Minister of Finance seeking our views on ways we can work together to address the Minister's concerns regarding rising house prices. Reserve Bank Governor Adrian Orr responded to this letter on 9 December. As noted in the letter, we remain committed to engaging with the Minister of Finance on how the Reserve Bank's role can best be utilised to address some of the concerns in the housing market.

37. We will also continue to work on other macroprudential tools that could complement the LVR policy, such as DTI restrictions. Where relevant, the other points raised by submitters during the consultation process have been passed on to other government agencies.

38. We also welcome engagement with the banks on the technicalities of the LVR policy and our capital adequacy framework, as well as with community housing providers.