Reserve Bank of New Zealand
Te Pūtea Matua

Tightening Loan-to-Value Ratio Restrictions

Regulatory Impact Statement

23 September 2021

Contents

Adequacy Assessment

This Regulatory Impact Statement (RIS) provides the Reserve Bank's analysis of tightening Loan-to-Value Ratio (LVR) restrictions from 1 November 2021.

The RIS has been prepared by the Reserve Bank in accordance with the requirements of section 162AB of the Reserve Bank of New Zealand Act 1989 (the Act).

Consultation

A consultation period was completed by the Reserve Bank from 3 September 2021 to 17 September 2021 following the announcement in August 2021 that we would look to tighten LVR restrictions. Banks, stakeholder groups and the general public were provided with the opportunity to respond to the consultation document released on 3 September 2021.

The Reserve Bank received 14 submissions to the September 2021 consultation paper, including four from industry, and ten from members of the public and stakeholder groups. A summary of submissions will be published alongside this that summarises the feedback received.

Quality Assurance

This RIS was reviewed by a number of Reserve Bank staff.

Executive Summary

1. Reserve Bank analysis indicates that house prices are above their sustainable level, and the risks of a housing market correction are continuing to rise.[1] This is despite a significant fall in investor activity following reinstatement of LVR restrictions in March 2021 and the Government's 23 March package of tax policy changes. We are also continuing to see higher risk borrowing from owner-occupiers – with a significant increase in borrowing at high Loan-to-Value (LVRs) ratios and high Debt-to-Income (DTI) ratios.

2. Although the financial system remains sound and banks are well-capitalised, we are concerned about the potential future financial stability risks of allowing this higher risk borrowing to continue at its current rate.

3. If left unaddressed, financial stability risks are likely to increase. In November 2021 we are tightening macroprudential lending standards to reduce the financial stability risks associated with high-risk mortgage borrowing and increasing house prices.

4. The Reserve Bank will be reducing the speed limit on high-LVR lending to owner-occupiers from 20 percent to 10 percent, effective from 1 November 2021 (Table 1). This decision was informed by policy analysis and a consultation process, both of which are discussed in this RIS.

5. Our consultation proposed implementing the new LVR settings from 1 October. However, given the heightened COVID-19 alert levels and feedback from banks, who were concerned about managing existing pre-approvals in light of the relatively short consultation period this time, we will be delaying our implementation start date to 1 November. Changing the implementation date to 1 November will give the banks nearly three months from when we first announced our proposed LVR change on 8 August.

Table 1: LVR restrictions from 1 November 2021

Borrower Group	Current Settings	Settings from 1 November 2021
Owner Occupier	Speed limit: 20% Threshold: 80%	Speed limit: 10% Threshold: 80%
Investors	Speed limit: 5% Threshold: 60%	Speed limit: 5% Threshold: 60%

6. The objective of LVR restrictions is to promote financial stability by directly improving the resilience of the financial system and mitigating the extremes of financial cycles. LVR restrictions reduce the risk in the banking system by limiting household leverage to lean

[1] Our analysis of house price sustainability is set out in detail in the August Monetary Policy Statement (MPS) and the key findings are also summarised in this document. https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Monetary%20policy%20statements/2021/mpsaug21.pdf?revision=3627c6fa-6462-453a-af85-06e62f47705c

against the risks of a severe correction in house prices. Moreover, LVR restrictions can also mitigate the scale of economic downturns. In doing so, they can support the Reserve Bank to meet our statutory purpose of "promoting the maintenance of a sound and efficient financial system", as set out in section 1A and Part 5 of the Reserve Bank Act. LVR restrictions are the main macroprudential tool we have used to date to address systemic risks related to the housing market.

7. All macroprudential policy interventions, including LVR restrictions, incur efficiency costs. While LVR restrictions are expected to reduce risky lending and mitigate the scale of economic downturns, this comes at an efficiency cost of curtailing the choices of some economic agents. In particular, LVR restrictions may impede access to credit for some creditworthy high income borrowers who are prevented from entering the market due to a low deposit.

8. This cost is partially mitigated through the policy design. Specifically, the inclusion of a speed limit for high-LVR loans (i.e., the amount of high-LVR lending that is permitted), allows banks to allocate high-LVR loans based on their underlying risk characteristics and value to the bank. We note that as the speed limit is reduced that there is less scope for this.

9. The tightening of LVR restrictions will also have implementation costs for banks. We expect these costs will be minor, as the LVR restrictions have been in place for some time and have been altered numerous times. However, there will still be some compliance costs in executing the change. These costs are likely to be small as a restriction at this level has previously been in place. Additionally, LVR restrictions could have impacts on dynamic efficiency, for example, by shifting the incentives to invest in housing relative to other assets.[2] This impact has not been quantified in this RIS.

10. We expect that reducing LVR speed limits for owner-occupiers will have a modest impact on house price inflation. However, we cannot be certain of the scale of the impact. The impact will mainly be over the short-term as there are longer-term pressures on the housing market that require a range of responses that are outside the scope of macroprudential policy.

11. We also note that most of the speed limit is currently allocated to first-home buyers. Therefore a reduction in the speed limit will have an impact on some first-home buyers, who will need a larger deposit to obtain a mortgage.

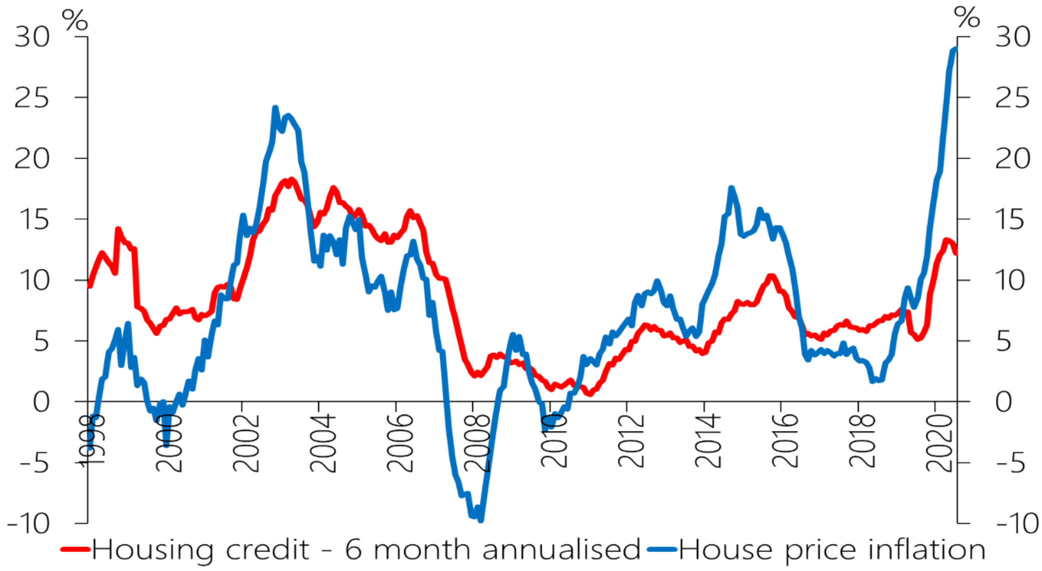
12. We will continue monitoring the market for changes and new developments and we will report regularly on our assessment of these through our Financial Stability Reports (FSRs) or other appropriate communication.[3] We may adjust LVR settings in the future based on these developments.

[2] Policy options to support sustainable house prices (rbnz.govt.nz)
[3] https://www.rbnz.govt.nz/financial-stability/financial-stability-report

Problem Definition

13. House prices continue to increase with the national year-on-year house price inflation rate reaching 30 percent in July, as shown in Figure 1. This is above the peaks seen in the last two housing cycles. Housing credit is also growing strongly, although remains below growth rates in the period leading up to the 2007 Global Financial Crisis.

Figure 1: Annualised house price inflation and housing credit growth



Source: REINZ, Reserve Bank Balance Sheet Survey

14. House prices are also at unprecedented levels relative to incomes. Nationally, the median house price is more than 11 times the median disposable income. House prices relative to rents and income are also high compared to historic averages. These trends have accelerated over the past 6 to 12 months

15. Our primary concern with respect to the housing market is the financial stability risks that arise when a strong run-up in house prices occurs alongside a growth in high-risk lending, particularly when the house price rises are out of line with fundamental drivers.

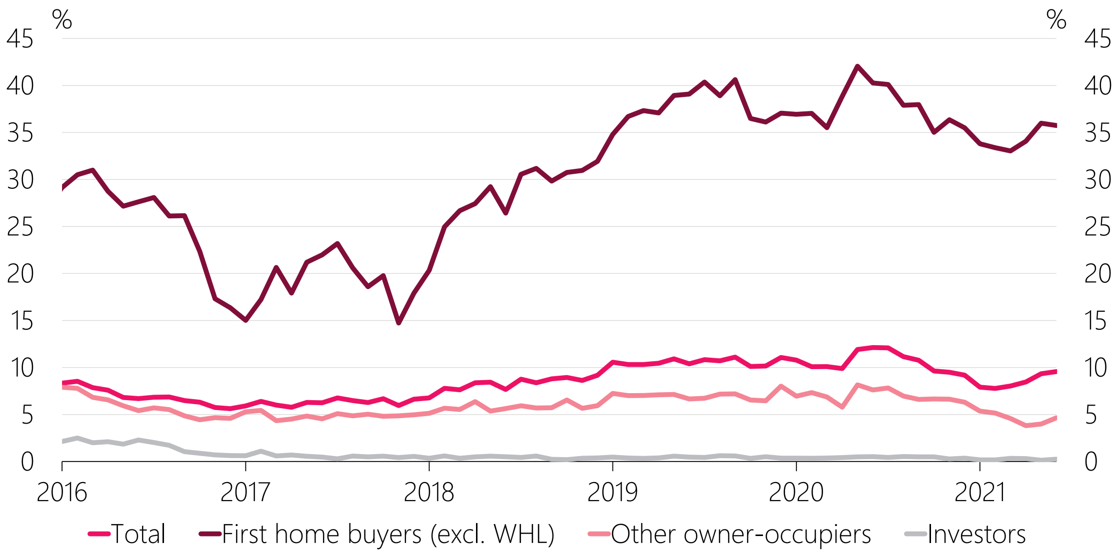
16. Risks to financial system resilience are relatively low, but growing. Despite recent growth in the flow of new high-LVR lending, the share of total mortgage loans at high LVRs is currently near historic lows. This reflects the success of our LVR policy in constraining risky lending since restrictions were first introduced in 2013.

17. Banks are also well-capitalised, and stress tests indicate New Zealand's banks are resilient to a range of shocks, including a significant downturn in the housing market of 20 to 30 percent. However, the stress tests also show that a severe downturn that included large

falls in house prices would have an impact on financial stability and the wider economy, through both mortgage loan defaults and feedback effects.

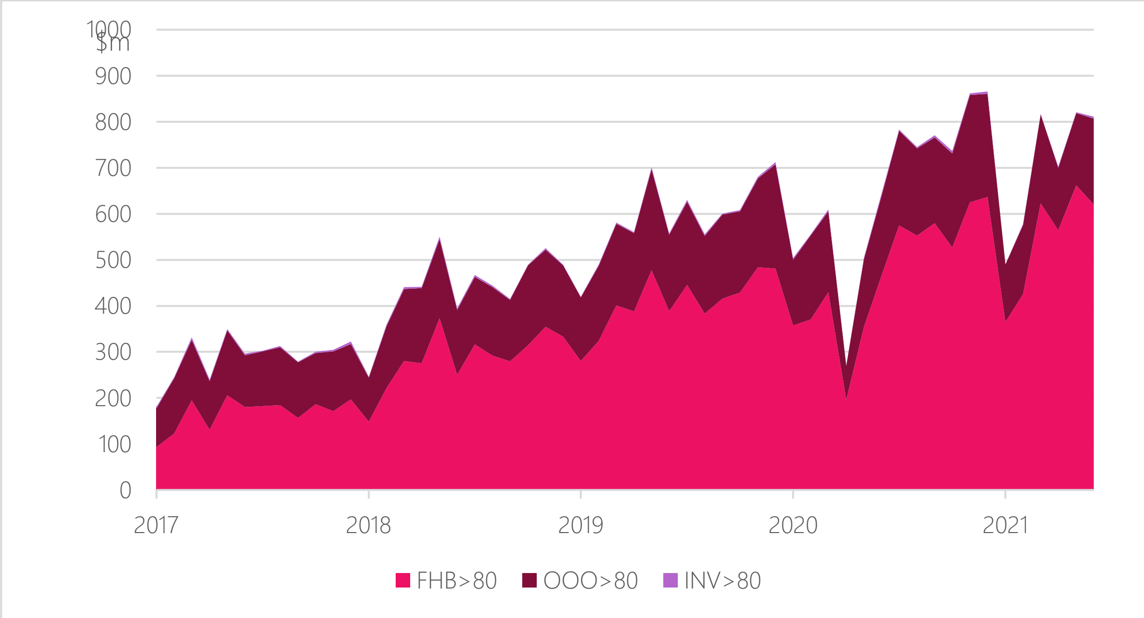
18. Banks tend to allocate most of their high-LVR owner-occupier speed limits to first-home buyers. With the easing of owner-occupier speed limits since 2017, around 35 percent of first-home buyer lending is now taking place above an LVR of 80 percent (Figure 2). Compared to 2017, a larger share of current lending to first-home buyers is also at an LVR of 90 percent. By contrast, less than five percent of new lending to other owner-occupiers is at an LVR above 80 percent, which has been relatively stable over the past few years

Figure 2: Share of new mortgage lending at LVR above 80%, by buyer type (before exemptions; excluding loans that are part of Kāinga Ora's "First Home Loan" scheme)



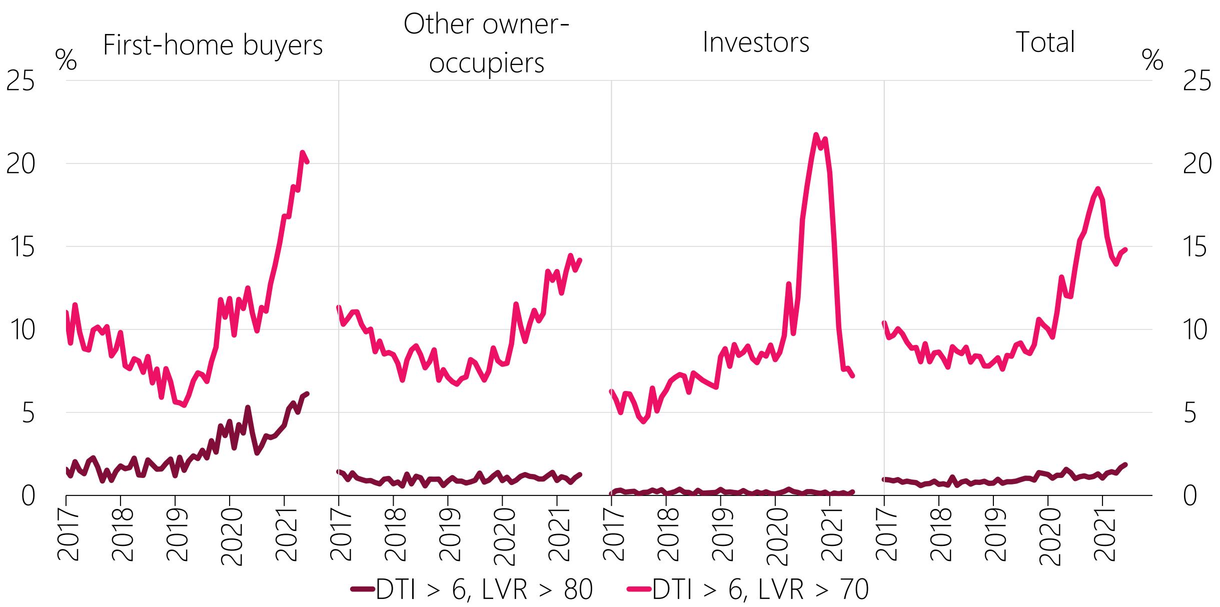
19. Although the share of new lending at high LVRs has been relatively stable, Figure 3 shows that the total quantity of high-LVR lending – which is the key issue for lender resilience – is elevated due to high house prices and sales activity. Lending at LVRs greater than 80 percent has nearly tripled since 2017, with the large majority of this lending going to first-home buyers, followed by existing owner-occupiers.

Figure 3: Quantum of lending at LVR > 80%



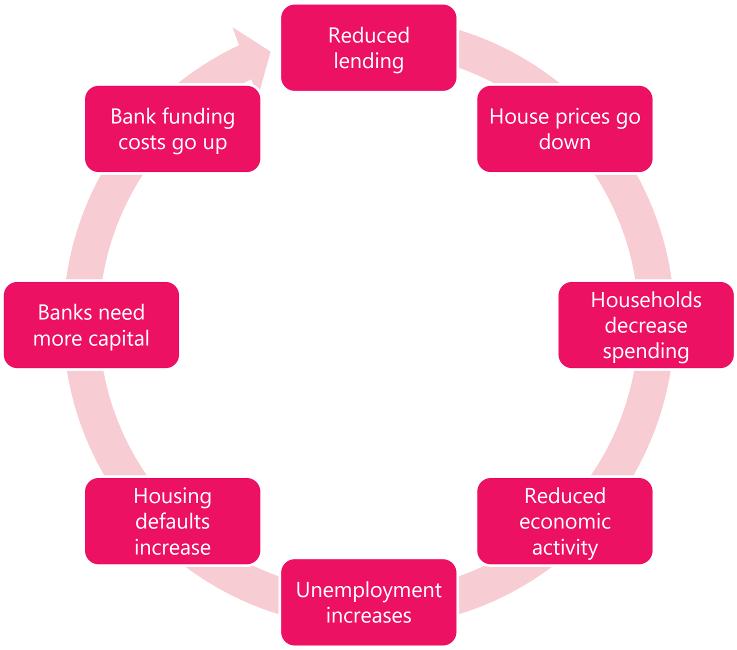
20. In addition, lending that is at both high LVRs and high DTIs has increased significantly, as shown in Figure 4. If the current flows of higher-risk lending continue unchecked, this would be expected to increase financial stability risks over time by building up risk in the stock of mortgages.

Figure 4: Share of new mortgage lending at high-LVR and high-DTI, by buyer type



21. When a strong run-up in house prices occurs alongside growth in high-risk mortgage lending, it can increase the risk of a sharp correction, leading to feedback effects between the financial system and the wider economy. Figure 5 shows the feedback loop that can occur between house prices and the wider economy, which can increase the size and effect of boom-and-bust cycles.

Figure 5: Feedback effects in housing market corrections



22. The risks of feedback effects from a housing market correction are reinforced by the fact that New Zealand's household debt levels are high relative to historical averages. Mortgage interest rates are at historically low levels, helping to keep debt servicing costs at manageable levels despite record-high levels of debt. However, these debt levels make borrowers vulnerable to a rise in interest rates. A large share of New Zealand mortgages are on a short-term fixed interest rate, putting a large share of borrowers at risk of sharp increases in mortgage costs if interest rates rise before they next reset their fixed term.

23. Households are borrowing more relative to their incomes in part because at current low interest rates, debt servicing costs are low for new buyers. If mortgage interest rates were to increase from current levels, recent first-home buyers would be the primary group to experience serviceability stress, as they typically have lower incomes than other borrowers, and therefore need a greater share of their income for living expenses. Investors are the second most likely to experience serviceability stress overall. Existing owner-occupiers are less likely to experience serviceability stress but it should be noted that these borrowers represent the largest share of the market.

24. For all borrower groups, increased serviceability stress would lead to a reduction in consumption, leading to lower overall economic activity and risking emergence of the feedback loop outlined above. At higher levels of stress, some borrowers may be forced to sell their property or default on their mortgage, further exacerbating negative feedback loops.

25. In summary, we consider the risk of feedback effects emerging in the case of a housing market correction to be medium and the overall level of risk has on balanced increased since our last macroprudential decision process earlier in 2021. This reflects the offsetting impacts of factors increasing the probability of feedback effects (very high debt levels, particularly among recent borrowers, along with rising interest rates) and factors reducing

the probability of such effects (wealth gains for earlier borrowers, a reduction in investor activity, and a strong labour market).

Objectives

26. Macroprudential policy focuses on systemic risks arising from the pro-cyclicality of the financial cycle, and the self-reinforcing interaction between credit and asset prices during boom-bust cycles. Macroprudential policy aims to reduce the risk that the financial system amplifies a severe downturn in the real economy. An unsustainable boom in credit and asset prices can result in a bust that creates losses for banks, businesses and households, and hampers the ability of banks to continue lending to the economy.

27. LVRs are a measure of how much a bank lends to a borrower, relative to the value of the borrower's property secured against the lending. LVR restrictions support the financial system by building financial system resilience against a disorderly correction in the housing market, and by dampening excessive credit growth. LVR restrictions can also moderate the scale of economic downturns by reducing household indebtedness and enhancing borrower balance sheets. If household balance sheets are highly leveraged, a downturn in the housing market can put banks and households under pressure through rising mortgage loan losses, especially if unemployment increases. In a worst-case scenario, this could lead to a 'fire sale' of distressed housing assets, increasing the likelihood of a negative feedback loop between the housing market and the wider economy.

28. Fukac, Greig and Snethlage (2018) find that LVR restrictions can moderate both the peak and the trough of the economic cycle and help maintain banks' balance sheets, thus, helping to ensure that banks are better placed to continue lending in a downturn. This should help reduce the feedback effects between the banking system, housing market and real economy.

29. Neither the long-run level of house prices nor housing affordability are direct objectives of the LVR restrictions. The pressures on the housing market from factors such as a growing population, a limited supply of housing, and low interest rates require a range of responses that are outside the scope of macroprudential policy. However, 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. LVR restrictions can help curb this speculative dynamic by restricting the leverage that home owners can take on.

Options Identification

30. This section discusses the analysis undertaken to identify Option A and B that were consulted on in September 2021 (Table 2). First we applied the Macroprudential Framework to assess if there was a need to tighten LVR restrictions on the basis of financial stability.

Table 2: Proposed LVR restrictions from 1 November 2021

Borrower Group	Status Quo	Option A	Option B
Owner Occupier	Speed limit: 20% Threshold: 80%	Speed limit: 10% Threshold: 80%	Speed limit: 20% Threshold: 75%
Investors	Speed limit: 5% Threshold: 60%	Speed limit: 5% Threshold: 60%	Speed limit: 5% Threshold: 60%

31. Our provisional view was that Option A (reducing the speed limit on high-LVR owner-occupier loans from 20 percent to 10 percent) is sufficient to manage emerging financial stability risks. Option B proposed reducing the threshold on high-LVR owner-occupier loans from 80 percent to 75 percent, while maintaining the speed limit at 20 percent.

Three-step assessment of macroprudential settings

32. To assess whether the current LVR settings should be tightened or held, we used the three-step Macroprudential Policy Framework to consider the options identified in Table 2.[4] This framework supports a systematic approach to improve the transparency of our macroprudential decision making, and reduces the risk that we act too late for the policies to be effective (Ovenden, P, 2019). The three steps are:
    1. Assess the probability of a housing market correction;
    2. Assess the risks to financial system resilience; and
    3. Assess the risk of feedback effects to the wider economy.

33. Table 3 provides an assessment of the current economic and financial situation against the Macroprudential Framework. As the Table identifies, the rapid increase in house prices and the risk of negative feedback effects between the financial system and the economy indicates it is necessary to tighten LVR restrictions. This will help meet the objective of LVR restrictions to promote financial stability by strengthening bank and borrower balance sheets, mitigating the amplitude of financial cycles, and reducing the risk that the financial system amplifies a severe downturn in the real economy.

[4] https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Background%20papers/Macroprudential-policy-framework.pdf

Table 3: Three-step assessment of macroprudential settings

		Tighten LVR settings	**Hold LVR settings**
Probability of housing market correction	↑	House prices are more stretched than any time since the GFC, and above sustainable levels when interest rates normalise. Moreover, supply growth continues to outpace demand. Recent policy changes have seen a fall in investor activity. Housing credit growth has accelerated to its highest level since 2007, but remains below levels seen in 2004-2006.	The full impact of recent tax policy changes may not yet have flowed through. Debt servicing costs as a share of income remain around historical averages given current low mortgage rates, supporting housing demand. Future demand could be stronger or supply growth weaker than currently expected, making a house price correction less likely. Net immigration could return to previous rates quickly when borders re-open putting upward pressure on demand, but considerable uncertainty remains on the timing for this to happen. Housing supply growth is hitting capacity constraints and Government initiatives to increase housing supply will take time to yield results.
Risks to financial system resilience	↑	The current stock of high-LVR lending is not a concern. However, if we do not act to stop the current high flow of high-risk lending then the stock of high-risk lending will grow over time and could pose a risk to financial system resilience in the future. Aggregate household debt is at all-time highs, as are flows of high-DTI lending. The share of high-LVR lending has stabilised since LVR restrictions were reinstated but the overall quantum is still high relative to recent years. If house prices decline, this could see the proportion of lending at risk of negative equity increase. Analysis indicates that the proportion of recent loans that would be in negative equity rises steeply in the case of a house price decline of more than 20 percent.	The stock of high-LVR loans remains low, reflecting the impact of past LVR policy as well as strong equity gains for earlier borrowers. The risks are rising but slowly and from a low base. Total lending to recent buyers does not make up a large share of lenders' portfolios, although this share is rising given high house prices. Capital ratios for the large banks are healthy and have increased in the past year. Results from 2020 stress tests showed banks would be resilient to a large fall in house prices, but these were run prior to recent growth in house prices and debt levels.

Risk of feedback effects with the economy	↑	Elevated house prices mean that recent borrowers are taking on historically large debts. This increases the chance of serviceability stress if interest rates rise, leading to negative feedback effects within the economy. If households experience an income shock coupled with a decline in prices then this could put recent borrowers under significant financial stress, leading to deleveraging and reduced consumption. Analysis indicates that a significant share of recent borrowers could face serviceability stress if interest rates were to increase to five percent or above. Lockdowns remain a potential risk given the emergence of new COVID variants and incomplete vaccination rollout.	Mortgage rates have fallen, reducing the servicing burden for earlier borrowers and hence their probability of default. Earlier borrowers have also experienced strong equity gains over the past 12 months, although some of that equity has been used to leverage new lending. The stock of high-LVR lending remains near historic lows, despite a recent uptick in the flow of high-LVR lending. The share of lending to investors, who may be more likely to sell in a downturn, has fallen since reinstatement of LVRs and Government tax policy changes. The economy has rebounded strongly and unemployment is falling.

Key	**Risk level**			**Trend in risk since previous LVR decision**		
				↓	→	↑
	Low	Medium	High	Fall	Steady	Rise

34. For more detail on this assessment please refer to the consultation document.[5]

Impact Analysis

35. This section outlines our assessment of the costs and benefits of the two options described above (Option A and B), compared to a counterfactual scenario in which the restrictions remain at the current levels. This follows the findings from the Macroprudential Framework analysis described in the previous section.

36. Tightening LVR restrictions will benefit financial stability and economic resilience by moderating the amplitude of the financial cycle during the upturn and mitigating the feedback effects on the economy during the downturn. Overall, we consider that the benefits of Option A outweigh the costs, when compared both with the status quo and Option B.

Table 4: Expected benefits of Option A and Option B

[5] https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Policy-development/Banks/LVRs/LVR-Consultation-Document-September-2021.pdf?revision=f3239f8c-4fe1-4449-8e9f-31db38ae0a04&la=en

Expected benefit	Option A - 10/80	Option B - 20/75	Comments
Strengthening bank and borrower balance sheets	✓✓✓	✓✓	Tightening LVRs will limit the amount of high-LVR lending on banks' balance sheets. The restrictions will also lower the number of highly leveraged households relative to current levels. Therefore, the financial system will have greater resilience to economic or housing downturns. However, it is noted that reducing the threshold (Option B) would allow more lending at very high LVRs (i.e. greater than 90%) under this option than there would be if the speed limit was reduced (Option A).
Reducing the amplitude of the financial cycle.	✓	✓✓	Higher risk, high-LVR lending to owner-occupiers will be reduced. Therefore, the restrictions are likely to moderate house price inflation, reducing the probability of a housing market correction. This reduces the likelihood of negative feedback effects to the financial system and wider economy. Under Option B, loans would mostly be low risk, but there would be a longer tail of high risk loans as the speed limit is higher than it would be under Option A. However, the overall impact on credit growth is likely to be greater under Option B, as this would impact a larger share of the market.
Medium-term economic performance	✓✓	✓✓	By increasing the resilience of the financial system, tighter LVR restrictions will decrease the number of highly leveraged households. This, in turn, reduces the risk of a pro-cyclical cut to consumption and the financial system's ability to amplify shocks if banks experience large losses (which would lead to damage to the real economy).
Moderate house price growth	✓	✓	Tightening LVR restrictions is likely to moderate house price growth, against a counterfactual where the restrictions are not tightened. Past experience shows that tightening LVRs is likely to have a small impact on house prices and that the effect only lasts around 12 months. Option B will likely have a slightly larger effect than Option A, but the effect of either option is likely to be small.

Table 5: Expected costs of Option A and Option B

Expected cost	Option A - 10/80	Option B - 20/75	Comments
Short-term economic performance	×	××	There may be a small negative effect on consumption in the short term, due to a decrease in the wealth effect as house price inflation slows.
Efficiency costs	×	××	Efficiency costs of LVR restrictions include reduced credit access for credit-worthy borrowers with low deposits and high incomes. Efficiency costs will be higher the tighter that the LVR restrictions are – this is especially the case for a reduction in the LVR threshold.
Disintermediation	-	×	The use of macroprudential instruments including LVR restrictions can also create incentives for financial institutions to avoid the policy by operating outside of the regulatory perimeter. Reserve Bank research (Lu, 2019) has found that historically, disintermediation has been too small to significantly erode the effectiveness of the LVR restrictions.
Impact on first home buyers	×	××	Tightening LVR restrictions on owner-occupiers will negatively impact first-home buyers' ability to purchase a house. Figure 2 shows that Option B will prevent roughly twice as many first-home buyers from purchasing as Option A.

Impact on financial system resilience

37. Both Option A and B will have positive impacts on financial stability by reducing the risks in the banking system. The LVR policy impacts on the resilience of banks through three main channels (Lu, 2019; Bloor and Lu, 2019):

- Asset quality channel – LVR restrictions reduce the share of new high-LVR lending over time. All else equal, this increases the resilience of the banking system.
- Risk weight channel – Reducing stocks of high-LVR loans leads to a decline in average mortgage risk weights, meaning less capital needs to be held by banks. This in part offsets the asset quality effect above.
- Indirect feedback effect channel – This effect arises from the LVR policy's mitigation of the magnitude of a potential correction to house prices. LVR restrictions can achieve this in two ways – firstly, by reducing the level of distressed house sales in a downturn and secondly, by dampening house price inflation during an upturn.

38. The financial system may come under stress if there was a negative shock to the housing market and borrowers found themselves in negative equity and unable to repay their loans. The LVR restrictions would mitigate the severity of this stress on the financial system largely through the indirect feedback channel, by dampening house price inflation in an upturn and the magnitude of any subsequent house price decline, as well as the expected level of distressed house sales in a downturn.

39. Relatively speaking, Option A is likely to improve financial resilience in the case of a smaller (but higher probability) price correction, because it reduces the amount of lending that can occur at very high LVRs (e.g. above 90 percent). Option B would have more impact in the case of a larger (but lower probability) price correction, but could create a bimodal distribution of risk on banks' balance sheets – mostly lower risk but with a bigger tail of high risk.

Wider economic impacts

40. The net overall economic impact of tightening LVR restrictions is expected to be positive in the long term. LVR restrictions can moderate the scale of economic downturns by reducing the amplitude of the financial cycle by lowering household indebtedness and enhancing borrower balance sheets.

41. In the short term, to the extent LVR limits are effective in moderating house price inflation, they can be expected to reduce consumption and residential investment in comparison with a counterfactual in which the limits remain off. We expect this effect to be smaller compared to other times where we tightened LVRs as (this time) our proposed tightening is not across all borrower groups.

42. Over the longer term, if LVR restrictions are effective in reducing the magnitude of a potential house price correction, this would support consumption in a downturn and thereby economic growth and employment. We expect that this would outweigh any short-term costs.

Section 68B directive and house price sustainability

43. Based on past Reserve Bank research, we expect that any tightening of LVR restrictions will have a modest and temporary impact on house price inflation (Bloor and McDonald, 2013). The magnitude and duration of the effect depend on the rate of house price growth at the time when the policy is implemented.

44. When house prices are increasing quickly, the effect of LVRs on house prices tends to be muted and short-lived (Armstrong, Skilling and Yao, 2019). The impact of an LVR tightening on house prices will mainly be over the short-term (one year or less).

45. There are longer-term pressures on the housing market (ranging from factors such as a growing population and a limited supply of housing) where the range of responses is outside the scope of macroprudential policy. Option B may have a larger impact on house price inflation than Option A as it is a more significant tightening. However, we cannot be certain of the scale of the impact on house prices, and it is likely to be muted and short-lived in both cases.

46. As this LVR tightening is targeted at owner-occupiers, they will be the most impacted. However, under Option B there would also be some impact on investor lending, since under the combined collateral rules the LVRs for loans to borrowers with both owner-occupied and investment property are calculated based on a weighted average. Hence, the ability of investors to borrow against equity in their owner-occupied property would be reduced under Option B, but not Option A.

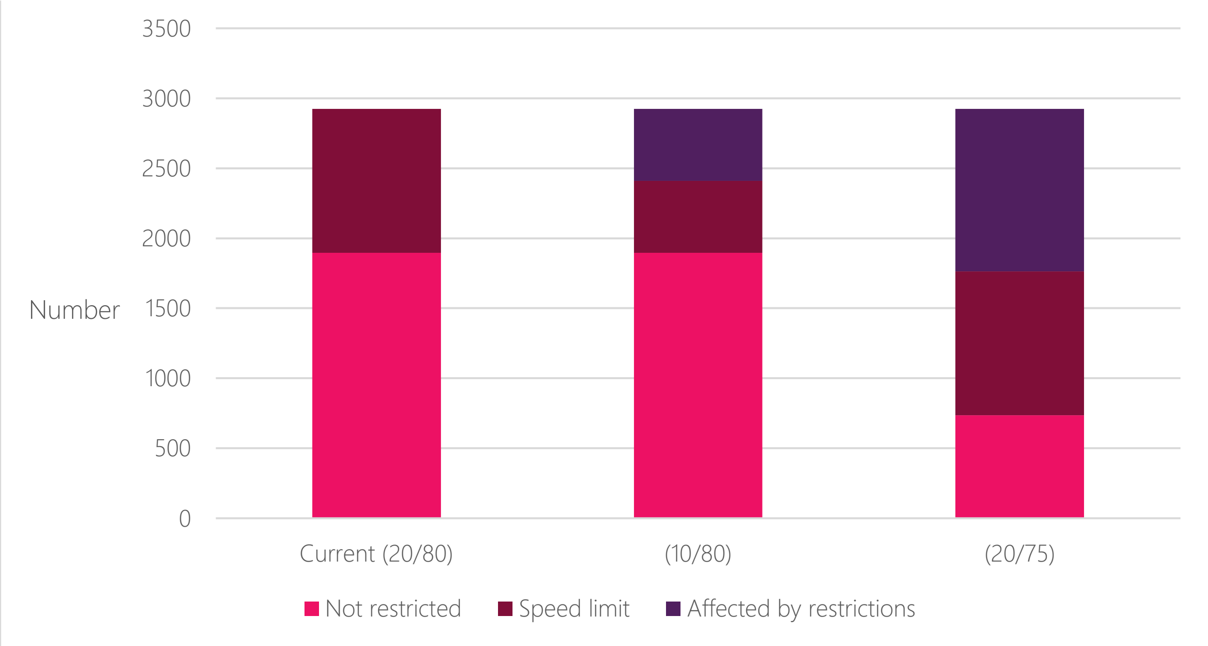
47. We also note that most of the speed limit is currently allocated to first-home buyers. Therefore, a reduction in speed limit will mean that some first-home buyers will need a larger deposit and may take longer to enter the property market. This would also be the case if the threshold was lowered.

48. We expect both Option A and Option B would lead to lower house price growth by removing some marginal buyers from the market, compared to a counterfactual where the LVR restrictions are left unchanged. Because of this, over the longer term, tightening the LVR settings should improve affordability for first-home buyers that do enter the market, relative to a counterfactual in which LVR restrictions remain at current levels.

49. First-home buyers are currently taking on the most risk in terms of high-LVR lending. Therefore, they will be more resilient to economic shocks and less susceptible to increases in interest rates and/or decreases in income if high-LVR lending is reduced.

50. Figure 6 shows that Option A is likely to have lower distributional effects than Option B. Many buyers cluster just below the current 80 percent threshold, so lowering the threshold to 75 percent (as in Option B) will impact more borrowers than lowering the speed limit (as in Option A).

Figure 6: Estimated number of first home buyers impacted by LVR restrictions



51. This would also be the case under Option B. We estimate that Option B will stop approximately twice as many first-home buyers from purchasing, compared to Option A (Figure 6). This may further tilt the playing field in favour of those whose families can help them, e.g. by becoming a guarantor on the loan.

52. Additionally, we estimate that Option B will stop approximately ten times as many other owner-occupiers from purchasing compared to Option A. This may potentially have a flow on effect to first-home buyers, because if a current first-home owner cannot upgrade to their next home it may leave fewer starter homes for first-home buyers to purchase.

Consultation summary

53. The consultation on the proposal to tighten LVR restrictions for owner-occupiers opened on 3 September 2021, and closed on 17 September 2021. We received 14 submissions to the consultation paper, comprising of:

- four submissions from industry – ANZ, ASB, Kiwibank and the New Zealand Bankers Association; and
- ten submissions from members of the public and stakeholder groups.

54. In addition, BNZ and TSB provided some feedback on the proposal via supervisors. BNZ stated that they supported the NZBA submission and did not have any additional comments to add.

55. Industry respondents recognise the need for further tightening in order to help control house price inflation and mitigate potential risks to financial stability. All of the

respondents that supported tightening LVR restrictions preferred Option A (the LVR threshold for owner-occupiers remains at 80%, but the speed limit reduces from 20% to 10%) over Option B (the LVR threshold for owner-occupiers reduces from 80% to 75%, but the speed limit remains at 20%).

56. A number of reasons were given for this, including:

- Option A is better targeted in terms of reducing high-LVR lending as the speed limit would be reduced from 20% to 10%. Option B may not reduce the amount of lending over the 80% LVR band as the speed limit would remain at 20% – this mean that 20% of lending to owner-occupiers could still be at an LVR of above 80%.
- Option B is likely to create quite a lot of complexity and would be difficult to implement.
- Option B would have a greater impact on first-home buyers than Option A as a lot of first-home buyers borrow in the 75% to 80% LVR bucket.

57. Most respondents felt that tightening LVRs would disproportionately impact first-home buyers. It was noted that many first-home buyers borrow at an LVR of greater than 80 percent and many are also borrow in the 75 percent to 80 percent LVR bucket. Therefore, a high proportion of first-home buyers would be impacted by either option.

58. We acknowledged in the consultation document that first-home buyers would likely be the most impacted by this change. However, this is an unavoidable consequence of addressing the financial stability risks we are currently seeing in the market. We note that under the new settings, banks will still be able to make up to 10 percent of new lending to owner-occupiers at high-LVRs, and the majority of this will be to first-home buyers. In addition, the LVR exemption regime allows buyers who qualify for Kāinga Ora First Home Loans, and those purchasing new build properties, to continue borrowing at higher LVRs.

59. Moreover, Option B (reducing the LVR threshold to 75 percent) would have had a larger impact on first-home buyers. It would have likely stopped a larger number of first-home buyers from purchasing homes, and forced those that did buy to have larger deposits.

60. Additionally, the banks felt that implementation from 1 October was very soon and would put them under pressure to manage down existing pre-approvals. However, given the heightened COVID-19 alert levels and feedback from banks, we will be delaying our implementation start date to 1 November.

61. A summary of submissions will be published alongside the RIS with more detail on the feedback received.

Implementation

62. The new LVR settings will take effect from 1 November 2021.[6] The policy change will be enacted by altering banks' Conditions of Registration (CoR). Registered banks will have a seven-day consultation period to comment on proposed changes to their conditions of

[6] Changes to LVR restrictions must be implemented from the 1st of the month.

registration (CoR) that are required to implement the LVR policy, with the technical aspects of this change set out in the Banking Supervision Handbook document BS19.

63. Moreover, we will continue to monitor indicators of mortgage and housing-related risks to financial stability. We may adjust the calibration of macroprudential restrictions in the future (as we have done in the past), as and when necessary to manage these risks.

Monitoring, Evaluation, and Review

64. To monitor the effect of the restrictions, we will assess multiple variables including the flow of residential mortgage lending by banks, asset price growth, changes to aggregate household indebtedness, the stock of high-LVR lending and DTI ratios. In addition, we will continue to monitor for signs that the policy is creating significant market distortions, such as a material and growing share of mortgage credit being financed by non-bank institutions that are not subject to the policy.

65. We will report regularly on our assessment of these effects, alongside our constant monitoring and supervision of banks and banking sector risks. We will primarily communicate our findings through the Financial Stability Report (FSR), the next of which will be published in November 2021. FSRs provide an opportunity for assessing the impact of the LVR restrictions and adjusting the calibration of the limits if necessary to respond to financial stability risks. Relevant data will also be released periodically in the macro-prudential indicator (MPI) chart pack. Other forms of communication may include press releases and speeches.

66. Additionally, we plan to consult on debt serviceability restrictions in Q4 2021, which will provide another tool for managing financial stability risks related to the housing market.

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