ANZ Research

NZ Insight: House prices - impacts from proposed DTI and LVR settings

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House prices – impacts from proposed DTI and LVR settings

Summary

- The RBNZ is proposing introducing debt-to-income (DTI) limits from the second half of this year. The consultation period closes on 12 March, with decisions to be announced mid-year.
- The accompanying slight easing in LVR restrictions may provide modest support to house prices over the second half of 2024, given the DTI limits are unlikely to be binding for some time. However, the RBNZ is not intending to have a big impact on credit conditions overall with these changes and we expect impacts to be small.
- Macroprudential policy can't eliminate the trade-off between risk and credit availability, and DTI restrictions will make it harder for first home buyers to get on the housing ladder, all else equal. But that's true of LVR restrictions as well.

Summary of proposed policy changes

Yesterday the RBNZ released proposed changes to mortgage lending macroprudential policy for consultation. These policies are intended to reduce the risk of bank failures in the event of a housing market downturn and are unrelated to the RBNZ's inflation-targeting objective.

Loan-to-value (LVR) restrictions, which limit the size of a loan relative to the value of the house, have been around for nearly a decade. The new element is debt to income (DTI) ratio limits, which restrict new bank lending according to a borrower's debt as a multiple of their income. The two types of policy have overlapping impacts on credit availability (see the RBNZ website for more detail). How binding they are at any given time will depend not only on their calibration, but also the level of interest rates, expected house price growth, and anything else that affects the demand for housing credit. At different points of the cycle only one or the other may be binding, or neither, depending on what the RBNZ is trying to achieve.

The RBNZ has proposed introducing debt-to-income ratio (DTI) restrictions as follows:

- banks cannot lend more than 20% of their lending to **owner-occupiers** with a DTI greater than 6 times income; and
- banks cannot lend more than 20% of their lending to **investors** with a DTI greater than 7 times income.

The introduction of DTIs is not intended to deliver a large shock to credit availability, but rather to change the mix of policies. Therefore, at the same time, the RBNZ intends to ease loan-to-value (LVR) restrictions. The RBNZ proposes that:

- banks may lend up to 20% (previously 15%) of their owner-occupier lending to owner-occupiers with an LVR above 80% (unchanged); and
- banks may lend up to 5% (unchanged) of their investor lending to investors with an LVR above 70% (previously 65%).

The intent is to revise LVR and DTI settings every 12 months, while retaining the flexibility to review more frequently if warranted.

The RBNZ imposes tougher LVR restrictions on investors than owner occupiers because during a housing market downturn, investors are more likely to sell their properties than owner-occupiers. This could further push down house prices, amplifying the risk to the financial system. However, the proposed DTI limit for investors is higher than that for owner occupiers because in the latter case the house typically reliably earns an income as well, meaning higher DTIs can be sustained.

How does the proposed DTI limit compare with historical lending?

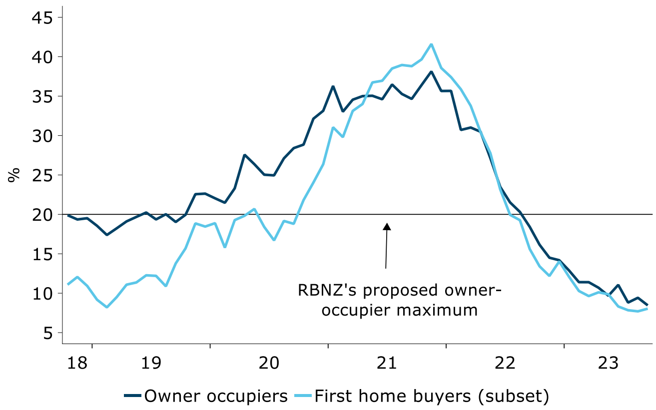
We can’t go back and say with any certainty what things would have looked like had DTI limits been in place, because we don’t know what the settings would have been, including for the overlapping LVR limits. When Covid hit in early 2020, the LVR restrictions were also suspended for a year, which undoubtedly contributed to the housing market taking off (indeed, the RBNZ ended up scrambling to put the restrictions back on earlier than envisaged). DTI restrictions might well have been suspended too had they been in existence, given the widespread expectation at the time was that double-digit house price falls were in the offing and that the housing market needed all the support it could get.

So we can’t produce a ‘what would have been’ counterfactual. But for the sake of illustration, let’s take a look at how the lending over the housing boom compares to the proposed DTIs.

In 2021 when the housing market was booming, the proportion of new owner-occupier lending occurring at a DTI over 6x peaked over 35%, and over 40% for first home buyers, compared to a proposed 20% limit (figure 1). That is, not far off double the proposed limit.

While first home buyers are not explicitly targeted by DTIs, they will be more affected simply because of the fact that first home buyers typically require more borrowing than people who are upsizing or moving (the same is true for LVR restrictions to some extent as well, so the easing of LVR restrictions will make it a touch easier for some first home buyers).

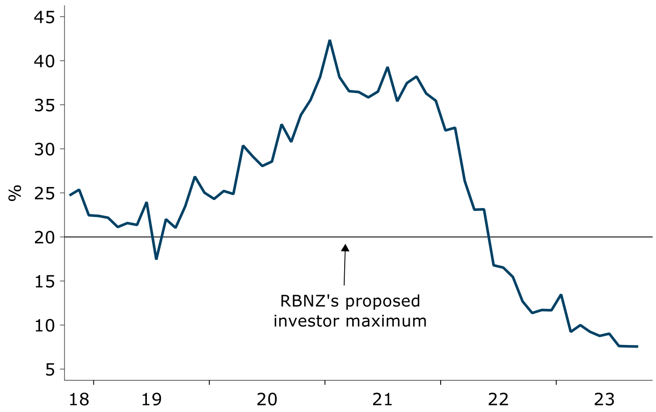
Figure 1. Percentage of new lending to owner occupiers with a DTI above 6x



Source: RBNZ, Macrobond, ANZ Research

What about investors? At the peak in 2021, over 40% of new lending to investors was at DTIs above the proposed limit of 7x, compared to a proposed 20% limit (figure 2), ie more than double.

Figure 2. Percentage of new lending to investors with a DTI above 7x



Source: RBNZ, Macrobond, ANZ Research

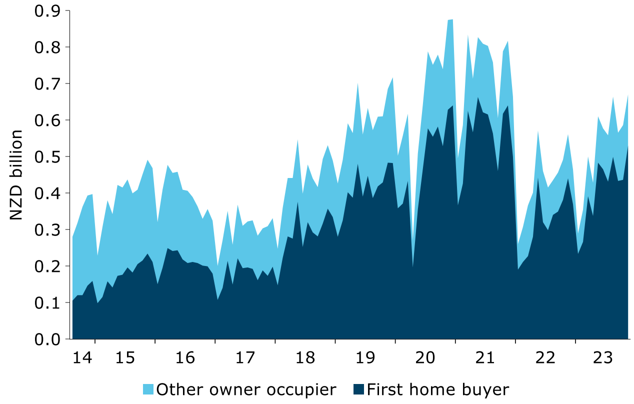
Potential impacts in 2024

We are forecasting a fairly subdued year for the housing market overall, with prices to rise just 4% over 2024. However, we do expect borrowing demand from investors (including at high DTIs) to pick up somewhat as the year progresses, and we expect interest rates to fall. As well as that, interest deductibility is set to be phased back in. So macroprudential settings will certainly not be irrelevant.

Whether LVR or DTI restrictions will have the most significant impact depends not only on their settings, but also on the macroeconomic context. When interest rates are relatively high, the amount most new buyers can borrow is typically limited by their ability to service the mortgage – borrowers couldn't borrow a huge multiple of their income at the moment in any case. The DTI limits are non-binding in that kind of scenario. On the other hand, when rates are very low and house prices are rising fast, DTIs are likely to be more potent – whereas with LVRs, borrowing capacity still rises as house prices do – which can be a lot faster than rises in incomes.

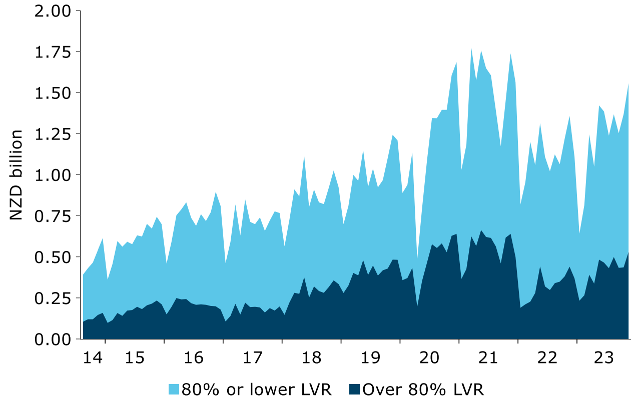
The new DTI limits are unlikely to have much impact on lending this year, as we don't see them being binding for some time. This is consistent with the RBNZ's stated intent to calibrate them "so they act as guardrails – in which they are binding during booms but minimally binding during other times." In our view the associated loosening of LVR settings is likely to provide modest support for house prices from the second half of the year. Figures 3 and 4 show that high-LVR lending is well off its lows for both first home buyers and investors, and figure 5 shows that investor LVR restrictions often tend to be binding – indeed our research has found that tweaks to LVR settings have a significant impact on house price inflation.

Figure 3. Owner occupier lending over 80% LVR



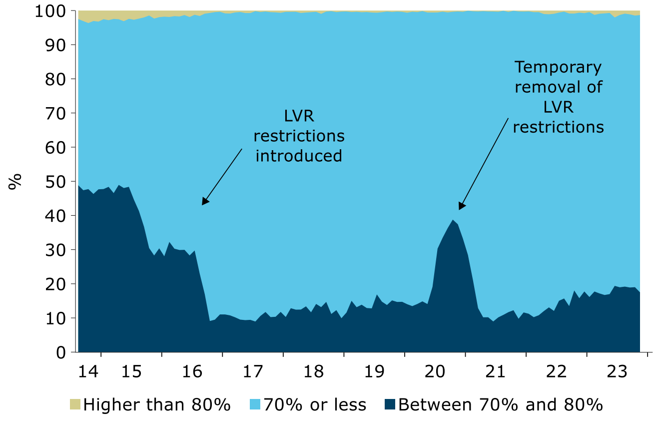
Source: RBNZ, Macrobond, ANZ Research

Figure 4. First home buyer lending by LVR



Source: RBNZ, REINZ, Macrobond, ANZ Research

Figure 5. Share of lending to investors by LVR



Source: RBNZ, REINZ, Macrobond, ANZ Research

The lift in the investor LVR cap from 65% to 70% will allow investors to acquire more leverage from the same amount of equity – borrowing more and potentially paying more for a property at the same time that the tax changes will, all else equal, lift the expected financial returns from a given rental property.

But the magnitude of the potential impacts is capped. If higher-risk mortgage lending lifts strongly, whether because of the change in the mix of policy settings or for some other reason, it will be limited by the new DTI policy – LVR settings can also be tweaked. In practice, although the RBNZ says the intent is to review macro prudential policy annually, LVR restrictions are likely to be tweaked more often than DTIs, because DTIs are "guardrails" reserved for booms. We expect house prices to rise 4% over 2024 and 5% over 2025 and do not see significant risks to this forecast, nor our OCR forecast, from the proposed changes at this stage.

Longer-run impacts

It's important to note that macroprudential tools are intended to influence the amount of higher-risk lending going on to enhance the stability of the financial system, not to enable the RBNZ to target a particular rate of house price inflation. Nor are these monetary policy tools. But given boom times in mortgage lending are typically inflationary times, odds are that attempting to soften the extremes of the credit cycle will seldom be at odds with monetary policy objectives.

It's not possible to assess the likely impact of macroprudential policy on overall credit growth over time, as we don't know how these settings will be tweaked after their initial implementation. The new tool does give the RBNZ more options in terms of taking the heat out of riskier lending at the peak of the housing cycle. But it's not costless: at times, it will make it harder for first home buyers to get on the housing ladder, all else equal. Buying a first house in a very expensive market is by its nature a risky thing to do. No macroprudential tool can eliminate the trade-off between credit risk and credit availability; it can only move the financial system along the curve.

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