MINISTRY OF HOUSING AND URBAN DEVELOPMENT

Aide-memoire

Information on bank lending			
Date:	9 July 2019	**Security level:**	In Confidence
Priority:	Medium	**Report number:**	AMI19/20070114

Information for Minister(s)	
Hon Megan Woods **Minister of Housing**	For your information

Contact for discussion				
Name	**Position**	**Telephone**		**1st contact**
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Other agencies consulted

Minister's office to complete

☐ Noted ☐ Seen ☐ See Minister's notes ☐ Needs change ☐ Overtaken by events ☐ Declined ☐ Referred to (specify) ______________________	**Comments**

Date returned to MHUD:

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For: Hon Megan Woods, Minister of Housing

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Purpose

1. This Aide memoire responds to your request for:
   a. Advice on relationship with banks.
   b. Advice on low deposit mortgage availability.
   c. Advice on bank's development of innovative products to address housing affordability.

HUD's relationships with the banking sector

2. HUD has contacts in the retail, commercial property, risk, and economics/research parts of the banking sector as well as the banking oversight department at the Reserve Bank of New Zealand (RBNZ). HUD's contacts are predominantly people that HUD staff have worked with in previous roles, rather than formal relationships.

3. HUD has been working with the banking sector on a range of matters as the need has arisen. These matters have included:
   a. Information sharing about bank lending criteria.
   b. Demonstrating the value of Auckland apartments/character flat typologies to the banks to encourage them to be more open to lending on high quality homes of these typologies. Banks have traditionally been reluctant to lend on small homes as they consider them to be higher risk and require larger deposits (typically 40-50% for apartments under 50 square meters, see section D for more information). Value in these smaller typologies is determined by design and the amenity available in the apartment complex and location; however, banks tend to define risk and the subsequent equity requirements on relatively 'broad brush' settings such as square metres, ownership status (owner occupier vs. investor) and location (eg, suburban, central city).
   c. Discussions with banks over the KiwiBuild deed requiring the buyer to remain in the house for three years, and the requirement to pay a portion of any capital gain if the property is sold prior to that without permission from the KiwiBuild unit. s 9(2)(b)(ii) [redacted] These discussions are leading many of them to adopt more flexible lending policies in respect of owner occupiers but KiwiBuild properties in particular.
   d. s 9(2)(b)(ii), s 9(2)(f)(iv) [redacted]

Low deposit mortgage availability

4. Low deposit loans are reasonably readily available for first home buyers, although this varies by the typology of the home and banks' willingness to take on high risk loans at any point in time.

5. Banks will generally lend up to 90-95% Loan-to-Value Ratio (LVR) on standalone homes and townhouses, but only up to 80% LVR for apartments. Banks are conscious of the risk of customers going into negative equity, which is bad for both the bank and the customer.

6. Banks will not usually lend with as little as a 5% deposit for construction loans (particularly self builds) given the risk of cost overruns. They will usually only lend with as little as a 5% deposit for completed new builds and existing homes. Policies vary in respect of 'off the plans' purchases, which are classified as new builds.

7. Banks generally see there being a misconception in the market that there is a hard requirement for a 20% deposit for a new home loan. They consider that this supresses the number of low deposit applications they receive.

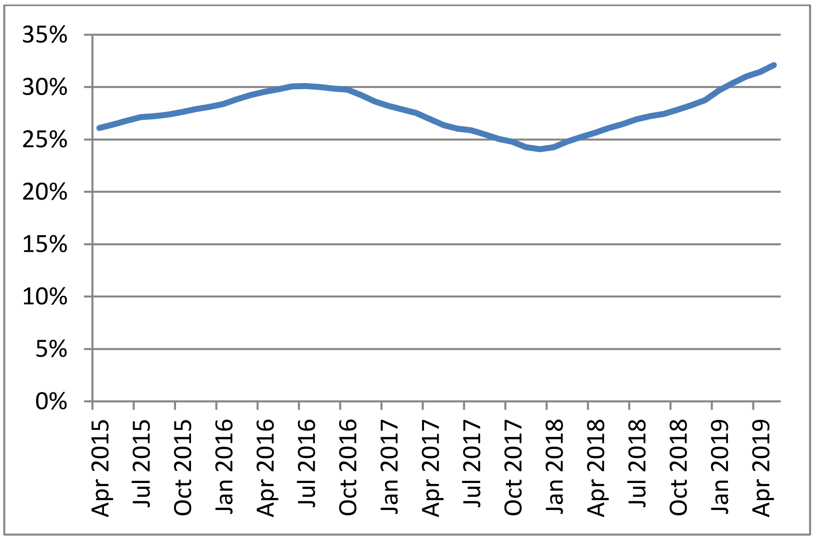
8. Borrowers usually pay some extra amount on loans over 80% LVR. The advertised rates[1] for high-LVR loans are around 40-50 basis points higher than low-LVR loans. Some banks have been known to charge up-front fees for low deposit loans. For Welcome Home Loans, the borrower pays the interest rate applying to low-LVR loans, but does have to pay an up-front insurance premium equal to 1% of the loan amount [redacted] s 9(2)(b)(ii)

9. The best data on high-LVR loans available is RBNZ's statistics.[2] This data shows that 32% of loans to first home buyers were over 80% LVR in the 12 months ended April 2019. This is the highest share since the RBNZ started collecting statistics (Figure 1). Only around one in six high LVR loans are Welcome Home Loans; the rest are made without government support. Over the past year, 61% of all the loans over 80% LVR loans that banks have made have been to first home buyers, with almost all of the remainder being to other owner-occupiers.

10. With very low deposit lending, the buyer may not have been able to demonstrate much of a savings history, particularly if their deposit comes from a HomeStart grant. Although a demonstrated savings history can be beneficial in obtaining a mortgage it does not seem to be essential for lending approval as banks can increasingly look at transactional behaviour to help assess a borrower's level of financial responsibility.

Figure 1: Share of loans to first home buyers that were over 80% LVR

12-month total by number



Source: RBNZ

Limitations on high-LVR lending

1 https://www.interest.co.nz/borrowing
2 https://www.rbnz.govt.nz/statistics/c31

11. Whilst all banks are happy to do some low deposit loans, the quantity they will write is limited by regulations, capital requirements and their willingness to bear risk. The specific number of low deposit loans banks will consider is commercially sensitive and difficult to quantify as it alters based on changes in other parts of their portfolio and the wider financial system.

12. The severe consequences of breaching regulations mean banks often build buffers into their lending practices below these limits. Their willingness to do high-LVR loans can vary depending on how much of a buffer they have against their regulatory requirements and risk metrics at any point in time.

13. There are several layers of bank regulation which affect how banks do low deposit loans:

    a. Basel Accords: The international framework for prudential regulation of banks

    b. The Australian Prudential Regulation Authority (APRA) has oversight of the 4 largest, Australian owned banks (ANZ, ASB, Westpac and BNZ)

    c. RBNZ regulations.

14. The RBNZ's LVR regulations prescribe limits on what percentage of a bank's total lending can be done above certain LVRs. Currently 20% of residential lending to owner occupiers can be done above 80% LVR. There are some exemptions to this, including:

    a. construction lending & new builds

    b. refinancing from one lender to another

    c. bridging

    d. Welcome Home Loans.

15. Banks may limit the number of high-LVR loans they do to conserve capital. Capital is equity funding (or similar) that can absorb losses (as opposed to deposits, which must be repaid in full). Capital adequacy requirements mean banks must hold a certain proportion of capital against their assets. As high LVR loans are considered more risky – due to the potential for borrowers entering negative equity – banks must hold more capital against the same size of loan for a low deposit customer versus a customer with a larger deposit.

16. Banks may limit the number of loans they do to manage their risk, independent of any regulatory requirements.

Risks to the borrower and economy

17. Beyond risks to the banks, large scale low deposit lending creates risks for both the borrower and the wider economy. The borrower is at greater risk of going into negative equity if house prices fall, and the large loan and interest margin may mean that the borrower's debt servicing costs are high (depending on the price of the house). High household debt can exacerbate economic downturns as highly indebted households may need to cut back spending by a greater extent in order to continue servicing their mortgage.

Innovative lending products

Lending alongside progressive homeownership arrangements

18. Most of the banks have entered into arrangements to provide mortgage finance to users of shared equity schemes, including arrangements with Māori organisations. A strong message from all of the banks was that it would be a lot easier to support shared equity arrangements if there were standardised agreements and documentation created in consultation with the industry.

19. Other things they have noted about lending alongside shared equity schemes were:

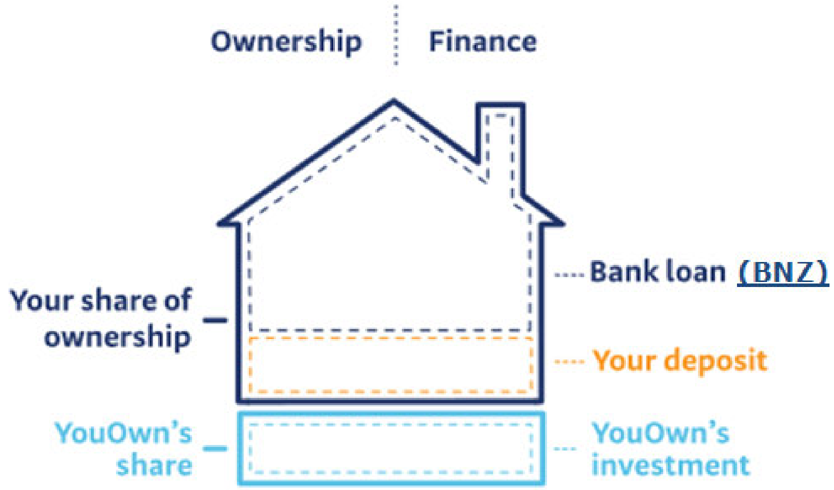
    a. a lot depends on the specific arrangements of the transaction (eg. whether it was fair and sustainable to the buyer)

    b. the arrangement needs to be consistent with the RBNZ's rules (eg. the third party has to provide equity, not a second mortgage)

c. banks are generally suspicious of commercial rent-to-buy schemes as they have seen predatory models in the past.

20. BNZ has partnered with YouOwn to provide a commercial shared ownership product. Households must have an income of at least $110,000 to access the scheme. YouOwn provides the shared equity contribution. BNZ does not provide equity and is not a party to the co-ownership agreement, but provides the regular mortgage as shown in figure 2. The scheme is in its pilot phase and is only available for certain new houses and apartments in Auckland, but it may be expanded to other types of properties if the pilot is successful. As it is provided on commercial terms, the household pays an equity charge (ie. rent) of 4.95% per year on YouOwn's share. Shared equity schemes provided by not-for-profits almost never charge an equity charge/rent on their share (although there is sometimes an administration fee) and this is largely how the subsidy is delivered through these schemes.

Figure 2: YouOwn and BNZ's shared ownership arrangement



21. For the banks, introducing more lending products or different criteria requires the banks to create systems and/or processes to handle these. This can be both expensive and heighten the risk of errors leading to exposure or imprudent lending. This issue relates to a range of innovative products, including shared equity, leasehold and other progressive homeownership schemes.

Offsite manufacturing

22. Most banks have commented to us that there is real potential to lower building costs through offsite manufacturing (also known as pre fabrication, or 'modern methods of construction') if the financing issues could be resolved. The financing issue is that the prefabricated units do not provide good collateral until they are installed on site. Westpac has initiated a small trial to develop a product.

23. Finance is not the only issue to be resolved to enable large scale use of offsite manufacturing in New Zealand; consenting issues are also significant. Consenting issues are included in consultation currently being undertaken by the Ministry of Business, Innovation & Employment ("MBIE"). These and other 'enabling issues' are considered in greater depth in the advice arising from the offsite manufacturing procurement process (KiwiBuild OSM ITP) which is currently in draft for the Minister's initial consideration.

Homestar

24. ANZ are offering discounted loans for loans to buy or renovate to 6 Homestar and above. Many, although not all, KiwiBuild homes have 6 Homestar ratings.

Other matters of interest in the banking sector

Deposits for small apartments

25. Banks commonly require larger deposits for small apartments, which is an important impediment to selling these typologies to first home buyers. This is an issue HUD has been discussing the banks. The specific requirements vary across banks, though they commonly require a 40-50% deposit for apartments smaller than 50 square meters. The thresholds can be quite bespoke and depend on the quality of the apartment, quality of the building, and the location. The market is quite dynamic, with the exact requirements changing regularly.

26. The main reason for the stricter lending criteria for apartments is that they are viewed as less reliable collateral, particularly in the case of low-spec apartments. The historical experience is that their prices are more volatile. Demand might be strong for low-end apartments now, but the market for them in a downturn might be limited given that relatively few people want to own or live in them.

27. Banks consider that demand for high-spec apartments is more reliable because they are popular with owner-occupiers like downsizers/empty-nesters. The other issue banks have with apartments is managing concentration risk. Banks do not want to have too much exposure to any particular apartment building or sector of the market. Value in these smaller typologies is determined by design and the amenity available in the apartment complex and location; however, banks tend to define risk and the subsequent equity requirements on relatively 'broad brush' settings such as square metres, ownership status (owner occupier vs. investor) and location (eg, suburban, central city).

Multiple borrowers (Aide Memoire AMI 18/1912041 from December 2018 provides further information)

28. One of the challenges larger and multigenerational households face in attaining homeownership is getting a mortgage. Banks can be reluctant to recognise all of the income streams in larger households during mortgage servicing assessments. This is particularly relevant for Pacific, Māori and Asian households.

29. Officials spoke to each of the major banks in 2018 to better understand bank lending requirements where there are more than two income earners in the household. These types of loans are referred to as multi-borrower loans.

30. The banks we spoke to said that multi-borrower loans are not common, but they do make them. The banks commented that the loans are more common in the Pacific, Indian and Asian communities. Having more than four borrowers is very rare but does happen occasionally. Since the Welcome Home Loan scheme commenced in 2003, 0.5% of loans made have had three or more borrowers.

31. The loans are processed the same way as any other mortgage application. However, multi-borrower loans can be complex and need to be structured in specific ways to manage the risks to both the bank and the household. Customers often lose interest in taking out a multi-borrower loan once they understand what is involved. In addition, front line bank staff may not be very familiar with multi-borrower loans since they are relatively uncommon, so bank staff may not be able to consistently provide good advice to interested households.

32. The *financial capability services to support Pacific households* programme, approved in Budget 2019, may help provide information about the process for getting a multi-borrower loan. This will help Pacific households to decide whether this type of loan is appropriate for them and help them to engage with banks.