NEW ZEALAND PROPERTY INVESTORS FEDERATION

Submission to the

Reserve Bank of New Zealand

Serviceability Restrictions as a Potential Macroprudential Tool in New Zealand

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NZPIF Submission on Serviceability Restrictions as a Potential Macroprudential Tool in New Zealand

The Submitter
This document has been prepared by the New Zealand Property Investors' Federation (NZPIF) in response to a call for submissions on the Residential Tenancies Amendment Bill.

Established in 1983, the NZPIF has twenty affiliated local associations situated throughout New Zealand. It is the national body representing the interests of over 7,000 property investors on all residential rental property matters including proposed earthquake strengthening requirements.

Industry background
The residential rental property industry is a vital component of New Zealand's economy.

According to a recent ANZ Bank survey of property investors, it was estimated that there are over 300,000 landlords in New Zealand. There are no corporate or institutional residential landlords.

There are over 450,000 residential rental properties, housing over 600,000 tenants, and worth around $150 billion.

Over 380,000 people, Trusts or Businesses derive income from rental property. 'Mum & dad' landlords are common, as 90% own just one or more rental properties. Around 5,000 (1.8%) own 5 or more rental properties.

The majority of landlords are using their rental income business as a mechanism for saving for retirement and are professional and committed long-term players.

Introduction

The NZPIF does not believe that a DTI policy should be introduced. If it is to be introduced, then as in the UK and Ireland, it should not be applied to rental property providers (investors).

The housing market is difficult to predict and the NZPIF has concerns that the Bank could inadvertently create more problems than solves due to incorrect timing of when it introduces and withdraw the DTI limits.

The NZPIF believes that the DTI limits are not necessary as New Zealand retail banks already implement policies that reduce risk for their borrower customers. Banks have already tightened their lending criteria which is one of the reasons why the housing market in New Zealand is cooling. (rising house prices were one of the Banks stated reasons for wanting to implement DTI limits)

As property investors' do not incur additional living expenses when they purchase a rental property, they can afford to spend a higher proportion of their rental income on debt repayment. Therefore they are at a lesser risk with a high DTI ratio than owner occupiers.

The NZPIF is extremely concerned that if applied, DTI restrictions would result in fewer rental properties and severe hardship for tenants that cannot afford to buy a home.

Answers to specific questions

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?

There is a fundamental flaw with using the same DTI calculation for investors as with owner occupiers.

An owner occupier has to pay for all their living expenses in addition to their debt expenses. An investor has a significantly lower level of expenditure as it only relates to their investment property.

Investment property expenses typically include items such as rates, insurance and maintenance, while owner occupiers have these expenses plus food, clothing, transport etc.

This means that when calculating a DTI for customers, banks typically assume that owner occupiers can afford around 35% of their personal income for loan expenses, while banks typically assume that rental property owners can afford around 75% of their rental income for loan expenses. The other 25% is for rates, insurance and maintenance of the rental.

By calculating the DTI the same way for investors and owner occupiers, the Reserve Bank is over stating the DTI for investors.

As a result, investors' are actually less liable to default on their loans at a higher DTI rate. Because of this, the DTI calculation for investors' should be different than owner occupier calculations.

The Reserve Bank claims that rental property owners are more susceptible to defaulting on their loans because it is not their own home and they are less likely to do whatever they can to keep it. This is no longer true as the high 40% equity requirement to purchase a rental property means that many rental property owners homes are used as collateral.

In addition, rental income from property is very stable, which means that the income stream is stable meaning less risk of default.

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?

No. New Zealand Banks are conservative and already have tightened their lending criteria. Banks are already applying higher interest rates to loan applications to stress test them. An extra level of bureaucracy in addition to the commercial banks policies is unnecessary.

Borrowers with high DTI levels can take steps to protect themselves from risk by taking out longer term fixed rates.

In addition, investors' are under less pressure with an equal level of borrowing than owner occupiers for the reasons explained in question 1.

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?

Under the current proposal, anything would be preferable than DTI limits as they will make it even harder to provide rental accommodation to tenants, reduce supply and increase rental prices.

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?

Under the Reserve Banks estimates, there would be 9,000 fewer private rental properties in New Zealand to house tenants. Even with a high level of Government support, social housing providers cannot provide the extra properties required to help tenants out.

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?

The NZPIF does not agree that a DTI policy should be implemented against rental property providers as it will reduce the stock of rental properties, create a combination of homelessness and lead to overcrowding or homelessness for displaced tenants.

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?)

It could potentially increase the home ownership rate of properties that the estimated 9,000 investors who could no longer afford to buy a rental property were bought by first home owners instead.

However if this was to occur, it would lead to extreme hardship for the remaining tenants that cannot achieve home ownership.

It is a commonly held view that the houses will still exist, they will just be owned and occupied by home owners rather than tenants. They believe that these home owners will be first home buyers and previous tenants.

However with the changes to LVR limits not applying to new builds, investors' are already being incentivised to build new rental properties. This could be negated if DTI's are introduced.

Additionally, those that believe that if a rental property is sold to a first home buyer then it is a neutral outcome. One less rental property but one less tenant.

However 2013 census data shows that nearly 50% of the population lives in a rental property, but rental properties only account for 33% of all dwellings in NZ. This means that the occupancy rate for owner occupied dwellings is approximately 1.7 and rental dwellings is 3.

When a rental property is sold to an owner occupier, an average 1.3 people need to find new rental accommodation.

If the Reserve Banks estimates are correct and the DTI limits will result in 9,000 people not being able to provide a rental property, then there will be a shortfall in rental property stock.

Assuming the 9,000 properties that people can no longer afford are instead purchased by first home buyers, there will be around 11,700 tenants that will still need rental accommodation that will no longer exist.