Squirrel

Reserve Bank of New Zealand: DTI settings Consultation Paper (January 2024)

Squirrel response to consultation questions

Q1: Do you have any comments on the proposed approach to using the DTI restriction? That is:

a) Activating the DTI restrictions at a level which is 'binding' during a boom, but minimally binding at other times;
b) Activating the DTI restrictions as soon as practical; and
c) Applying the policy to both owner-occupiers and investors, albeit not at the same level for both groups.

Squirrel supports the proposed approach.

Q2: Do you see any major risks or issues with activating the DTI restriction in mid-2024?

Squirrel sees no major risks or issues with mid-2024 implementation.

Q3: Do you have any feedback on our proposed DTI calibration of:

a) A DTI threshold of 6 with a speed limit of 20 per cent for owner-occupiers?
b) A DTI threshold of 7 with a speed limit of 20 per cent for investors?

Squirrel supports the proposed DTI limit of 6 for owner-occupiers. This feels appropriate and we believe its introduction will be useful and effective in helping to moderate periods of instability in New Zealand house prices.

Looking to point **b)** however, Squirrel has a number of concerns.

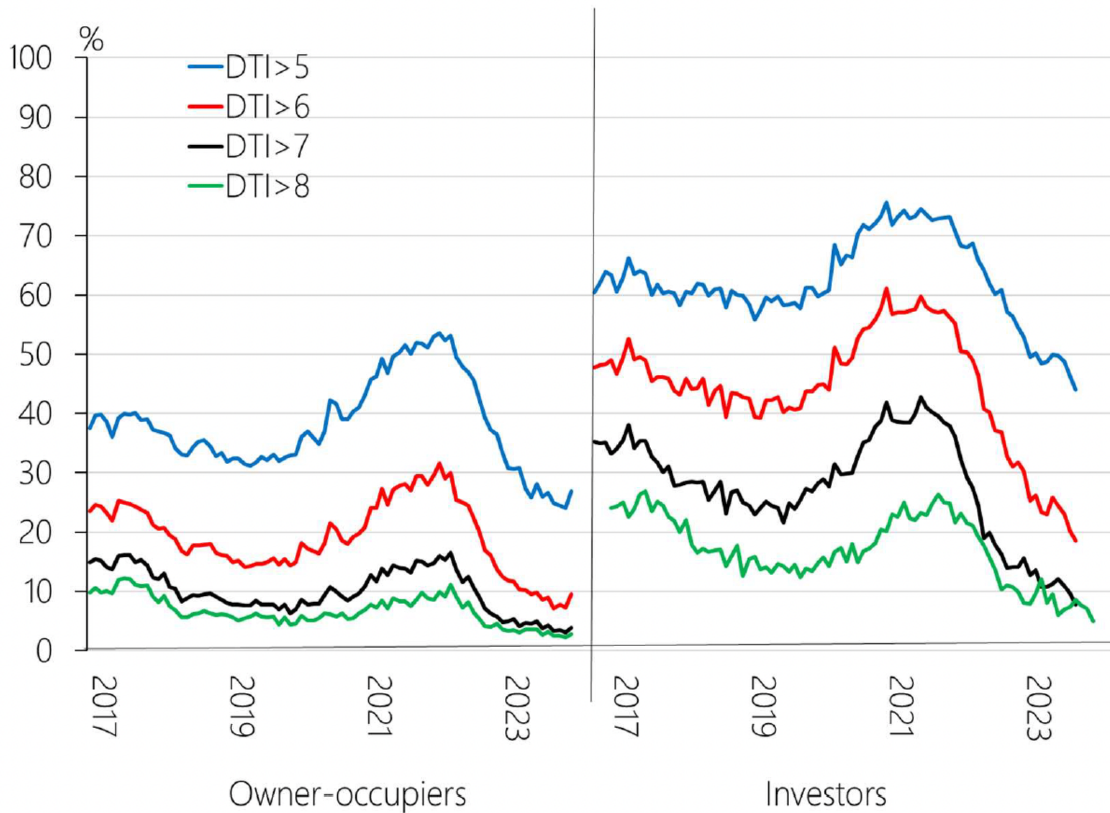
Significant potential to restrict buyer activity at all periods in the housing market cycle

In Squirrel's view, the current proposed DTI setting for property investors is too restrictive and could significantly limit buying activity through all parts of the housing market cycle, not just during booms.

It would effectively mean that as soon as the housing market starts to pick up any sort of momentum, investors would become severely limited in their ability to participate. This would have a detrimental impact on the availability of rental properties, and push up rents. The impact would be felt hardest amongst lower income earners who are more likely to be renters.

Referring to **Figure 2** in the Consultation Paper, below, between 2017-2019 (so excluding the 2021 housing boom) a significant proportion of lending activity occurred above the proposed DTI limit of 7.

Figure 2: High-DTI lending by borrower type (as a percentage of total lending to each borrower type)[15]



In fact, the only period during which the percentage of high-DTI lending for investors (DTI 7+) has fallen comfortably within the proposed 20% speed limit is from 2022 onwards.

During this time, several factors – the removal of tax benefits on rental properties, falling house prices, high interest rates, and increasing costs – caused investors to step back from the market in huge numbers. The last two years have been an unusually quiet period in the property investor market, and therefore, in Squirrel's opinion, are not a good baseline against which to assess the restrictiveness (or not) of the proposed DTI settings.

Squirrel notes that it was not possible to determine whether new build lending was included in **Figure 2**, bearing in mind the DTI exemption on new builds. Operating under the assumption that new build lending *was* included, and that the proportion of high-DTI lending (under the proposed settings) is lower than depicted in the chart, it is still Squirrel's view that a DTI of 7 is too restrictive for the property investor market.

In addition, Squirrel refers to **Figure 3** in the submission document, below, depicting levels of financial stress at different DTI limits during periods of higher mortgage interest rates.

Figure 3: Financial stress for owner-occupiers at different interest rates and DTI level[20 21]

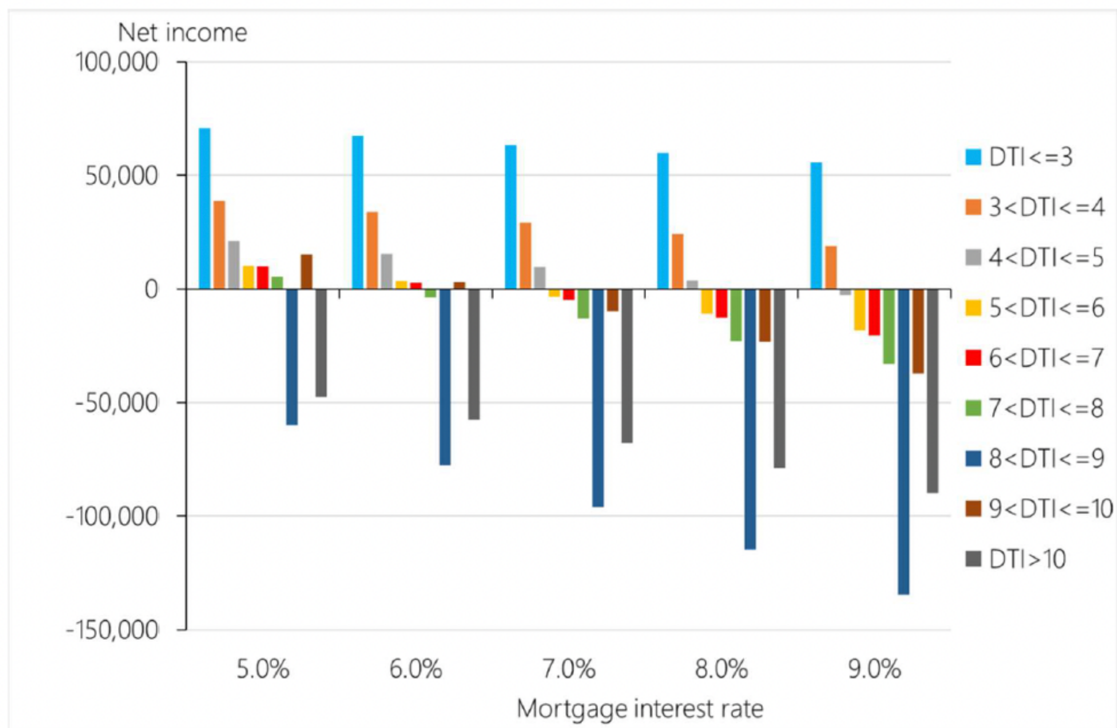
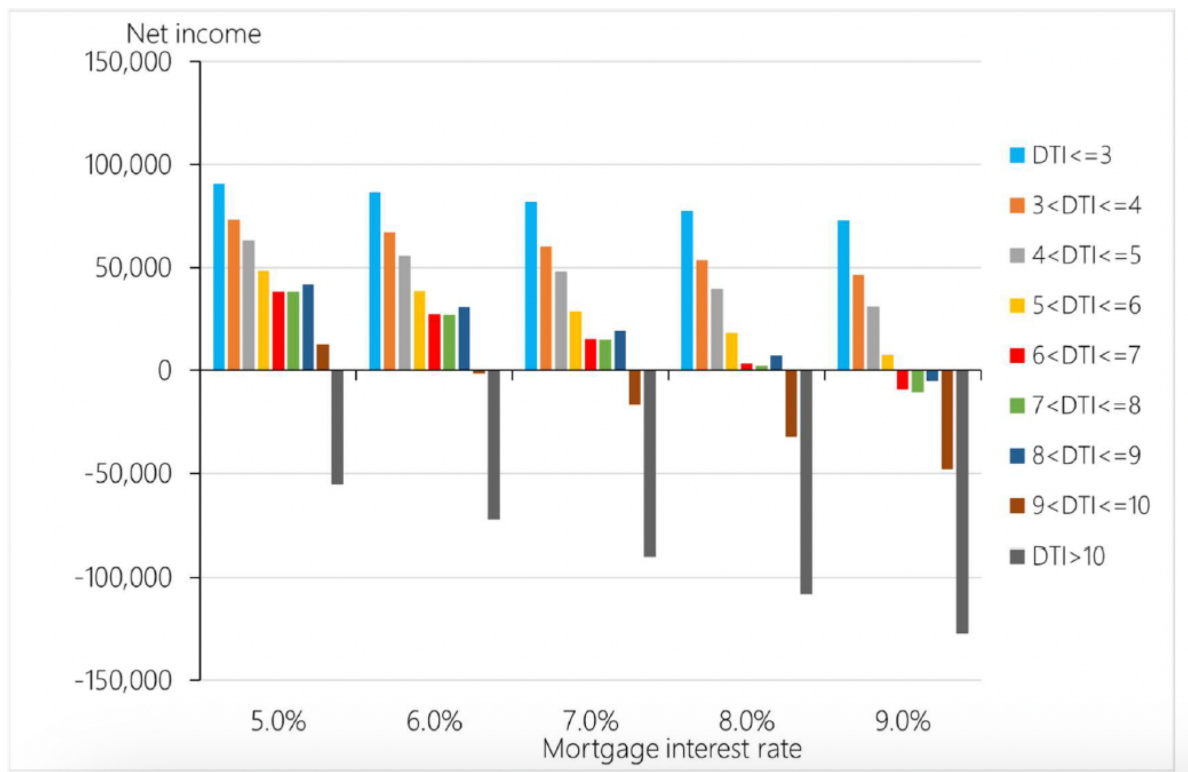


Figure 4: Financial stress for investors at different interest rates and DTI level[22 23]



Squirrel notes that, based on the data provided, even up to a DTI of 9 property investors would be largely unaffected until interest rates reached levels of around 9.0%. This suggests that there is scope to be less restrictive in terms of the proposed property investor DTI limits, without dramatically increasing the likelihood of these buyers experiencing financial stress during periods of higher interest rates.

By contrast, owner-occupiers would (at the proposed DTI limit of 6 for this market) start to experience financial stress much sooner, once interest rates reached levels of 7.0%.

In light of the above, Squirrel believes that a DTI limit of 8 for property investors would be more appropriate. This would effectively moderate levels of activity during housing booms and mitigate the likelihood of financial stress during periods of higher interest rates, without severely hampering the ability of property investors to participate in the market.

Likelihood of banks taking a more conservative stance when enacting DTI speed limits

In Squirrel's experience, lenders always take a more conservative stance when implementing these limits as part of their internal operations.

There's a strong likelihood that the banks' appetite for high-DTI lending will see them choose to work to a speed limit of somewhere between 15% and 17%, under the current proposed rules.

If this is the case, that would mean even less scope to accommodate situations where otherwise credit-worthy property investors need to operate at a DTI ratio higher than 7.

Squirrel submits that a DTI limit of 8 for property investors is more appropriate, or alternatively that the speed limit should be increased to 30% to allow banks more room for discretion when dealing with high-DTI lending.

Q4: Do you have any comments on whether the proposed DTI calibration best achieves the policy objectives and approach of the policy?

Squirrel submits that the proposed calibration for property investors is overly restrictive and over-reaches the policy objectives.

Q5: Do you have any comments on our proposed initial regulatory measurement window of six months?

Squirrel supports the proposed initial regulatory measurement window.

Q6: Do you agree with our proposed LVR calibration of:

a) A 20 per cent limit on new lending to owner-occupiers with an LVR above 80 per cent; and
b) A 5 per cent limit on new lending to investors above 70 per cent.

Squirrel supports the proposed 20% limit on new lending to owner-occupiers.

Squirrel submits that the LVR limit and threshold for investors are overly restrictive, and will serve to reduce the availability of rental property and inflate rents (to the detriment of lower-income New Zealanders). We submit that the LVR threshold should be set at the same level as for owner-occupiers (80%) with a 5% limit. We believe that, alongside the

investor DTIs limits, these levels will support the RBNZ in meeting the stated policy objectives.

An alternative would be to set a 70% threshold with a 20% limit, though our view is that this would be materially less effective as it will open the door to a significant amount of very high LVR investor lending.

Q7: Do you have any comments on our initial assessment of impacts?

Squirrel believes the initial assessment of impacts fails to consider a number of potentially serious, albeit unintended, consequences for existing property investors and business owners.

These consequences are based on our view that a DTI limit of 7 for property investors would be highly restrictive, to the point where it is binding throughout all parts of the housing cycle, coupled with the belief that the current proposed speed limit does not give banks enough capacity to cater to higher DTI lending under these circumstances.

Property investors will become significantly more limited in their ability to make changes to their portfolio, in the event that those changes would inadvertently take them over the proposed DTI limit

DTIs will not just apply when a property is purchased but will also be reassessed at any time a property investor changes the structure of their property portfolio.

The nature of the DTI framework also means that it is based across an entire portfolio, rather than property-by-property, as with LVRs.

These two factors combined can create significant issues for existing property investors, who were not subject to DTI limits when they bought but will be subject to them when they wish to sell a property.

Squirrel believes that, as a result, we will see an increasing number of scenarios where, when an investor's DTI is reassessed at the point of sale of a property, that investor will find they now (inadvertently) fall outside the DTI restrictions. As a result, they will likely be faced with a situation where their lender wishes to claim the full sale proceeds to reduce their overall loan amount.

This would carry serious implications, particularly in cases where that property investor was selling the property intending to free up capital for an express purpose.

The way DTI restrictions apply to newly built properties also has the potential to create further issues.

It is proposed that at the time of purchase, new builds are exempt from DTI restrictions. Squirrel questions the logic of this – why is a lack of affordability acceptable for new builds but not existing property purchases?

One major implication of the new build exemption is that, should the borrower make changes to their portfolio in the future, the "new build" definition will no longer apply.

For investors whose portfolio includes one or more new builds, the sale of any property within their portfolio would trigger a DTI reassessment. At this time, these properties, previously exempt from the DTI restrictions, would become subject to them.

Again, this creates a scenario where investors may inadvertently find themselves outside the DTI limit and vulnerable to having the proceeds of sale claimed by their lender to pay down other debt.

The issue becomes even more complex for property investors who have loans from multiple lenders. Because the DTI limit is to be applied across the entire property portfolio, falling outside the limit with one lender means falling naturally outside the limit with all lenders.

The potential repercussions of this are significant.

These conditions could also create a significant lack of flexibility for property investors needing to restructure their portfolios or lending arrangements to access business capital

Squirrel's concern is a result of the fact that a large number of property investors in New Zealand are also business owners. It is common practice among this group to leverage property to access additional business capital when required, to grow or free up cashflow when earnings are reduced.

The nature of owning a business is that income is often cyclical – either due to the seasonal fluctuations inherent to a particular industry, or (more broadly) due to economic downturns like that which New Zealand is currently experiencing.

Should a property investor wish to leverage their portfolio to access capital during periods when business is slow, there's a much greater likelihood of them falling outside the proposed DTI limit when their income is reassessed as part of those changes.

If the banks are already operating at capacity in terms of their high-DTI lending, which is probable given (in Squirrel's view) how restrictive the limits will be for investors generally, there will be very little scope to accommodate investors in this situation.

Squirrel foresees this having major implications for businesses in New Zealand, seriously restricting access to a key source of capital at times when it is most sorely needed.