



Date 18 June 2014

To: Minister of Finance

Proposed changes to Welcome Home Loan Scheme and Kiwisaver Subsidies

Introduction

1. We understand that a range of changes are being proposed to the Welcome Home Loan (WHL) Scheme and to housing subsidies available to first home buyers under Kiwisaver. Our understanding is that the number of loans available under WHL would be expanded from 2,500 per annum to 5,000 per annum. Income caps would be set at \$100,000 for individual borrowers, and \$150,000 for couples. House price caps would be set at \$550,000 in Auckland, \$450,000 in other areas defined as having a housing affordability problem under schedule 1 of the Housing Affordability and Special Housing Areas (HASHA) Act and \$350,000 elsewhere.
2. Under the proposals, first home buyer subsidies available under Kiwisaver would be expanded to a maximum of \$7,500 per individual (\$15,000 per couple), with the maximum amount being available after 4 years' membership in the scheme. A higher subsidy would be available for the purchase of a new home in those areas of New Zealand with a housing affordability problem (as per Schedule 1 of HASHA Act). The lump sum available after 4 years would be \$12,500 for an individual and \$25,000 for a couple (an increase over the current subsidy of \$15,000).
3. The income and house price caps applying under Kiwisaver would be expanded in line with the WHL scheme.
4. We understand these changes are proposed to take effect from 1 April 2015.

Expected Impacts

5. Since the introduction of restrictions on high-LVR loans in October last year, the rate of house sales has fallen by the equivalent of around 10,000 per annum. The proposed 2,500 expansion in the WHL quota has the potential to offset around a quarter of this reduction, but if the quota were fully used the effect could be larger since only around half of the existing WHL quota is currently being used. We understand the Treasury is investigating options to increase uptake of the scheme.
6. Data on sales over the past year suggest that around 43 percent of house sales in Auckland fall under the expanded cap. Nationally, the equivalent figure is 53 percent. The proposed increase in the house price caps would increase each of

these proportions by around 10 percentage points. We therefore expect take-up of the scheme by new home buyers to be high.

7. We estimate that the new income caps for couples fall at around the 85th percentile of household income, implying a very high level of potential eligibility.
8. The impact of the proposed changes to subsidies is more difficult to gauge. The increase in the standard subsidy available for purchasing an existing home combined with the ability to withdraw the member tax credit would be the equivalent of a reduction in the loan-to-value ratio of 1-2 percent for the typical borrower using Kiwisaver. Thus, while it certainly represents a boost to demand – and an offset to LVR restrictions – the impact is likely to be less pronounced than the change to the WHL quota.
9. The proposed subsidy available for purchasing new builds could be expected to stimulate demand for new dwellings in lieu of placing pressure on the existing housing stock. While the extra subsidy may thus result in extra housing supply, there is also some potential for at least part of the increase in demand for new dwellings to be absorbed into higher margins for developers/builders.
10. A 1 April 2015 start date has potential implications for the path of house sales/ new construction over the next 12 months. It is possible that potential buyers (especially of new builds) will look to defer purchases until they can take advantage of the subsidies. Thus announcement of the changes could result in some market weakness in the near term, but promote stronger activity through the middle of 2015.

Implications for Reserve Bank Policy

11. As you are aware, the Reserve Bank's objective in introducing loan-to-value ratio restrictions (LVRs) in October 2013 was to reduce the systemic risk arising from increasingly overvalued house prices. We believe the LVR restrictions have been effective in reducing house price inflation broadly in line with our original estimates.
12. In the Bank's view, the proposed changes to WHL and Kiwisaver could have a material offsetting effect on the effectiveness of the restrictions on high-LVR lending.
13. In particular, the proposed expansion of the WHL scheme could significantly dilute the dampening effect that the LVR policy has had on the housing market to date. Accordingly, we recommend consideration be given to a more modest expansion of the scheme. We consider that a smaller increase in the WHL quota, to 3,500 rather than 5,000 would be less dilutive of the LVR policy. We also believe there is merit in reducing the magnitude of the proposed increase in house price caps.
14. While the higher subsidy for new builds should promote increased housing supply, it is unclear what the ultimate effects of this will be. We would caution that if the supply of affordable housing is restricted by other factors such as planning and resource constraints, then the likely expansion in demand from increased subsidies could result in increased developers' profit margins. Over the longer term,

subsidies have the potential to add to existing house price pressures in what is a highly overvalued market.

15. In practice, an increase in housing subsidies could also be very difficult to remove in the future. The Bank has always indicated that we consider loan-to-value restrictions to be a temporary measure. We believe there would be merit in linking any changes in the Welcome Home Loan Scheme and Kiwisaver subsidies to the period in which loan-to-value restrictions are in effect.
16. We would be happy to discuss the contents of this memorandum with you.

Graeme Wheeler
Governor