

Legal implications for bank lending restrictions

The Reserve Bank has announced that from 1 October, banks will be subject to restrictions on high loan-to-value ratio (LVR) housing mortgage loans.

They will be required to restrict new residential mortgage lending at LVRs of over 80 percent to no more than 10 percent of the dollar value of their new housing lending flows. If a bank's new home lending book is one hundred million dollars, then no more than ten million can be at greater than 80 percent under the new rules.

A LVR means if a property is valued at \$100,000, an 80 percent restriction means the bank cannot lend more than \$80,000 against it. Presently, some banks go to 95 percent, depending on the type of property and the nature of the borrowers. Those relatively high LVR thresholds are going to be tested under the new regime.

What might this mean for ordinary folk?

The restriction has come to try and curb out of control house prices. But the problem is really only exacerbated in Auckland, and to an extent in Christchurch. Both cities have supply issues, yet these restrictions address the demand side.

Recent figures show the median price for Auckland at \$670,000. That means the median deposit now required will be \$140,000. Presently, some of that comes from Kiwisaver contributions, and that is not expected to change from 1 October. But it is expected second-tier lenders and families will need to contribute to the initial contribution/deposit. Or, sellers may leave money in the property for a few years, which won't be common.

For family members lending money to sons and daughters, various issues will arise. Gift duty is now abolished, so any amount of money can be given without tax liability. But once it is given, it is gone and unable to be recovered. If a young couple are the recipients, and the relationship doesn't last, it is possible half of the gift could go to the other party at separation. For this reason, it might be better for parents, if they do assist their children, record it as a loan, rather than a gift.

Whether it is a loan or a gift, the bank lender will need to know of the arrangement. Because a gift doesn't need to be repaid, that will be beneficial to the parties. But a loan might make it problematic for all concerned, depending on the loan repayment requirements, if any. A related issue is whether that second loan is to be secured against the property by way of a second mortgage, registered or unregistered. Again, the bank lender is going to be very interested in this information.

Mortgage lenders, if more than one, are allowed to arrange their affairs in a way that regulates who gets how much money in the event of enforcement. These are called priority arrangements. These could come into play a lot more under the new restrictions.

And what about second tier lenders? The global financial crisis saw a lot of these lenders disappear, and a lot are still yet to resurrect. They ordinarily charge much higher interest rates, making loan repayments more difficult for first home buyers already facing high entry levels in Auckland. They certainly will want their loan secured against the property.

Proper legal advice from the outset will assist all parties under these new arrangements.