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Could Loan to Value Ratio changes be your pathway into the property market?

While this turbulent year has come with its fair share of wildcards, there has been some welcome news for those looking for a loan to finance their property purchase. Not only are interest rates at an all-time low for borrowers, there has also been a removal of the Loan to Value Ratio (LVR) restrictions. In April 2020, the Reserve Bank announced the LVR restrictions would be removed for 12 months, ending May 2021. So, what could this mean for your ability borrow going forward?

What is a Loan to Value Ratio?

A LVR is the amount of your loan in comparison to the value of your property (your debt to equity ratio in your property). Your LVR is calculated by dividing your loan amount by the value of the property you are purchasing. For example, if you are purchasing a property worth $400,000, you have a deposit of $80,000 and need to borrow $320,000, the LVR would be 80% ($320,000 ÷ $400,000 = 80%). LVR's were brought in to strengthen the banking system in New Zealand so that in the event of a reduction in house prices the banks were not caught out. They were also used to slow down house price increases by reducing the pool of buyers.

Removed restrictions

Previously having a LVR of greater than 80% would limit your chances of gaining an approved new home loan. The Reserve Bank restricted banks to only allowing 20% of their new home loans issued to have an LVR of more than 80% (deposit of 20% or less). Since 1 May these restrictions have been removed meaning banks are able to approve more loans for those who do not meet the 20% deposit threshold. This has been a boost for prospective purchasers in their ability to enter the property market along with the record-low interest rates currently being offered by the major banks.

Consequences of the removal of restrictions

While the removal of these restrictions has been seen as a positive for many buyers, particularly first home buyers who were struggling to reach that 20% deposit mark, there are some consequences for having a high LVR. Having to borrow more comes with the fact that your loan payments will be larger. Further low interest rates currently being advertised by banks are usually their "special" rates which require an LVR of under 80%. Those with an LVR of above 80% will have to settle for banks "standard" rates which, while low comparatively to where they were at the start of year, are not at the same level as the special rates. A further consequence is that it is common for banks to add on a low equity premium to interest rates for borrowers who have a deposit of less than 20%, resulting in higher loan payments for the borrower.

What the LVR changes mean for you

While the removal of the LVR restriction is good news for first home buyers who previously were not able to borrow due to their high LVR, any borrower will still have to meet the banks income and credit criteria. These changes are unlikely to assist investment property buyers. Due to the current uncertainty around where the property market is heading in the post-Covid world, banks are unlikely to lend to an investment buyer with a high LVR. Once banks are content the property market has stabilised, they many then be more comfortable with lending to investment buyers with higher LVRs.

If you have questions or would like to discuss your options going forward, contact our Commercial / Property team.

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Please note, the following information is current as at 12 August 2020. Given recent events, this may be subject to change as the situation develops over the coming weeks. The opinions expressed in this article are general in nature and do not purport to be specific legal or professional advice. If you have a specific query, please contact one of our lawyers.