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Macro-prudential policy for residential mortgage lending

Consultation paper CP87

Contents

Section 1: Introduction and background

The property bubble that ended in 2007 showed the damage to financial stability that can be caused by too lax mortgage credit standards. Such an approach can fuel housing demand in a way that drives prices up beyond what can be sustained. This can result in a wave of defaults and insolvencies that destabilises the whole economy.

Before the crash, there had been a widespread belief that lenders would manage risk and be sufficiently prudent to eschew such a pattern of behaviour, but this was shown not to be the case. While many lenders may have learned from the crisis, some may not. Risk management and prudence voluntarily adopted, or not, by lenders and borrowers need to be supplemented by a set of simple rules that increase resilience to sudden changes in housing prices and help avoid the mistakes of the past.

The Central Bank proposes to introduce regulations placing ceilings on the proportion of mortgage lending at high loan-to-value (LTV) ratio (i.e. a maximum fraction of the purchase price to the fraction financed by bank credit) and on the proportion of mortgage lending at high loan-to-income (LTI) ratio (i.e. a maximum multiple of the borrower's gross income before tax or other deductions) by regulated financial services providers. The objectives of the proposed regulations are to increase the resilience of the banking and household sectors to the property market and try to reduce the risk of bank credit and housing price spirals from developing in future. The Central Bank does not wish to regulate or directly control housing prices.

It is recognised that loans at higher LTV and LTI ratios can be appropriate in certain circumstances. For this reason, instead of imposing absolute limits, the Central Bank proposes a "proportionate limit" according to which each lender will be allowed to make a certain limited fraction of its mortgage loans at LTV and LTI ratios in excess of the threshold ratios.

The proposed measures will require banks to restrict lending for primary dwelling purchase above 80 per cent LTV to no more than 15 per cent of the aggregate value of the flow of all housing loans for principal dwelling home purposes; and to restrict lending for primary dwelling purchase above 3.5 times LTI to no more than 20 per cent of that aggregate value. Such thresholds would ensure a greater degree of safety around the mortgage business. Lending to households for the purpose of purchasing investment properties calls for greater prudence. The paper proposes a lower threshold for buy-to-let (BTL) properties, requiring banks to limit BTL loans above 70 per cent LTV to 10 per cent of all BTL loans. The different thresholds could be adjusted in the future if this seems warranted by evolving circumstances.

Taking into account the prevalence of existing loans in negative equity, the proposed regime will include exemptions enabling excess LTV ratios to be carried across to new properties for borrowers wishing to move. A number of other provisions are also covered in Section 4.

The proposed regulations are complementary to existing micro-prudential supervision and to lenders' own risk management practices. They are not intended to capture all aspects of credit risk associated with the borrower, nor to replace or substitute for a bank's existing internal credit assessment policies and procedures, but rather to reinforce and strengthen the existing suite of credit risk mitigation tools employed by prudent lenders. The Central Bank will continue to supervise lenders. Compliance with the regulations will not exempt lenders from additional supervisory action.

While the regulations are not yet in place, regulated lenders are instructed to take account of the likely introduction of such a regime and to begin to adapt their lending practices already in anticipation of its introduction.

The accompanying paper discusses further these proposals. Draft regulations are also contained in Annex 1. The Central Bank will consider carefully the feedback it receives on these proposed regulations and the questions asked in this consultation paper. Details on how to respond to this consultation paper can be found in Section 6. The consultation period closes on 8th December 2014.

Box 1: The new policy framework for macro-prudential policy in Ireland

The financial crisis highlights the importance of protecting the stability of the financial system. Strengthened tools of prudential supervision that focus on the governance, risk management, and capital adequacy of individual financial firms are increasingly being supplemented by tools focused on the interaction of credit decisions of firms and macroeconomic variables. These so-called "macro-prudential" tools are being applied around the world, especially in relation to the housing market, which has been the repeated focus of costly boom-and-bust cycles.

Ireland's emerging framework for macro-prudential regulation is being articulated within a framework that has been defined by the European Systemic Risk Board (ESRB)[1], but relies mainly on Irish national laws and institutions, especially the Central Bank.

Similar to other regulatory tools, macro-prudential policy will not necessarily prevent future financial crises but instead aims to reduce the probability and

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[1] The ESRB is is tasked with the macro-prudential oversight of the financial system within the European Union, in accordance with Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board [2010] L 331/1.

depth of such events. Macro-prudential policy has particular importance in economies in a currency union, where monetary and exchange rate policy cannot be used by national authorities to prevent the build-up of country-specific risk.

The Central Bank has been designated as the authority responsible for the implementation of macro-prudential policy in Ireland. This responsibility reflects its statutory mandate in relation to the overall stability of the financial system. The Central Bank is also the national macro-prudential authority for the purposes of the ESRB and the responsible national authority for the purposes of certain macro-prudential tools in the Capital Requirements Regulation (CRR)[2] and Capital Requirements Directive IV (CRD IV)[3].

The Central Bank's framework for macro-prudential policy is outlined in a recent paper (CBI 2014).[4] This framework elaborates the aims of macro-prudential policy which are to:

- Strengthen the resilience of the financial system so that it can withstand adverse movements in credit and property cycles or the impact of other economic shocks.
- Reduce the potential for vulnerabilities that could lead financial distress to accumulate. Many of the vulnerabilities arise through the pro-cyclicality of the credit cycle.

Objective of macro-prudential policy for residential real estate

Irish households and banks are very exposed to the residential real estate sector, with over eighty per cent of the total stock of lending to households being for the purpose of purchasing housing and mortgage loans making up almost sixty per cent of the total stock of loans by Irish banks.

Property lending is prone to cyclical fluctuations, with increased lending driving increases in asset prices which can fuel expectations of further price increases and prompt additional lending. Poorly managed property lending increases the economy's vulnerability to boom-bust cycles. Furthermore, the behaviour of each lender in such circumstances can be strongly influenced directly and indirectly by

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[2] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L 321/6.
[3] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC [2013] OJ L 176/338.
[4] Central Bank of Ireland (2014), A macro-prudential policy framework for Ireland.

the lending behaviour of others. This pro-cyclicality can be exacerbated if lending standards are loosened during an upswing, as occurred during the past decade when lenders increased the LTV and LTI ratios and the durations at which they were prepared to lend even as housing prices became increasingly disconnected from fundamentals. Such behaviour weakens the resilience of both borrowers and lenders to future shocks, whether to the economy as a whole or to the housing market. Macro-prudential policy measures that impose lending standards on the system as a whole throughout the credit cycle can help remove this dynamic and enhance the stability of the financial system.

There is little indication at present of bank credit being an important driver of the recent increase in property prices in Dublin, with the volume of new lending still very low. However, the introduction of precautionary measures will help ensure that the recovery of the property market is not destabilised by the re-emergence of a dangerous credit-driven price dynamic. Prudent LTV and LTI ratios should be the outcome of a well-managed credit decision process in each lender; unfortunately, experience shows such prudence cannot be relied on and that a policy overlay which would inhibit the emergence of imprudent lending is desirable. This overlay should be in place even in normal times and its introduction will in itself help dampen unrealistic expectations.

The macro-prudential tools proposed in this consultation paper are consistent with sustained growth in aggregate credit supporting the effective functioning of the housing market and on terms that do not place financial stability at risk.

Objectives of macro-prudential policy in the real estate sector:

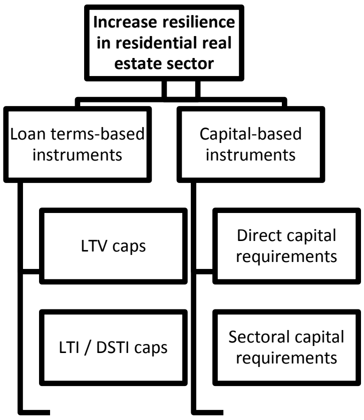
Primary objective:
Increase the resilience of the banking and household sectors to financial shocks

Secondary objective:
Dampen the pro-cyclical dynamics between property lending and housing prices

Section 2: Macro-prudential instruments

Many different types of government and regulatory policies affect housing market conditions, either directly or indirectly. These include policies in relation to zoning and physical planning, construction regulations, taxes (including the treatment of housing purchases, costs and returns in the capital gains tax, income tax, stamp duty, development levies, etc.), subsidies, and rental market conditions. The Central Bank has at its disposal a number of instruments that can be used to meet its financial stability objective. These include instruments based on varying the capital requirements on lenders, depending on the sector of lending or on cyclical conditions, and instruments based on the terms and conditions of individual credits, which include limits on LTV, LTI, debt-to-income (DTI) or debt-service-to-income ratios (DSTI). The Central Bank has considered the use of these instruments in light of the stated objective.

Figure 1: Available macro-prudential policy instruments



Capital-based instruments

Countercyclical capital buffer

The Countercyclical Capital Buffer (CCB) tool, which, according to the EU CRR regulations, could be deployed on a phased basis from January 2016, will require banks to hold more capital during periods of strong credit growth and rising systemic risk.[5] This buffer is designed to increase banking system resilience during a downturn and act against pro-cyclicality in the financial system by dampening excessive credit growth during an upturn. While such a buffer increases banks' capacity to absorb losses in a downturn, it does not specifically target household resilience or indebtedness. A CCB would apply to all exposures of banks operating in the domestic market and could not be aimed only at real estate exposures.

While the Central Bank may introduce a CCB at a later date, it is not a useful instrument to consider at this time as it cannot be aimed at real estate exposures and, in any case, is not available until 2016.

Sectoral capital requirements

Sectoral capital requirements allow the Central Bank to increase capital requirements on banks' exposures to a specific sector, such as the residential property sector. While an increase in sectoral capital requirements could lead to an increase in banks' lending spreads, which could moderate lending volumes to

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[5] See, e.g., Regulations 119, 125 and 128 of the European Union (Capital Requirements) Regulations 2014 (S.I. 158 of 2014).

that sector, it would not directly address household demand for credit, or the household sector's resilience or indebtedness. In addition, sectoral capital requirements would be applicable to exposures of banks only and would not apply to lending by non-banks. Note that the Central Bank engages with the banks on a bilateral basis through the supervisory process to ensure that they are holding sufficient capital against new lending.

While the Central Bank has introduced some sectoral capital add-ons in the past, and while it may do so again, further sectoral capital add-ons are not considered useful in present circumstances.

Loan terms-based instruments

Macro-prudential tools that focus on credit conditions include limits on LTV, DTI/LTI, and debt-service-to-income (DSTI) ratios. These caps are often used together and can be introduced on all new lending or on a proportion of new lending (a proportionate cap). LTV, DTI/LTI, and DSTI limits can strengthen the resilience of the banking sector by reducing the likelihood of mortgage defaults and the losses in the event of defaults.

Based on the growing international experience with LTV and LTI caps, an increasing body of literature shows the benefit of limits on LTV and LTI ratios in reducing the severity of downturns (Box 2). International authorities, including the European Union in the Mortgage Credit Directive,[6] also recommend their use. A common theme in recent recommendations on this matter is that they should be put in place early to help prevent problems emerging and not be deferred until corrective action is necessary.

LTV ratios

Limits on LTV ratios impose the requirement of a minimum deposit of households relative to the value of the property. LTV limits make lenders less vulnerable in the event of property prices falling by reducing the losses in the event of a default. This can be seen for Ireland in the positive relationship between higher originating LTV and bank losses from defaults for loans issued prior to end 2013, which is shown in Figure 2. This indicates a sharp increase in the losses of defaulted loans at high originating LTV ratios.

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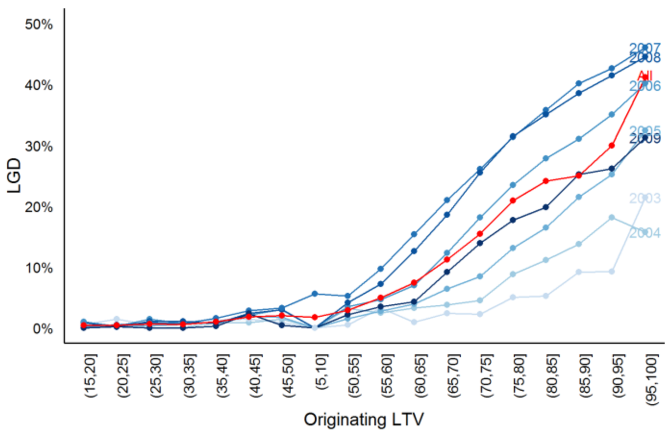
[6] Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 [2014] OJ L 60/34.

Figure 2: Current loss-given-default by originating LTV for different years of origination and for the entire loan sample (red line)



Source: Central Bank of Ireland loan level data[7] for primary dwelling purchase - loans currently in default.
Notes: Figure shows current loss-given-default for the entire sample of loans (red line) and for different years of loan origination (blue lines).

Lending at high LTVs was a feature of the last crisis, with the proportion of new loans issued at over 90 per cent LTV growing from 14 per cent of loans in 2000 to 29 per cent in 2006.[8] These loans, issued near the peak of the cycle, led to large numbers of borrowers in negative equity once housing prices turned, which is a well-documented cause of mortgage defaults.[9] Central Bank research suggests a positive relationship between originating LTV and LTI ratios and subsequent defaults, with higher originating ratios associated with higher defaults. The

[7] The data are a point-in-time view of the current stock of mortgages held on the books of the banks as of 31st December 2013. See Macro-prudential Tools and Credit Risk of Property Lending at Irish banks for a description of the loan level data (LLD) used. The sample of LLD used for the charts in this paper varies according to data availability of different data fields.

[8] Kennedy, G. and T. McIndoe Calder (2011), The Irish Mortgage Market: Stylised Facts, Negative Equity and Arrears, Central Bank of Ireland Research Technical Paper, No 12/RT/11.

[9] E.g. Lydon, R., and Y. McCarthy (2011), What Lies Beneath? Understanding Recent Trends in Irish Mortgage Arrears, Central Bank of Ireland Research Technical Paper, No 14/RT/11.

strength of the relationship depends on the point of the property cycle at which a loan is originated.[10]

If there had been an effective LTV cap in place in the early 2000s it is likely that the costs of the crisis would have been very greatly reduced. For one thing, binding ceilings on LTV ratios would have reduced the effective demand for housing, very likely lowering prices. Furthermore, faced with weaker demand and a smaller flow of profits, it is likely that developers would have built fewer houses, and would have been left with a smaller stock of unsold properties when the crash came.

It is not easy to get a precise estimate of how this behaviour would have changed had stronger macroprudential tools been in place. In some countries property price increases have continued despite the imposition of binding LTV limits in recent years. But even if there had been no moderating influence on prices, LTV caps would have materially improved the resilience of the system. The benefit a LTV cap would have had in reducing the losses from the last crisis – even if housing prices had not been dampened – can be illustrated using the Central Bank's loan loss forecasting models. According to those models, if it is assumed that the same number of loans was made and that housing prices were the same as actually prevailed, but that each loan was capped at a LTV of 80 per cent, credit losses on residential property of the banks over the coming three years would be lower by 17 per cent. Again, this is only a partial analysis as it does not account for the feedback that would have occurred between tighter lending standards, housing prices and mortgage credit growth and therefore it *understates* the true effect a LTV cap would have had on banks' losses.

When considering the impact of an introduction of a LTV cap, it should be noted that the deposit paid by first time buyers has fallen as a percentage of borrower income relative to the pre-crisis years (Figure 3). The fall in property prices of 46 per cent from 2007 peaks to end 2013 has reduced the deposit-to-gross income ratio to levels last seen in the late 1990s.

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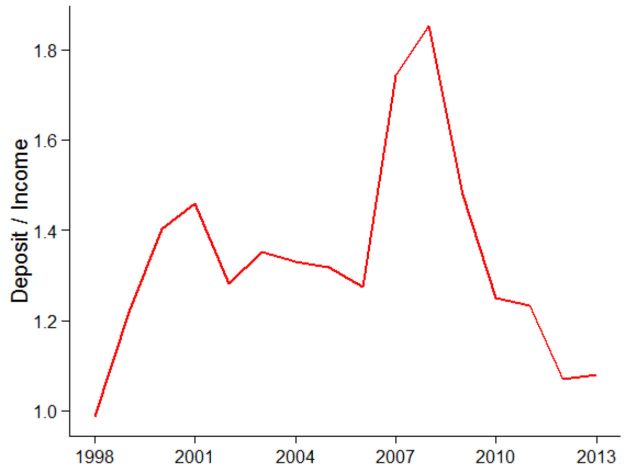
[10] Hallissey, N., Kelly, R., and T. O'Malley (2014), Macro-prudential Tools and Credit Risk of Property Lending at Irish banks. Central Bank of Ireland Economic Letter, Vol 2014, No 10.

Figure 3: Multiple of borrower gross income to actual deposit paid over time



Source: Central Bank of Ireland sample of loan level data.
Note: Calculated mean for first time buyers. Gross income as reported to banks at loan origination. Deposit paid is calculated as the residual from the loan value and the collateral value at time of origination.

The benefit a LTV cap would have had through the last cycle is clear. It is the Central Bank's view that a limit on LTV ratios is an appropriate tool to address the current macro-prudential objective and to foster prudent lending standards as housing market activity begins to improve.

LTV caps do not completely eliminate pro-cyclicality: as property prices increase, the capped loan amount also increases. However, a LTV cap prevents the more extreme pro-cyclicality that was observed pre-crisis when LTV ratios increased with housing prices. In addition, LTV caps can be supplemented by a further tool that dampens pro-cyclicality, namely caps on LTI ratios.

LTI / DTI ratios

As discussed in Section 3, lending at high LTI ratios was a feature of the pre-crisis period, when banks increased credit by loosening lending standards.

Limits on LTI ratios, which restrict the size of a mortgage loan to a multiple of the borrower's gross income, act as a restraint on excessive repayment burdens and unsustainable increases in household debt. LTI limits reduce the probability of default by providing a buffer in the event of a loss of income for borrowers. They are consistent with the Central Bank's supervisory focus of encouraging lending based on affordability of the borrower. Typically, LTI ratios become more binding than LTV ratios in a credit boom.

An acknowledged weakness in the use of LTI as a guide to creditworthiness is the fact that income at the time of borrowing may not be a good guide to average income over the life of the mortgage or to the risk of unemployment. Lenders need to take this into account in their lending decisions and must not rely mechanically on LTI.

Part of the over-indebtedness of households in this crisis comes from the presence of additional secured or unsecured borrowings from multiple sources. A cap on mortgage LTI does not deal with this aspect and could result in leakage through additional non-mortgage borrowing, frustrating the aims of the measure. One theoretical approach to this problem of potential leakage would be to apply a ceiling also to the household's total debt-to-income (DTI) ratio. Such ratios take into account a borrower's total debt and are therefore, if they can be enforced, more effective in constraining the build-up of household debt. However, this ratio requires a comprehensive view of all a borrower's debts, which has been more difficult for the lender to obtain reliably given the absence in Ireland of a Central Credit Register. The necessary legislation to underpin such a Register is now in place and the Central Bank is creating a Register, which is expected to become operational in early 2016.[11] The new Credit Register will be another important step in enhancing the functioning of a well-regulated and stable mortgage lending market in Ireland and will allow for further consideration of macro-prudential tools such as DTI and DSTI in future. Pending the availability of this Register, it would be premature to attempt to establish realistically enforceable regulations on total debt. Lenders must nevertheless seek to inform themselves about total borrower indebtedness and limit their lending accordingly, as per their requirements under the Consumer Protection Code 2012.

The role of lending at higher LTIs in extending credit during the last cycle is clear. It is the Central Bank's view that a limit on LTI ratios is appropriate to foster prudent lending standards as housing market activity begins to improve.

Combination of LTV and LTI caps

As noted, LTV and LTI caps help to increase the resilience of banks and borrowers to downturns in the property market. LTV caps may not be sufficiently countercyclical on their own, given that indebtedness still increases as housing prices increase. Accordingly, LTI may be more effective in markets where housing prices are rising faster than incomes. These ratios naturally complement each other in dampening the cyclicality of lending to the property sector, with the LTV addressing the wealth aspect and the LTI the income aspect of the same risk. Put another way, LTI addresses affordability for the borrower, while LTV addresses the scale of potential loss to the lender in the event of the default of a borrower unable to service the debt. International experience shows that LTV and LTI caps are often used together (see Box 2 overleaf). In an Irish context, Central Bank

[11] See the Credit Reporting Act, 2013, S.I. No. 19 of 2014.

research[12] discusses the need for both these tools in order to mitigate risk on the different sources of credit risk, via both the collateral channel and the repayment channel.

It is the Central Bank's view that limits on a combination of LTV and LTI ratios are appropriate to address the objectives of increasing household and bank resilience and dampening pro-cyclicality in the housing market.

DSTI ratios

DSTI limits act in a similar way to LTI limits by restricting the debt servicing cost relative to the income of the borrower. Imposing a DSTI ratio on net income is operationally difficult. In order to define the numerator of a DSTI ratio, a comprehensive view of the debt service cost, including all the borrower's loans, and potentially under different interest rate scenarios, is needed. DSTI caps can be circumvented by increasing the term on the loan.

It is the Central Bank's view that DSTI limits are less appropriate than LTI limits at this point in time. The Central Bank may introduce such a ratio in future.

Question 1: Which of the tools or combination of tools available to the Central Bank would, in your opinion, best meet the objective of increasing resilience of the banking and household sectors to shocks in the Irish property market and why?

Box 2: International experience of LTV and LTI ratios

Limits on LTV and LTI ratios have been common in Asia over the past decade and are coming to increasing prominence in Europe. According to an IMF survey[13] of macro-prudential instruments to address real estate booms, the most widely-used tool is the limit on LTV ratios, followed by sectoral capital requirements and LTI caps or a combination of LTV and LTI limits. There has been an increase in the use of LTVs and LTIs since the global crisis, especially in advanced economies. Norway and Sweden introduced guideline limits on LTV ratios of 85 per cent for new residential mortgage lending in recent years. Finland introduced a limit, effective in 2016, for real estate loans of 90 per cent (95 per cent for new home buyers), measured against the fair value of all collateral. In Denmark, covered-bond legislation limits bond-backed mortgages to 80 percent of home values and in Italy mortgages over 80 per cent LTV are discouraged. Canada has had a LTV cap in place since 2008. New Zealand introduced a LTV cap of 80 per cent on a proportion (90 per cent) of new lending in 2013. Hong Kong implemented LTV caps in the early 1990s and has varied the level of these caps counter-cyclically, as has Korea, where caps on LTV

[12] Hallissey, N., Kelly, R., and T. O'Malley (2014), Macro-prudential Tools and Credit Risk of Property Lending at Irish banks. Central Bank of Ireland Economic Letter, Vol 2014, No 10.
[13] IMF (2013), "Key Aspects of Macroprudential Policy-Background Paper", International Monetary Fund, June.

and DTI have been in place since the early 2000s. Singapore has had a LTV cap in place since 1996 and reduced the level of the cap from 90 to 80 per cent for all borrowers in 2010. Tighter limits for non-owner occupiers are in existence in Hong Kong (50 per cent LTV for all non-owner-occupied residential properties) and Singapore (60 per cent LTV cap in place for borrowers who have one or more outstanding housing loans and 50 per cent for non-individuals). The UK introduced a LTI cap of 4.5 times, also on a proportion (85 per cent) of new lending, in 2014.

There is a large literature addressing the effectiveness of macro-prudential measures for the housing sector. The cited IMF survey highlights that a number of studies have empirically found that a tightening of LTV and DTI ratios can slow the growth rate of mortgage loans, and reduces the potential for a housing bubble to emerge. It also examines the growing body of evidence that shows the benefit of LTV and DTI ratios in reducing the severity of downturns, fire-sale dynamics and loan losses when the housing market turns. Hong Kong has had a LTV cap in place since 1994 and suffered very low mortgage losses after the Asian crisis even though housing prices fell more than 60 per cent. A Bank of England study[14] reviews international experience with these policy measures and notes that they have typically reduced risk in the financial system and make it more resilient. It concludes that although these instruments have not typically been aimed at housing price growth, there is some evidence of a modest and lagged effect on housing price growth.

Section 3: Lending standards in Ireland

As is widely understood[15] and confirmed by recent quantitative research[16], the loosening of lending standards played a large role in fuelling the Irish property boom. Banks increased credit to the economy through increasing LTV ratios, increasing the amount of a borrower's gross income allocated to mortgage repayments (the income fraction, similar to LTI ratios) and by offering mortgages of longer duration.[17] In particular, the variation in the income fraction was found to be one of the main causes of price increases in the upturn but also a significant reason for the sharp contraction in the downturn.

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[14] Bank of England, (2014) "Prospects for Financial Stability", Financial Stability Report June 2014, Bank of England.

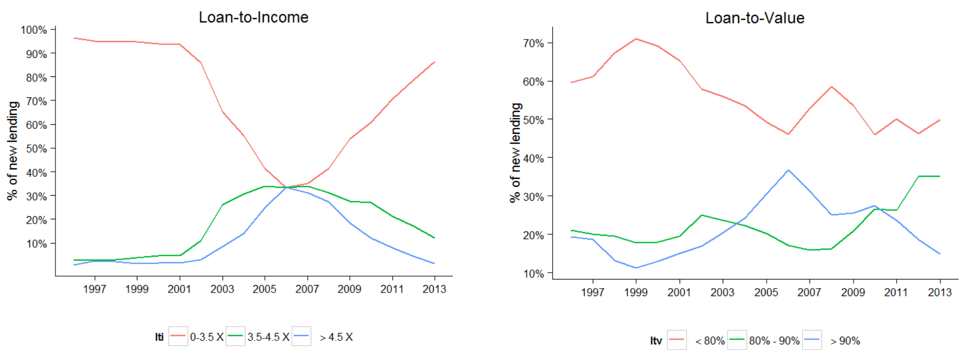
[15] Cf. Honohan, P. (2010), The Irish Banking Crisis – Regulatory and Financial Stability Policy 2003-2008. Report for Commission of Investigation into the Banking Sector in Ireland, May 2010.

[16] E.g. What Lies Beneath? Understanding Recent Trends in Irish Mortgage Arrears; Dis-entangling the mortgage arrears crisis: The role of the labour market, income volatility and housing equity; Credit conditions in a boom and bust property market.

[17] McCarthy, Y., and K. McQuinn (2013), Credit conditions in a boom and bust property market, Central Bank of Ireland Research Technical Paper, No 8/RT/13.

These trends are evident in Figure 4 which looks at the LTVs and LTIs on new lending for the purchase of a primary dwelling home over time[18] and also demonstrates how lending standards have changed in the aftermath of the crisis. On the left hand side, the sharp rise in loans issued above 3.5 times income from 2001 to 2006 can be seen. At the peak of the cycle, almost two thirds of new loans for primary homes were at over 3.5 times income and around a third at LTI above 4.5 times. Use of high LTIs fell significantly after 2006 and they now account for only a small proportion of new lending. The chart on the right hand side illustrates the rise and fall in the proportion of loans issued above 90 per cent LTV between 2000 and 2013. While the proportion of new lending above 90 per cent LTV has fallen in recent years, the proportion of new lending between 80 and 90 per cent LTV has risen and accounts for a significant proportion of lending for home purchases with 50 per cent of new lending above 80 per cent LTV in 2013 (see Table 1 for a more complete breakdown of 2013 lending data, covering five of the banks active in the domestic market). 100 per cent mortgages, a feature of the pre-crisis period, are no longer in evidence.

Figure 4: New lending for primary dwelling purchase for LTV and LTI over time



Source: Central Bank of Ireland samples from loan level data.

Individual householder borrowing to finance the purchase of investment property raises further complications. Such lending can be considered more risky for the lender, all other things being equal, even though recovery of the collateral may be less problematic than for owner-occupied collateral. Central Bank research shows that BTL mortgages were more likely to be in arrears and finds evidence that negative equity had an important effect on trends in arrears.[19] This suggests that a lower cap on LTV could be warranted for these borrowers. In current market conditions, as shown in Figure 5, lending above 80 per cent LTV to BTL borrowers

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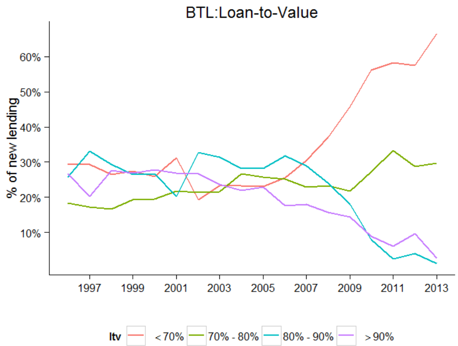
[18] Point-in-time view of the current stock of mortgages for PDH purchase on the books of three domestic banks at 31st December 2013.

[19]Lydon, R., and Y. McCarthy (2011), What Lies Beneath? Understanding Recent Trends in Irish Mortgage Arrears, Central Bank of Ireland Research Technical Paper, No 14/RT/11.

is now at extremely low levels, having fallen from over half of new lending to this sector prior to the crisis. Almost 70 per cent of new lending to BTL borrowers is now under 70 per cent LTV.

The appropriateness of a LTI cap on BTL lending is less obvious, in contrast with borrowing for a principal private residence, to the extent that this economic activity has the characteristics of a business, which might be less reliant on the borrower's non-rental income as an underpinning source of security. Nevertheless, to the extent that such loan contracts continue to include provision for recourse to the borrower in the case of default, high LTI loans for the purposes of BTL can still represent a risk for the borrower, although this risk is lower if LTV is low, as is proposed. The imposition of a DTI cap, taking some account also of potential rental income on the property, could be considered when the Credit Register is fully established.

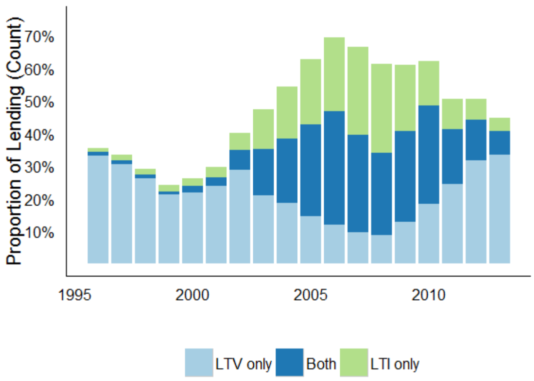
Figure 5: New lending for buy-to-let purchase for LTV over time



Source: Central Bank of Ireland sample from loan level data

Figure 6 shows the percentage of borrowers for primary dwellings over time that would have been affected by an absolute LTV cap of 80 per cent and an absolute LTI cap of 3.5 times. This demonstrates again how lending at higher income fractions expanded over the period 2002 to 2006 and then declined post 2007. If both LTV and LTI caps had been in place, 30 per cent of new loans in 2001 would have been affected and this would have risen to 70 per cent in 2006, which would have reduced the riskiness of these loans and lowered the losses experienced.

Figure 6: Percentage of the number of loans issued above 80% LTV and 3.5x LTI



Source: Central Bank of Ireland sample from loan level data

Impact on new lending

Table 1 shows the 2013 breakdown of new mortgage lending for owner occupier housing purchase by LTV and LTI buckets for the banks active in the Irish mortgage market.

Table 1: LTV and LTI ratio breakdown on new mortgage lending for primary dwelling purchase in 2013

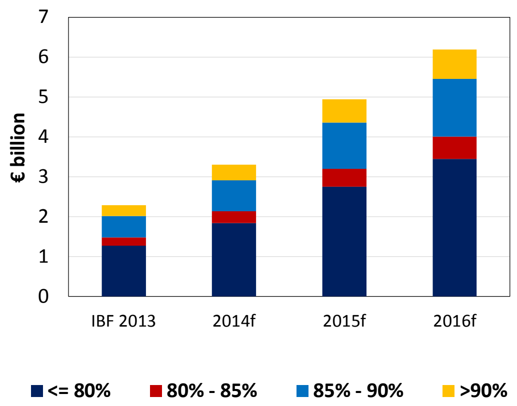
LTV ratio	% of the euro amount of new lending	% of the number of new loans	LTI ratio (times)	% of the euro amount of new lending	% of the number of new loans
Over 90%	12	11	**Over 4.5**	7	6
Between 85% and 90%	23	21	**Between 4 and 4.5**	6	5
Between 80% and 85%	9	8	**Between 3.5 and 4**	10	9
80% and below	56	60	**3.5 and below**	77	80

Source: Central Bank of Ireland. LTV sample includes five largest institutions active in the mortgage market. LTI sample includes four of these institutions.

Given the relatively small amount of new lending at high LTI ratios, the introduction of a proportionate LTI cap need not constrain new lending terms significantly. Instead, a cap would act as a preventative measure, to ensure against lending standards loosening to the same extent as happened in the past.

A LTV cap as proposed would have been exceeded by a considerable number of the loans issued in 2013.[20] Approximately €1bn of new loans in excess of 80 per cent LTV was issued in 2013, around half of which was between 85 and 90 per cent, as shown in Figure 7. If high LTV lending continued to represent the same share of lending in the coming years as market activity picks up, new lending above 80 per cent LTV could rise to between €2.5bn and €3bn by 2016.[21] If an 80 per cent LTV cap and a 15 per cent proportionate cap were in place, the amount lent above 80 per cent LTV would remain at under €1bn. The LTV ceiling need not, of course, restrict the total volume of lending to the extent that loan demand at lower LTV ratios continues to grow.

Figure 7: LTV breakdown of new lending assuming 2013 lending standards



Source: IBF data, aggregated banks' forecasts, Central Bank calculations

The overall impact of a proportionate LTV cap on the amount and terms of new lending will depend on how borrowers react: what proportion of borrowers will be able to meet the additional deposit, what proportion will buy a cheaper property, and how many will delay purchase.

[20] The sample of loan level data taken for 2013 for primary dwelling purchase covers 92% of the IBF lending for housing purchase data. The LTV breakdowns have been scaled up to the IBF data.

[21] Aggregate forecasts for new lending are indicative only and are compiled from banks active in the domestic mortgage market and adjusted for Central Bank calculations.

Section 4: Details of LTV and LTI proportionate limits

This section sets out key points of the proposal for the implementation of LTI and LTV proportionate limits. The details of the measures are set out in the attached draft Regulations (Annex 1). Responses to the questions posed should consider both the high level proposal in the consultation paper and the detailed proposal in the draft Regulations.

Box 3: Setting the level of LTV and LTI caps

Choosing a threshold beyond which LTV ratios are considered high is not an exact science. Adopting a proportionate limit (as is proposed here) means that choosing a lower LTV cap is partly mitigated by permitting a proportion of loans above the cap. International experience provides some guidance. The Joint Forum of the Basel Committee on Banking Supervision[22] defines high LTV lending as that "greater than 80 per cent LTV". The CRR requires that certain banks[23] hold higher capital against the portion of residential loan exposures where the LTV is over 80 per cent. The Central Bank of Ireland is currently availing of a discretion within the CRR enabling the setting of a lower LTV for this purpose and certain Irish banks are required to hold higher capital against the portion of residential loan exposures exceeding a LTV of 75 per cent.[24] Irish legislation sets the maximum LTV requirement of the mortgage assets pool for covered bonds issued by Irish banks at 75% for residential property and 60% for commercial property.[25]

Several of the countries which have recently introduced LTV caps have brought them in at 80% for primary residence, though some have allowed higher LTVs and of course many countries still have not introduced formal caps (Box 2). In an Irish context, Figure 2 shows that the losses in the event of a default increase sharply for loans with originating LTV greater than about 80 per cent.

In setting a cap for BTL mortgages, consideration can be given to international experience also, where non-owner occupied mortgages can have limits as low as 50 per cent. In an Irish context, the aforementioned higher link between negative equity and mortgage arrears for BTL borrowers could point to having a tighter LTV limit on these borrowers.

For LTI ratios, it is also difficult to pinpoint a critical level. The UK recently introduced a proportionate limit on new lending above 4.5 times income. In setting this level, the Bank of England considered the fact that a LTI threshold of 4.25 to 4.75 times (at 25-year loan term and a stressed 7 per cent interest rate) would be equivalent to a gross debt service ratio of 35 per cent to 40 per cent, beyond which level they found evidence that borrowers had been more likely to experience payment difficulties.[26] For Ireland, taking

[22] Review of the Differentiated Nature and Scope of Financial Regulation by the Joint Forum (BCBS, IOSCO, IAIS), January 2010.
[23] Article 125 CRR for banks using the standardised approach to capital requirements.
[24] See Central Bank, Implementation of Competent Authority Discretions and Options in CRD IV and CRR (May 2014), p. 22.
[25] http://www.ibf.ie/pdfs/ACS%20Framework.pdf
[26] Bank of England Financial Stability Review, June 2014

current average incomes and the same term and rate as used in the UK calculation, a 3.5 times LTI ratio generates a gross debt service ratio of about 30 per cent but a net (after tax) debt service ratio of about 40 per cent.

Rationale for a proportionate cap

LTV and LTI caps can be introduced across the existing loan book (mainly in countries where amortisation of mortgages is slower), on new lending, or on a proportion of new lending (a proportionate cap).

A proportionate cap involves restricting lenders' new residential mortgage lending at LTV / LTI ratios of over a certain level to no more than a certain per cent of new residential mortgage lending. The benefit of a proportionate cap is that it recognises that high LTV and high LTI lending can be appropriate in certain circumstances. Examples could include otherwise very creditworthy borrowers who cannot raise the deposit required but who would be able to afford the loan servicing, or younger borrowers whose income can reasonably be expected to rise in the future.

In setting this type of cap it must be decided whether to set the cap using the value of new lending or on the number of new loans. Higher LTV loans tend to have higher average loan balances, so setting the cap on the value of new loans would likely affect a higher proportion of the value of new loans than would setting a cap on the number of new loans. The Central Bank is minded to introduce a proportionate cap based on the value of new lending rather than on the number of new loans issued, reflecting the fact that higher LTV loans tend to have higher average loan balances.

Details of LTV limit

The Central Bank proposes to introduce a proportionate LTV limit for residential mortgage lending.

The Central Bank considers a LTV limit of 80 per cent as a reasonable level, taking into account international and other evidence and the specificities of the domestic market. The Central Bank considers that a proportionate limit which would allow 15 per cent of new lending above the LTV cap as a balance between allowing sufficient flexibility yet maintaining prudent lending standards.

Thus, the Central Bank proposes to require lenders to restrict new lending for primary dwelling purchase above 80 per cent LTV to no more than 15 per cent of the euro value of all housing loans for principal dwelling home purposes entered into in a six monthly period.

BTL lending: For mortgages granted on investment properties (BTLs) to persons, the Central Bank proposes to place a proportionate LTV ceiling requiring lenders to limit new BTL loans above 70 per cent LTV to 10 per cent of all BTL loans issued over a six monthly period.

The limits would apply to all new residential mortgage lending by regulated financial services providers to persons for property purchase, excluding the exemptions listed below. The application of the measures is to be on an individual residential property basis. Any equity release or top up on a mortgage that would bring the LTV on that property above the level of the cap would be in the scope of the measure.

It may be necessary to adjust any or all of these parameters in response to economic, market, or other developments in due course. It is envisaged that such adjustment could be made without a lengthy process of consultation.

Exemptions from the LTV limits

There needs to be certain exemptions from these limits. When considering these, the benefit of each exemption must be balanced against the increase in complexity and the potential this brings for unintended consequences including leakage, where lending that should be within scope because of its threat to financial stability is re-configured to fall within the exempt categories.

The exemptions below would not count towards the total value of mortgages in scope or the percentage limit and so would be excluded from both the numerator and denominator in calculating compliance with the proportionate cap.

1. **Switcher mortgages:** re-mortgages with no increase in principal (allowing for reasonable fees and costs associated with switching) would be exempt from the limits.

2. **Mortgages in arrears:** Alternative Repayments Arrangement or other options agreed with a borrower, the purpose of which is to resolve a borrower's pre-arrears or arrears situation, would be exempt from the limits.

3. **Residual debt from negative equity mortgages:** Credit granted for the purpose of discharging residual debt under a negative equity mortgage is excluded from the calculation of the LTV. The LTV limit will only apply to the loan secured on the new property, before the residual debt is applied. The residual debt which can be exempted only applies if the property sold is a primary dwelling.

   Given the prevalence of negative equity in the current market (268,000 mortgage loans at end 2013[27]), it is necessary to include an exemption for households in this situation to avoid unduly limiting mobility for these borrowers.

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[27] Duffy, D. (2014), Updated Estimates for the Extent of Negative Equity in the Irish Housing Market, ESRI QEC Research Notes 2014/2/1.

Treatment of mortgage insurance: It can be argued that lenders wishing to make loans at higher LTV ratios than the cap and who have obtained an adequate form of guarantee from a highly credit-worthy guarantor for the excess of the loan over the cap should be allowed to treat this guarantee as allowing an exemption from the LTV cap. This would likely need to be a high-quality guarantee, for example provided by a highly-rated financial intermediary and payable on first demand. While the involvement of an independent mortgage insurance guarantor could help improve loan underwriting quality, and could protect the lender against default, permitting such an exemption would weaken the effectiveness of the macroprudential measure as a tool to dampen the pro-cyclical credit-price dynamics.

A recent Government strategy document[28] indicated that consideration would be given to the concept of a mortgage insurance scheme. No details of such a scheme have yet been announced. Any such scheme would need to be carefully thought through in terms of its potential for resulting in fiscal costs as well as the risk that it could exacerbate housing price dynamics.

The Central Bank intends to consider further whether to introduce at a later stage a limited exemption for suitably insured mortgage loans.

Question 2: Do you agree that the measures should apply to all lending secured by residential property (which will include lending on property outside the State)?

Question 3: Do you agree with the exemptions set out? Are there any additional exemptions which you consider appropriate, taking into account the objectives of the proposal and the balance between the benefit of any exemptions and the resulting increase in potential for unintended consequences?

Question 4: If there are any *significant* operational difficulties envisaged by regulated financial services providers in complying with the measures as outlined above and in the draft Regulations (Annex 1) and the proposed exemptions, please submit brief details of same.

Question 5: Should some adequately insured mortgages with higher LTVs be exempted from the measures and if so what should be the criteria for exemption?

Details of LTI limit

The Central Bank proposes to introduce a proportionate LTI limit for residential mortgage lending.

The Central Bank considers a limit of 3.5 times loan to gross annual income as a reasonable level for a LTI limit, taking into account international evidence and the

[28] http://www.merrionstreet.ie/wp-content/uploads/2014/05/Construction-Strategy-14-May-20141.pdf

specificities of the domestic market. The Central Bank considers that a proportionate limit which would allow 20 per cent of new lending above the LTI cap as a balance between allowing sufficient flexibility yet maintaining prudent lending standards. Income means the total gross annual income, before tax or other deductions, of a borrower taken into account by a lender to calculate the amount which it is willing to advance.

Thus the Central Bank proposes to require lenders to restrict new lending for primary dwelling purchase above 3.5 times LTI to no more than 20 per cent of the euro value of all housing loans for principal dwelling home purposes entered into in a six monthly period.

The limits would apply to all new residential mortgage lending by regulated financial services providers to persons for property purchase, excluding the exemptions listed below. The application of the measures is to be on an individual residential property basis. Any equity release or top up on a mortgage that would bring the LTI on that property above the level of the cap would be in the scope of the measure.

It may be necessary to adjust either or both of these parameters in response to economic, market, or other developments in due course. It is envisaged that such adjustment could be made without a lengthy process of consultation.

Exemptions from the LTI limits

There would be certain exemptions to these limits. When considering these, the benefit of each exemption must be balanced against the increase in complexity and the potential this brings for unintended consequences, including leakage.

The exemptions below would not count towards the total value of mortgages in scope or the percentage limit and so would be excluded from both the numerator and denominator in calculating compliance with the proportionate cap.

1. **Buy-to-let mortgages:** these are not covered by the proposed regime inasmuch as the loan-to-income ratio is a less relevant metric for such lending. However, the more demanding LTV ceiling that is proposed will contribute to limiting the risk for both borrower and lender.

2. **Switcher mortgages:** re-mortgages with no increase in principal (allowing for reasonable fees and costs associated with switching) would be exempt from the LTI limits.

3. **Mortgages in arrears:** Alternative Repayments Arrangement or other options agreed with a borrower, the purpose of which is to resolve a borrower's pre-arrears or arrears situation, would be exempt from the limits.

Question 6: Do you agree that the measures should apply to all lending secured by residential property (which will include lending on property outside the State)?

Question 7: Do you agree with the exemptions set out? Are there any additional exemptions which you consider appropriate, taking in to account the objectives of the proposal and the balance between the benefit of any exemptions and the resulting increase in potential for unintended consequences?

Question 8: Do you consider restrictions on loan-to-income ratios as suitable for buy-to-let mortgages? What impact would a restriction on such loan-to-income ratios have on buy-to-let lending in the State?

Question 9: If there are any *significant* operational difficulties envisaged by regulated financial services providers in complying with the measures as outlined above and in the draft Regulations (Annex 1) and the proposed exemptions, please submit brief details of same.

Compliance with the limits

Regulated financial service providers should be aware that, if it is decided to introduce these limits, there will not be a long period between making the regulations and their coming into effect. Regulated financial service providers are therefore advised to consider the steps necessary to prepare for compliance with the proposed rules. Likewise, the Central Bank expects regulated financial service providers not to act in a way which might undermine or circumvent the Central Bank's macro-prudential objectives in imposing LTV and LTI limits as described in this consultation paper, such as offering secondary mortgage products to finance in part the down payment made by the borrower.

These limits would not obviate regulated financial services providers from complying with any of their other regulatory obligations, including those arising under the Consumer Protection Code 2012 relating to the assessment of affordability and suitability of mortgages on a case-by-case basis.

These limits would not obviate lenders from making lending decisions in line with their own risk appetite and credit risk management policies.

These limits would not obviate regulated financial services providers from complying with all other existing micro-prudential regulations in place.

Link with micro-prudential supervision

The proposed measures are not designed to address how regulated financial service providers take individual lending decisions. Regulated financial service providers must continue to maintain and apply credit risk management policies including appropriate supplementary criteria designed to ensure that lending is commensurate with their capacity and appetite for risk (as well, of course, as being compliant with the Consumer Protection Code) when taking individual lending decisions.

The main focus of micro-prudential supervision is to safeguard individual financial institutions from idiosyncratic risks and prevent them from taking too much risk. To reduce the level of credit risk, banks have developed their own internal credit assessment policies and procedures which are focused on individual borrower affordability and suitability criteria. These internal credit assessment policies and procedures should incorporate a holistic approach to debt servicing capacity and include variations on mortgage service ratios and minimum net disposable income levels in order to mitigate against the risk of future default. The macro-prudential use of LTV and LTI caps should be understood and implemented by lenders so that it is complementary to existing micro-prudential supervision and to lenders' own risk management practices.

Question 10: What unintended consequences do you see from the proposed measures and how could these be avoided?

Monitoring

- Regulated financial service providers will be required to submit data on their new residential mortgage lending to the Central Bank via a specific data template.

- Where a regulated financial service provider grants €50 million or more in housing loans over 2 quarters it will provide the data on a six monthly basis or such other period that the Bank may specify in writing. Compliance with the limits will be determined on this basis.

- Data submitted are to be based on actual drawn loan balances. The application of the measures is to be applied on an individual residential property basis.

- The Central Bank will determine whether regulated financial service providers have complied with the restrictions on the basis of their return for that calculation period.

- If regulated financial service providers advance less than 85 per cent of their total value of new residential mortgages at LTVs higher than 80 per cent or less than 80 per cent of their total value of new residential mortgages at LTIs greater than 3.5 times there will be no carry over from one reporting period to subsequent reporting periods in respect of any 'un-used' lending capacity.

- The first calculation period would begin immediately upon the limits coming into effect.

- If a regulated financial service provider has entered into a Mortgage Offer (Sanction in Principle) commitment before the date on which the LTV/LTI limits come into effect, the limits do not apply to that commitment. If a regulated financial service provider enters into a Mortgage Offer (Sanction in

Principle) commitment after the date on which the LTV/LTI limits come into effect, the limits do apply to that commitment should the mortgage be drawn down.

- Committed but undrawn amounts on an existing mortgage lending facility that was formally agreed via a signed letter of offer before the date on which the LTV/LTI limits come into effect will not be included in the limits.

Question 11: Is the threshold of €50 million over 2 quarters an appropriate threshold and time period for reporting requirements? If not, please indicate a threshold you believe to be appropriate and provide reasons why you believe this is the case.

Question 12: Are there any *significant* obstacles to compliance by regulated financial services providers with the limits?

Section 5: Evaluation and review of measure

The Central Bank will monitor any implemented measures in line with its policy cycle as laid out in the Framework document. In the event that the Central Bank proceeds with the implementation of limits on LTV and / or LTI ratios, it may be necessary to adjust any or all of the parameters of the proportionate LTV and LTI ratios in response to economic, market, or other developments in due course. These adjustments could include, but not necessarily be limited to, the level of the LTV and / or LTI caps, the level of the proportionate caps, the scope of the measure and to the exemptions applied. It is envisaged that such adjustments may be introduced without a lengthy period of prior consultation.

The Central Bank will notify the ESRB in line with Recommendation 2011/3 of the ESRB on the macro-prudential mandate of national authorities which recommends that the ESRB be notified of the actions taken to address systemic risks at national level.[29]

Section 6: Making submissions

The Central Bank invites all stakeholders to provide comments on the draft regulations which form part of this Consultation Document and on the questions raised in this Consultation Paper. Please make your submissions electronically by email to realestate@centralbank.ie. Responses should be submitted no later than 8th December 2014.

The Central Bank is committed to clear, open and transparent engagement with stakeholders in fulfilling its financial regulatory and supervisory objectives,

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[29] ESRB Recommendation on the macro-prudential mandate of national authorities (ESRB/2011/3)

particularly when introducing new codes, regulations, standards or guidelines. The Central Bank's Stakeholder Consultation Protocol can be found on the Central Bank's website:
http://www.centralbank.ie/regulation/poldocs/documents/consultation%20protocol%20final.pdf

It is the policy of the Central Bank to publish all responses to its consultations and such responses will be made available on our website. Stakeholders should thus not include commercially confidential information in consultation responses and the Central Bank accepts no liability whatsoever for the content of stakeholder consultation responses that are subsequently published by the Central Bank. We shall not publish any information which we deem potentially libellous or defamatory.

While the Central Bank will take full account of all such submissions, it can be assumed that a regime of the type foreshadowed in this document is likely to be introduced. With this in mind, lenders are expected not to accelerate high LTV or LTI loan approvals for the purpose of circumventing the limits, in case they are introduced. Instead, lenders are instructed to take account now of the likely introduction of such a regime and begin to adapt their lending practices already in anticipation of its introduction. In order to minimise any disruption to the market that might be caused by a long lead-in period, the consultation period will last two months rather than the standard three months.

Annex 1: Draft Regulations

Question 13: Please provide comments on the following draft Regulations.

S.I. No. of 201[]

CENTRAL BANK (SUPERVISION AND ENFORCEMENT) ACT 2013 ((SECTION 48)

MACRO PRUDENTIAL MEASURES)

REGULATIONS 201[][30]

[30] These regulations are in draft form for the purposes of consultation. The Central Bank of Ireland reserves the right to make amendments as it deems appropriate.

S.I. No. of 201[]

CENTRAL BANK (SUPERVISION AND ENFORCEMENT) ACT 2013 ((SECTION 48) MACRO PRUDENTIAL MEASURES) REGULATIONS 201[]

In exercise of the powers conferred on the Central Bank of Ireland (the “Bank”) by section 48 of the Central Bank (Supervision and Enforcement) Act 2013 (the “Act”), the Bank, having consulted with [ ] in accordance with section 49(1) of the Act hereby makes the following regulations:

1. These Regulations may be cited as the Central Bank (Supervision and Enforcement) Act 2013 ((Section 48) Macro Prudential Measures) Regulations 201[].

2. These Regulations come into operation on the []

3. In these Regulations:

‘Appraiser’ means the person conducting the **residential property** valuation in accordance with Regulation 8;

‘Arrears’ means a payment or part of a payment under a **housing loan** that is overdue after missing one or more scheduled repayments by the due date.

‘Bank’ means Central Bank of Ireland;

‘Borrower’ means a person to whom a **housing loan** is granted;

“durable medium” means any instrument that enables a lender to store information in a way that renders it accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored;

‘**Half year period’** means any of the two halves of each year, the first beginning on 1 January;

‘**High Loan to Income Housing Loan**’ means a **housing loan** or the total sum of **housing loans** provided by a **lender in respect of an individual residential property** under which the total amount advanced meets or exceeds a multiple of 3.5 times the **borrower’**s **income** at the time at which that **income** is assessed by the **lender** for the purpose of entering into the **housing loan**.

‘**Housing loan’** means a loan between a **lender** and a **borrower.**

'**Income**' means the total gross annual income, before tax or other deductions, of a **borrower** taken into account by a **lender** to calculate the amount which it is willing to advance under a **housing loan**;

'Lender' means a **regulated financial service provider** providing a **housing loan** to a **borrower**;

'L**oan**' means an amount advanced or a total sum of amounts advanced to a **borrower** secured on an individual **residential property**. For the purposes of calculating loan to value only, the definition excludes any **residual debt under a negative equity mortgage**.

'**Residential property'** is defined as a building or part of a building, or land on which a building is to be constructed which, at the date the conveyance or lease is executed, was used, or it is the intention of the borrower that the building or part of the building be used, as a dwelling or have a dwelling constructed on it, and the building, or part of the building does not have any commercial use.

'Pre -arrears' means a **housing loan** where there is a reasonable prospect that the **borrower** will go into **arrears**;

'Market value' means the estimated amount for which the **residential property** should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion;

'Principal Dwelling Home ', means a **residential property** which an individual occupies as his or her main dwelling or, where the **housing loan** is provided for the purpose of constructing a building, where the individual intends to occupy that building as his or her main dwelling immediately on completion of the building;

'**Regulated financial service provider'** has the same meaning as in Section 2 of the Central Bank Act 1942.

'**Residual debt under a negative equity mortgage'** means the monetary balance outstanding on a partially discharged **housing loan** in respect of a **principal dwelling home** where the proceeds from the sale of that **principal dwelling home** were insufficient to discharge the full outstanding monetary amount.

'Value' means:

(a) **'Value'** means, at the point in time at which **the lender** advances the **housing loan** the lower monetary amount of :

i. the price agreed in the contract of sale between the buyer and the seller for the **residential property** excluding associated costs such as legal fees, stamp duty; or

ii. the **market value** of the **residential property**;

or

(b) Where the borrower already has one or more existing **housing loans** secured on an individual **residential property**, for all subsequent **housing loans** advanced to the borrower secured on that residential property**,** the **value** of that **residential property is the market value.**

4. (1) These Regulations shall apply to **housing loans**.

(2) A **regulated financial service provider** to whom these Regulations apply shall not:

a) engage in a practice,

b) enter into an arrangement,

c) execute a document, or structure or restructure a **loan**

in order (where or not as the sole or primary purpose) to avoid its obligations under these Regulations.

5. These Regulations shall not apply to:

i. a **housing loan** which replaces another **housing loan**, and under which the amount advanced under the replacement **housing loan** does not exceed the monetary amount outstanding to the **lende**r, or to a different **lender** under a previous **housing loan**. In determining the amount of **the housing loan** provided, no account shall be taken of:

(a) arrangement fees;

(b) professional fees and costs; or

(c) administration costs.

ii. a **housing loan** entered into between a **borrower** and a **lender** the purpose of which is to address the **arrears** or **pre arrears** of the **borrower** on an existing **housing loan** by agreeing alternative repayment arrangements; and

iii. without prejudice to the generality of (ii), any financial arrangement which is entered into as part of the Mortgage Arrears Resolution Process described in Section 16 of the Code of Conduct on Mortgage Arrears issued by the Bank.

6. Loan to Income

(1) A **lender** shall ensure that the total aggregate value of **High Loan to Income Housing**

Loans it enters into in a **half year period** does not exceed 20 per cent of all **housing loans** for **principal dwelling homes** it enters into in that **half year period.**

(2) Paragraph (1) shall only apply to **housing loans** for **principal dwelling home** purpose.

7. Housing Loan to Value

(1) In this regulation, the housing loan to value ratio shall be calculated in accordance with Schedule 1.

(2) A **lender** shall ensure that the total aggregate value of **housing loans** for **principal dwelling home** purposes with a **loan to value ratio** in excess of 80 per cent it enters into in a **half year period** does not exceed 15 per cent of **all housing loans** for **principal dwelling home** purposes it enters into in that **half year period**.

(3) A **lender** shall ensure that the total aggregate value of **housing loans** other than such amounts advanced for **principal dwelling home** purposes with a housing **loan to value** ratio in excess of 70 per cent it enters into in a **half year period** does not exceed 10 per cent of all such **housing loans**.

8. Valuation of Residential Property

The **lender** shall ensure that the process to determine the **market value** of the **residential property** shall be conducted as follows:

(a) the **lender** shall appoint an **appraiser** to calculate the **market value** and the such **appraiser** shall:

(i) be professionally competent and sufficiently independent from the **housing loan** underwriting process so that he can provide an impartial and objective valuation;

(ii) assess the **market value** of the **residential property**, and document that assessment in a clear and transparent manner;

(iii) record the methodology for the calculation of the **market value** in a **durable medium**;

(iv) provide a copy of the information referred to in (iii) to the **lender**.

(b) The **lender** shall maintain a copy of the information referred in subparagraph (a)(iii) in a **durable medium.**

SCHEDULE 1

(1) The Loan to Value Ratio (LTV) is the total amount of **housing loans** advanced expressed as a percentage of residential property value. It shall be calculated based on the total amount of **housing loans** advanced to a borrower in respect of an individual residential property in accordance with the following equation:

$$LTV = \frac{L}{V}$$

Where:

LTV = LOAN TO VALUE

L =HOUSING LOAN

V = VALUE