



FIPS

Financial Institutions Performance Survey
December 2021 Quarterly Results



Overview

Information current as at 1 April 2022

While Covid-19 continues its impact on the banking sector's operations and results, it has been joined by a raft of co-conspirators in the form of inflation, rising interest rates, the Credit Contracts and Consumer Finance Act (CCCFA), decreasing house prices and a fall in business confidence this quarter. For the first time in a long time the dark clouds aren't just on the horizon, but are actually much closer. A number of indicators point to a very challenging few months ahead for the New Zealand economy.

Despite the uncertain future, the December quarter set another near record for the banking sector with a 6.7% increase in net profit after tax (NPAT) to \$1.61 billion.

Impact of Omicron

Since the release of KPMG's *Financial Institutions Performance Survey (FIPS) Banks – Review of 2021*¹, headlines have been dominated by estimates of whether the peak of the Omicron outbreak has been reached. Off the back of that, the relaxing of restrictions at the border, shorter home isolation requirements and ultimately the removal of vaccine passports and mandates have occurred.

New Zealand has now been operating under the red traffic light setting for over two months with the Government encouraging employees to work from home where practical. Many organisations have imposed additional restrictions, splitting up teams to ensure Omicron does not require a significant proportion of their workforce to isolate.

In February, the Reserve Bank of New Zealand (RBNZ) noted that resource constraints were evident in the economy, and may only get worse with further disruptions from the Omicron outbreak and resulting employee isolation². The Government has followed other countries by reducing isolation requirements from close contacts to household contacts and reducing the isolation period from 10 days to 7 days in an attempt to limit disruption to businesses and prevent the economy from slowing down unnecessarily.

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The Government has also made a number of announcements relating to the border in order to open the country up to the rest of the world sooner rather than later.

On 16 March 2022, the Government announced that the date from which Australians would be able to travel to New Zealand without isolating was being brought forward to 13 April 2022, with vaccinated travellers from visa-waiver countries such as the United Kingdom, the United States, Japan and Germany being able to enter from 2 May 2022³. While the Government acknowledged it would take some time to see tourism scale up again, it hoped the announcement would be a welcome boost for tourism operators. A further announcement was made on 18 March 2022 that allowed unvaccinated New Zealand citizens who were overseas to travel to New Zealand without isolating⁴.

With more certainty around border restrictions, it remains to be seen whether New Zealand can attract enough overseas talent to relieve some pressure off the tight labour market. Critical to this will be where and how the Government reacts to various visa settings. Many businesses are also expecting the build-up of those employees wanting overseas experience to now head abroad given the increasing certainty around New Zealand's border. Which of these two impacts we will see first and which has the largest impact is still largely unknown.

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Inflation and interest rates

The Consumer Price Index (CPI) hit a three-decade high⁵ with inflation of 5.9% for the year ended 31 December 2021. The most notable driver being oil prices, there were many other contributors to global inflation including the effects of large scale fiscal and monetary stimulus, increases in shipping costs and continuing supply chain disruptions².

Oil prices have surged over the last couple of months after rising steadily throughout 2021. This was predominantly driven by the instability in Eastern Europe in the lead up to the Russian conflict with Ukraine from 24 February 2022, with a number of countries imposing sanctions on Russia. Fuel prices at the pump have also hit the headlines, with the Government announcing that it would temporarily reduce fuel excise taxes by 25 cents per litre as part of their cost of living relief package⁶. The RBNZ noted that annual inflation is expected to peak in early 2022 and then ease over the course of the year, returning to within the target band of 1-3% by mid-2023². The big four banks all expect inflation to peak in the June 2022 quarter at between 6.8% and 7.6%^{7, 8, 9, 10}.

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In response to inflationary pressure, the RBNZ has continued to increase the Official Cash Rate (OCR), with the latest hike from 0.75% to 1.00% occurring on 23 February 2022.

The RBNZ explained that it was a finely balanced decision whether to raise the OCR by 25 or 50 basis points; however, it was noted that interest rates had already increased significantly in late 2021 and are expected to continue rising as the OCR was progressively increased². The RBNZ has forecast the OCR to peak above 3.25% by 2024, an increase on the 2.5% peak it predicted in its November 2021 statement¹¹.

The RBNZ explained that while higher interest rates were necessary to reduce inflation, households and businesses may have become more sensitive to interest rate changes as their debt levels have risen². A number of households will face increasing mortgage repayments through 2022 as their mortgage rates are renewed at higher interest rates². The RBNZ acknowledged that some more highly leveraged borrowers may be financially stretched in a higher interest rate environment². Since the end of the December 2021 quarter, some banks have continued to increase mortgage interest rates, with one major bank no longer offering any carded mortgage interest rates under 4% while some longer term rates are over 6%¹².

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The RBNZ also noted that the Funding for Lending Programme (FLP) window closes this year, and that the cost of bank funding from this programme was rising in line with the OCR¹.

Credit crunch

A key challenge to lenders continues to be the updates to the CCCFA. The changes came into effect on 1 December 2021 and were intended to protect vulnerable borrowers from taking on loans that they would not be able to repay. A large proportion of lenders believed it was going to have strong, unintended negative impacts and these have been borne out in the first few months with lenders noting both a fall in the number of mortgage and other loan applications and a sharp decrease in approval rates of loan applications¹³. The proportion of mortgage applications resulting in approval fell from over 40% before the changes to 34% in February 2022¹⁴. The largest reduction in approval of loans also hit those with higher credit scores the hardest, as can be seen in the Centrix article on [page 18](#), *The credit market is tightening for the first time in a decade*. Strong initial commentary on the changes from the financial services sector resulted in the Commerce and Consumer Affairs Minister announcing in January that an inquiry would take place to determine whether the legislation and guidance was at fault or whether it was being misapplied by the banking sector.

A key challenge to lenders continues to be the updates to the CCCFA.

On 11 March 2022, the Government announced that it would be making changes to the CCCFA following the inquiry, describing these as practical amendments to curb any unintended consequences of the Act.

It is expected that the proposed changes will be released for public consultation before coming into effect by June 2022¹⁵. The Government stated the amendments were informed by the feedback it received from banks, other lenders and consumers and they sat comfortably within the intent of the Act. The announcement explained that the initial changes would ensure borrower-ready Kiwis could still access credit while still protecting those most at risk of predatory and irresponsible lending. The Government assured the public that it was on the same page as the banks and budget advisors in that all parties wanted to stop vulnerable people from finding themselves with unaffordable debt¹³.

The changes included clarifying that lenders did not have to look at potential borrowers' recent bank transactions to determine their current living expenses, and the removal of regular savings or investments as examples of outgoings that lenders needed to inquire about. The changes would also clarify that the requirement to obtain information in 'sufficient detail' only related to information provided by borrowers directly, rather than relating to information from the borrower's bank statements¹³.

While the Government was quick to look into the concerns raised and it was pleasing to see that some of the key points had been addressed, some commentators have said that it was still not clear whether the changes would move the dial sufficiently to make a material difference. The New Zealand Bankers' Association thought more could be done to reduce the impact on most consumers while at the same time protecting vulnerable consumers. The proposed changes maintained the 'one size fits all' approach which had not worked so far¹⁶.

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In addition, some commentators have noted that it looks like the announcements are saying the problems have been fixed and borrowers will, as a result, expect business to be back to normal almost immediately. If this doesn't happen, the banks will likely be blamed for not matching the expectations created by those announcements.

More tightening of credit via new loan-to-value ratio (LVR) requirements from the RBNZ took effect on 1 November with banks being restricted to a maximum of 10% of new residential mortgage lending being given to borrowers with less than a 20% deposit, down from a maximum of 20% of lending previously. Initially this led to a number of banks no longer accepting any mortgage applications for existing homes with less than a 20% deposit, however this has since been relaxed¹⁷. This was also likely to have had an impact on the lower number of lending approvals.

Slowing housing market

It has been widely reported that the housing market is slowing, driven by higher interest rates, changes to the CCCFA, more restrictive deposit requirements and higher rates of residential building. The national house price index decreased by 2.3% in the three months to February 2022, with the Auckland house price index falling 5.5%¹⁸.

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It must be noted that these decreases hardly dent the increases seen through 2021, with the national house price index still up 14.3% over the 12 months to February compared to Auckland which is up 10.3%¹⁸.

The RBNZ noted that house prices in New Zealand are above their sustainable level and are expected to ease over time². Some commentators are predicting house prices to fall by up to 10% through 2022 as interest rates rise and credit tightens¹⁹. Auction clearance rates have already fallen as low as 21% for some agencies, providing buyers with the opportunity to present more conditional offers²⁰.

Lending to first-home buyers remained at elevated levels in the December 2021 quarter increasing to \$4.8 billion from \$4.2 billion in the September 2021 quarter. However, more recent lending data shows that first-home buyers have been hit hard since the end of the December 2021 quarter. January 2022 saw lending of \$819 million to first-home buyers which was 20.4% lower than the \$1,029 million lent to first-home buyers a year earlier²¹. Other owner occupiers have also been affected, with January 2022 lending being 17.3% lower than January 2021, falling to \$2,985 million. These decreases have been driven by the tighter income and expense checking that is taking place as a result of the CCCFA changes, with the proportion of mortgage applications resulting in approval falling from over 40% before the changes to 34% in February 2022²¹.

Commentators noted the reduced allowance for low deposit lending and rising mortgage interest rates have also contributed to the recent decline in lending volumes. Just 3.4% of all loans were provided to owner occupiers who had a low deposit (under 20%) in February 2022, while the proportion of first-home buyers receiving a low deposit home loan had halved since October 2021²².

Property investor lending continued to decrease, falling to 16.8% of total lending in December 2021 from 24.7% a year earlier²¹. Lending to property investors in January 2022 was 51% lower when compared to lending in January 2021, falling to \$812 million²¹. This showed the continued effect of the Government's interest deductibility changes which impacted investors from 1 October 2021. Investors will see the impact of these changes for the first time when filing their March 2022 income tax returns, and will also be conscious of the impact of increasing interest rates on their investments.

Lending to property investors in January 2022 was 51% lower when compared to lending in January 2021.

Quarterly analysis of results

The December 2021 quarter set another record for the banking sector with a 6.7% increase in NPAT to \$1.61 billion.

The strong result was primarily driven by large decreases in operating expenses, particularly from three of the larger banks. This illustrates a continued focus from banks to both control costs across a number of areas and the fact that certain expenditure (travel, accommodation, entertainment and some business development) can't naturally occur due to the red traffic light setting.

The operating expenses/operating income decreased to the second lowest level since the pandemic began, falling from 43.1% in the September 2022 quarter to 39.7% in the December 2022 quarter. The increase in NPAT was also supported by an increase in net interest income, driven by continued growth in gross loans and advances partially offset by slightly lower interest margins. Gross loans and advances increased by 1.63% to \$487.6 billion.

There was a 5.3% reduction in total loan provisioning down to \$2.44 billion, reflecting a 3.3% decrease in collective provisioning and a 17.1% decrease in individual provisioning. These reduced provisioning levels led to a fifth consecutive quarter of net impairment writebacks as provisions raised near the beginning of the pandemic continued to be unwound.

What will be interesting over the next few quarters is the impact that recent events such as continued inflation, rising interest rates and the conflict in Eastern Europe have on the levels of past due and impaired loans and how this translates to the level of provisions going forward.



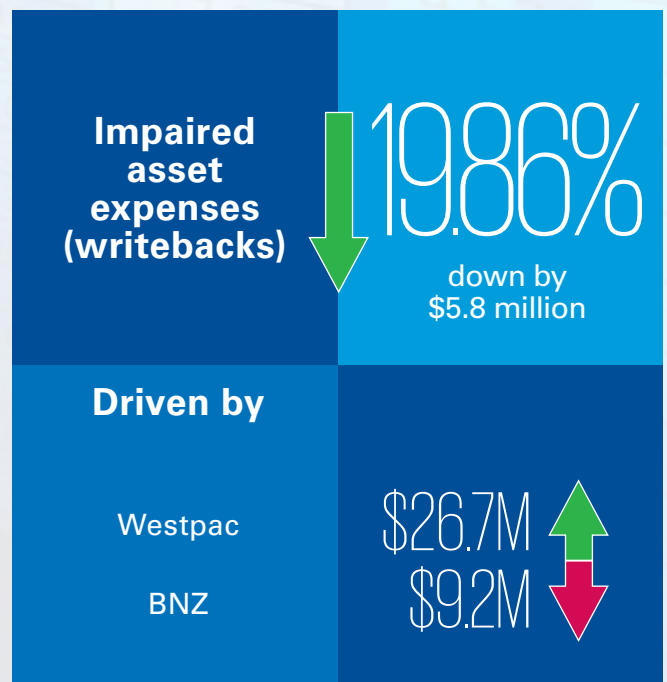
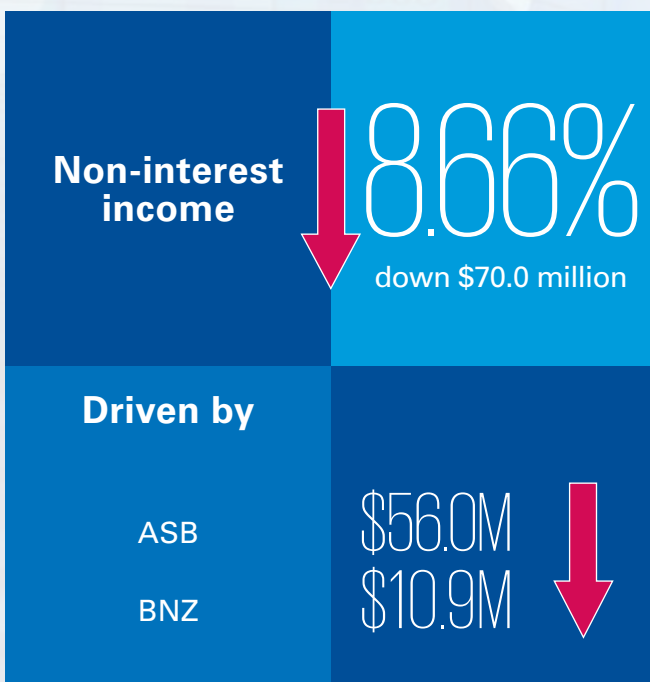
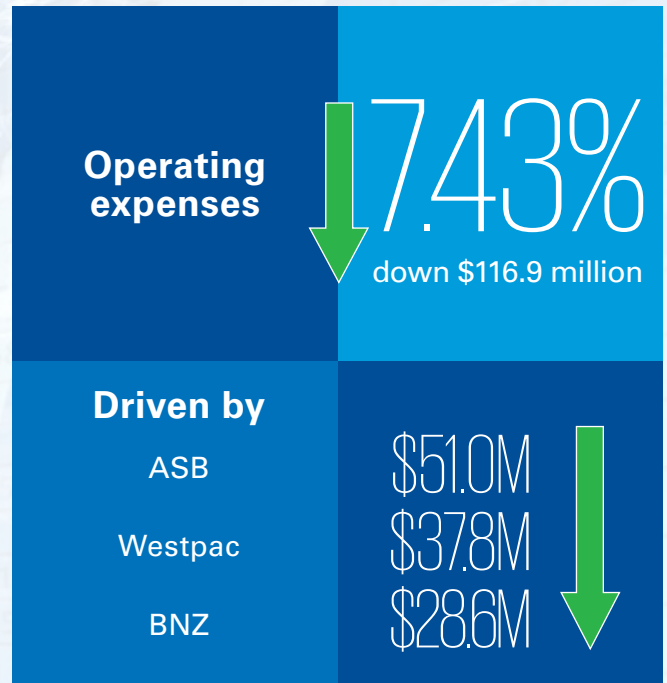
Net profit after tax

Movement in net profit  **6.73%**
to \$1,613.9 million

Net interest income  **3.05%**
to \$2,932.6 million

TABLE 1: Movement in interest margin

Entity ²³	31 Dec 21 quarter ended (%)	Mvmt. during the quarter (bps)	Mvmt. for the 6 months (bps)	Mvmt. for the 12 months (bps)
ANZ	0.02	0	-10	10
ASB	0.02	10	10	20
BNZ	0.02	0	0	0
Heartland	0.05	-30	-40	-10
Kiwibank	0.02	-10	-10	0
SBS	0.03	-10	-20	20
TSB	0.02	10	10	20
Co-op	0.02	-10	-20	-10
Westpac	0.02	10	0	0



Lending

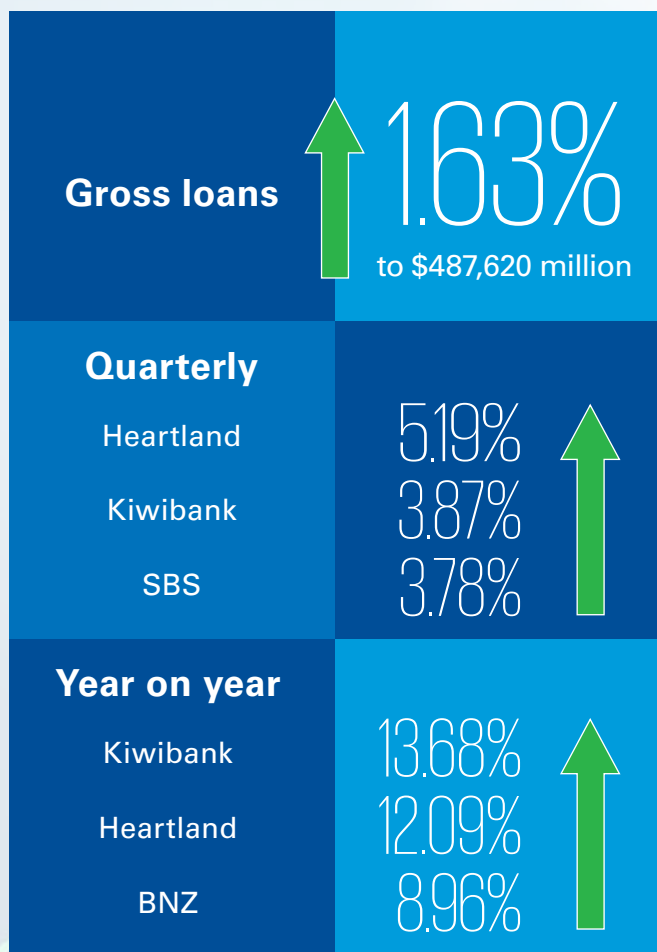
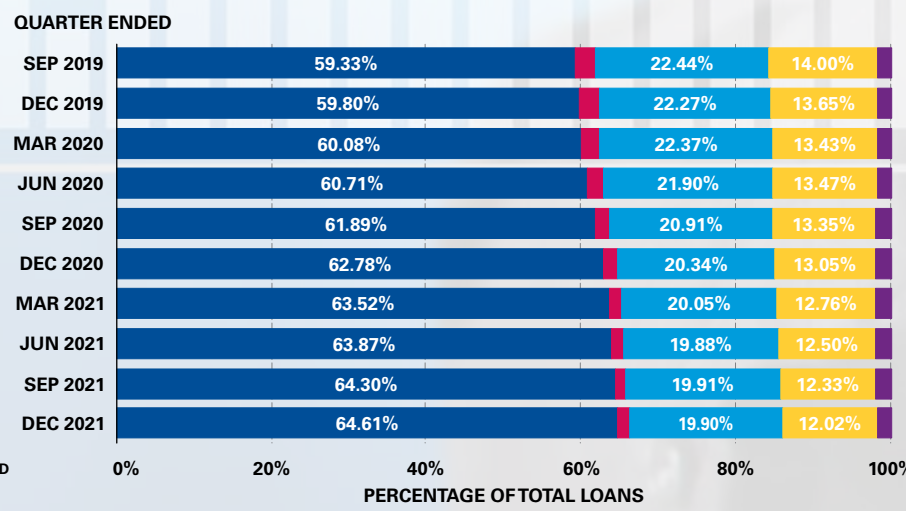
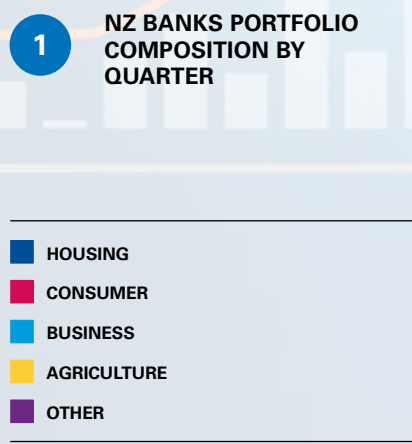


TABLE 2: Analysis of gross loans

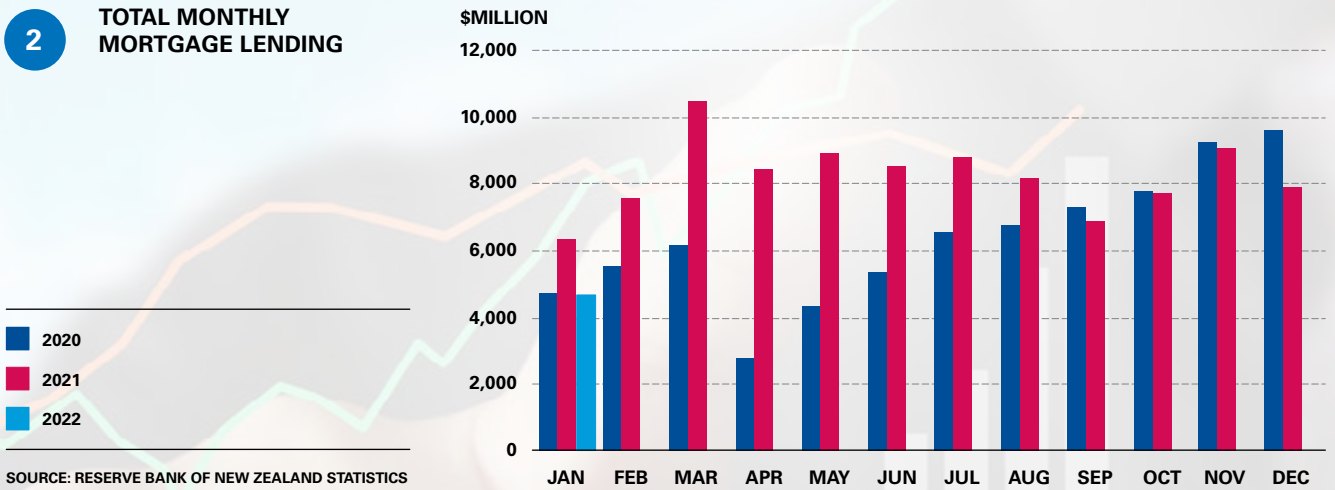
Entity ²³ Quarterly analysis	31 Dec 21 quarter ended \$Million	30 Sep 21 quarter ended \$Million	% Increase (Quarterly)
ANZ	144,219	141,658	1.81%
ASB	106,062	105,132	0.88%
BNZ	97,895	95,794	2.19%
Heartland	4,170	3,964	5.19%
Kiwibank	27,237	26,221	3.87%
SBS	4,321	4,164	3.78%
TSB	6,734	6,621	1.70%
Co-op	2,722	2,760	-1.36%
Westpac	94,261	93,501	0.81%
Total	487,620	479,815	1.63%

Entity ²³ Annual analysis	31 Dec 21 quarter ended \$Million	31 Dec 20 quarter ended \$Million	% Increase (Annual)
ANZ	144,219	135,691	6.28%
ASB	106,062	98,647	7.52%
BNZ	97,895	89,844	8.96%
Heartland	4,170	3,720	12.09%
Kiwibank	27,237	23,959	13.68%
SBS	4,321	4,073	6.10%
TSB	6,734	6,243	7.86%
Co-op	2,722	2,665	2.14%
Westpac	94,261	90,154	4.56%
Total	487,620	454,996	7.17%

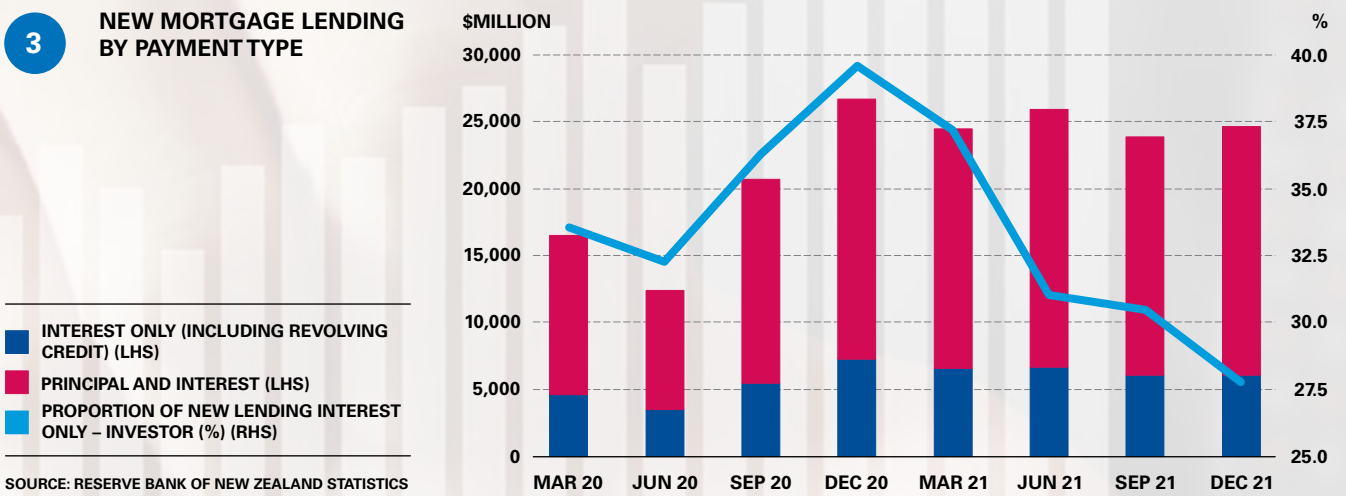


SOURCE: RBNZ BANK FINANCIAL STRENGTH DASHBOARD

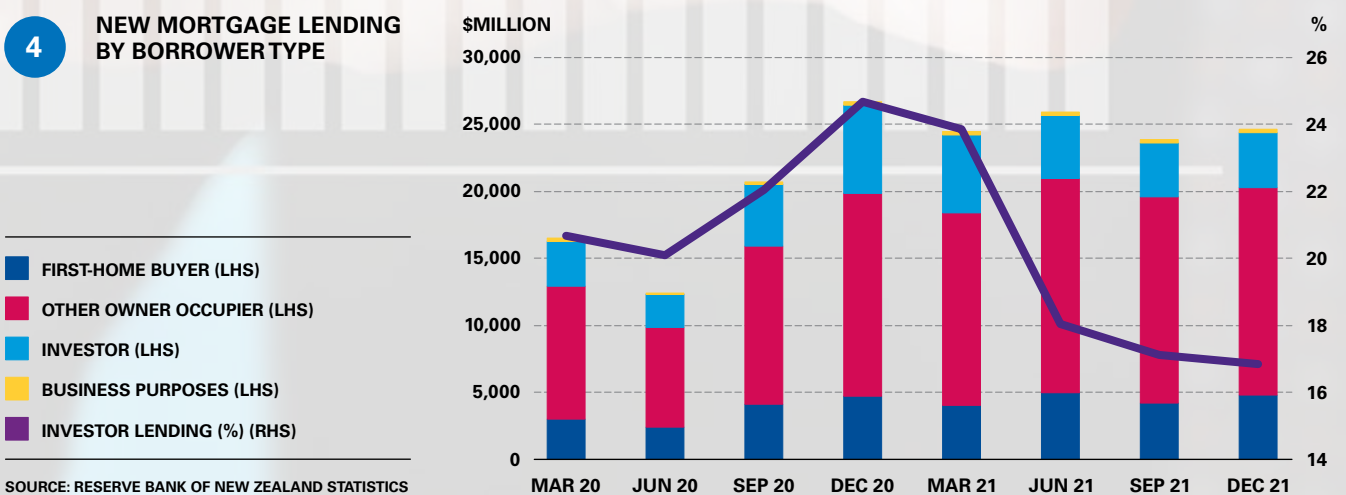
2 TOTAL MONTHLY MORTGAGE LENDING



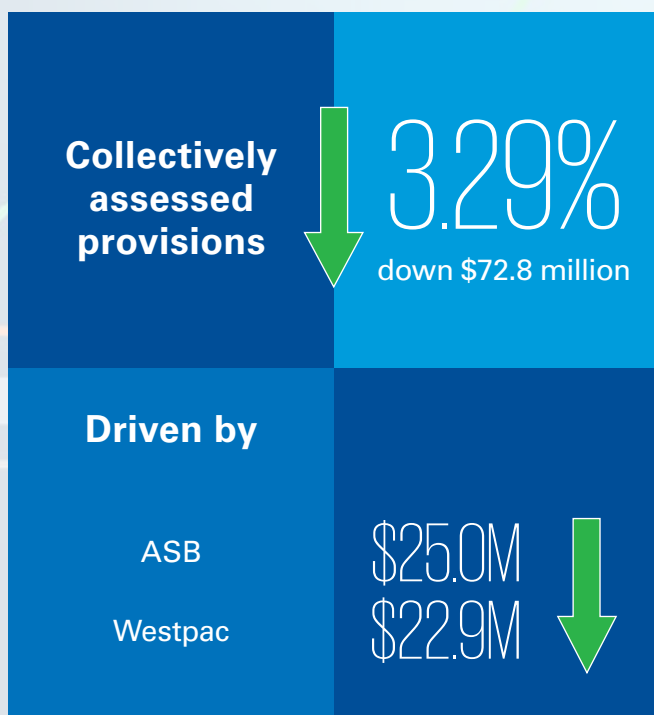
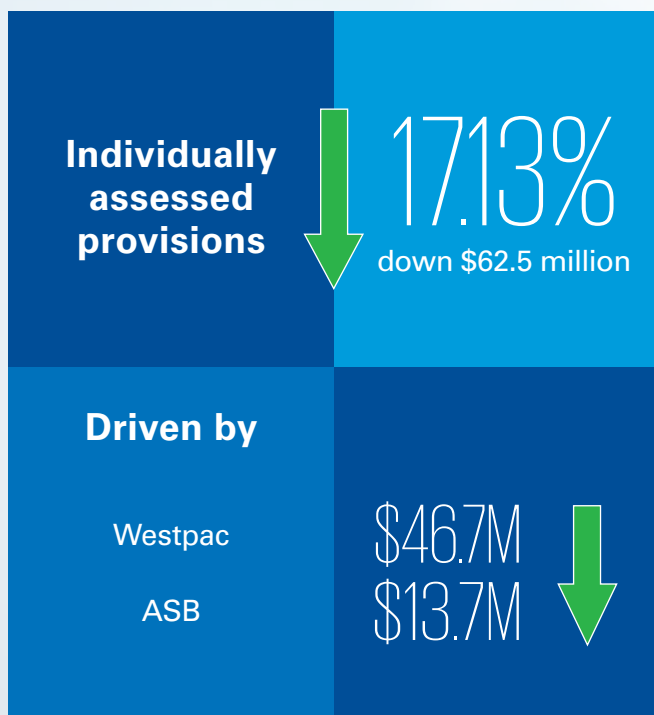
3 NEW MORTGAGE LENDING BY PAYMENT TYPE



4 NEW MORTGAGE LENDING BY BORROWER TYPE



Asset quality

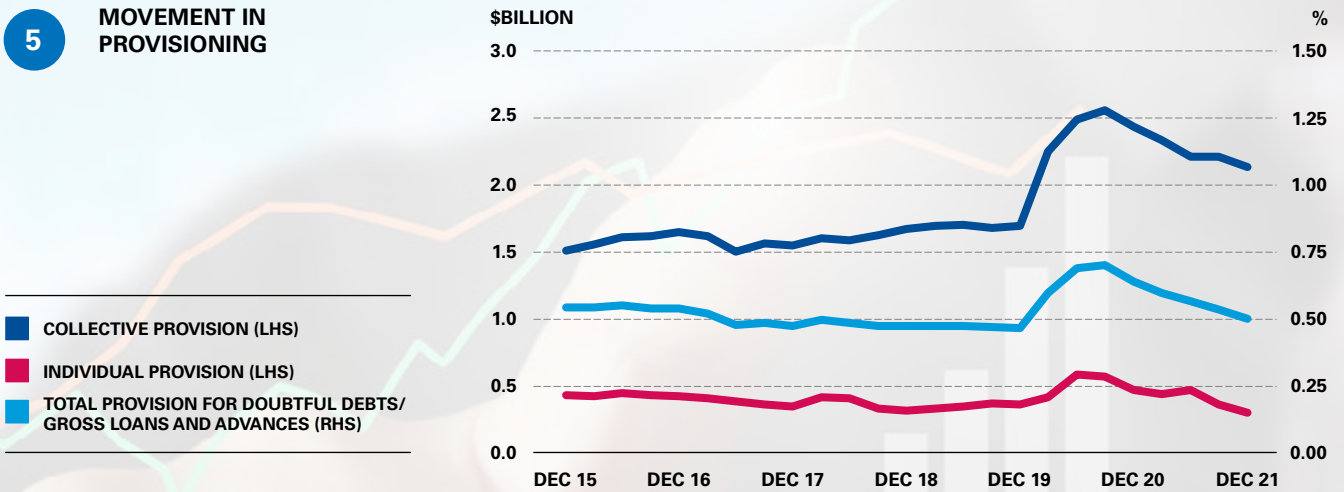


	\$Million
December 2021	-\$35.0
September 2021	-\$29.2
June 2021	-\$70.7
March 2021	-\$76.6
December 2020	-\$126.0
September 2020	\$188.6
June 2020	\$478.0
March 2020	\$749.3

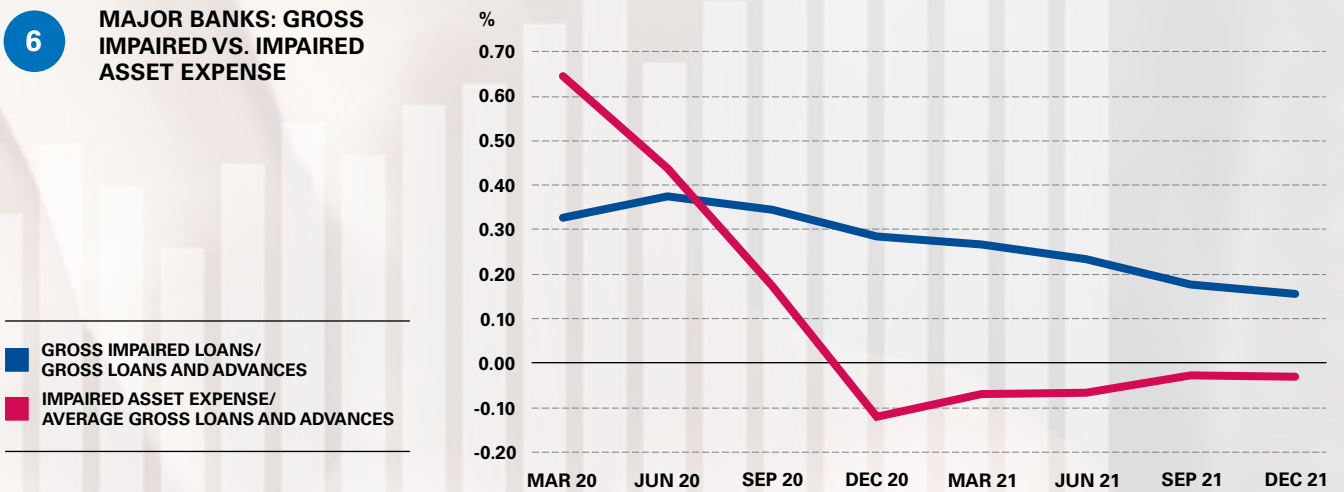
The December 2021 results maintained the downward trend of the industry's provisioning coverage ratio towards the level seen before the pandemic. This ratio rose from 0.47% in December 2019 to a peak of 0.70% in September 2020, and has since fallen in each consecutive quarter to 0.50% in December 2021. Despite these decreases, provisioning levels remain above those seen before the pandemic, indicating there is still some uncertainty around impacts to come. The focus of this uncertainty appears to be shifting from a health response including lockdowns and border closures to a more economic lens and the expected cost pressures that come with it in the form of rising inflation and interest rates. It should also be recognised that while many areas of the economy have recovered, there are some sectors that are still struggling and will continue to struggle due to the impact of lengthy border closures and the undoubted lead time to return to full capacity once borders re-open. It is also worth considering whether the worst of the pandemic's economic impacts on New Zealand are still to come, with the country being affected a couple of years' later than the rest of the world in previous crises. The events post the quarter end (continued inflation, rising interest rates, CCCFA changes, supply chain issues, conflict in Eastern Europe and falling business confidence) have placed further pressure on borrowers and are likely to play out over the next two quarters.

Entity ²³	31 Dec 21 quarter ended (%)	Movement during the quarter (bps)	Movement for the 12 months (bps)
ANZ	-0.03%	0	0
ASB	-0.02%	2	-1
BNZ	-0.03%	4	10
Heartland	0.40%	-6	-4
Kiwibank	0.06%	1	9
SBS	0.22%	-6	13
TSB	-0.04%	27	-7
Co-op	0.01%	7	-4
Westpac	-0.09%	-11	30
Average	-0.03%	-1	8

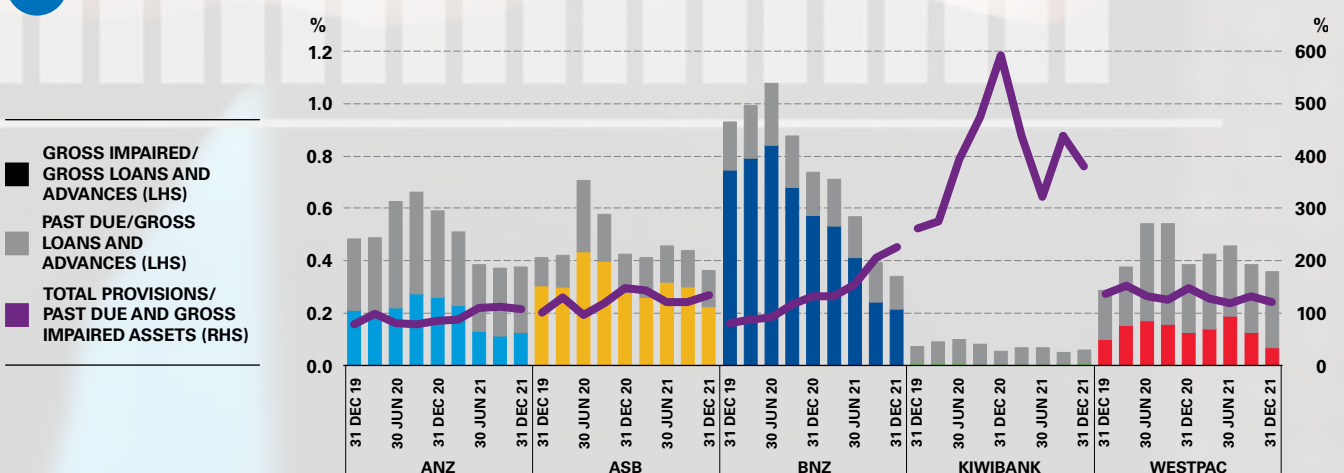
5 MOVEMENT IN PROVISIONING



6 MAJOR BANKS: GROSS IMPAIRED VS. IMPAIRED ASSET EXPENSE



7 MAJOR BANKS: PAST DUE AND GROSS IMPAIRED ASSETS VS. GROSS LOANS AND ADVANCES



Major banks - Quarterly analysis

Entity ²³	Size & strength measures							
	31 Mar 20	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21	31 Dec 21
Total assets (\$Million)								
ANZ	183,424	181,688	180,087	186,404	183,811	187,064	185,072	190,636
ASB	116,042	113,464	115,064	117,967	121,115	120,810	120,230	121,030
BNZ	118,501	114,452	112,310	117,287	114,314	118,549	119,122	123,038
Heartland	4,315	4,315	4,288	4,358	4,297	4,419	4,484	4,703
Kiwibank	25,249	25,510	26,645	27,283	27,546	28,230	29,379	30,970
SBS	4,942	4,836	4,842	4,839	4,832	4,789	4,889	5,024
TSB	8,179	8,332	8,575	8,761	8,789	8,725	8,780	8,934
Co-op	2,980	3,008	3,048	3,064	3,122	3,171	3,194	3,239
Westpac	120,525	114,223	113,187	117,160	114,726	116,786	119,848	122,382
Total	584,157	569,827	568,047	587,123	582,552	592,543	594,998	609,954
Increase in gross loans and advances (%)								
ANZ	0.98	-0.02	-1.92	1.51	2.00	1.41	0.93	1.81
ASB	1.03	0.09	2.41	2.58	1.70	2.79	1.94	0.88
BNZ	1.41	-1.36	-0.30	1.43	2.07	2.78	1.64	2.19
Heartland	1.23	-2.03	-0.62	0.72	0.78	3.11	2.54	5.19
Kiwibank	1.91	1.51	3.06	3.86	3.16	2.51	3.49	3.87
SBS	0.58	-1.36	-0.36	-1.10	0.01	0.23	2.00	3.78
TSB	-0.16	-0.28	0.58	0.81	2.09	2.32	1.53	1.70
Co-op	1.32	-0.31	1.14	2.83	1.61	2.05	-0.13	-1.36
Westpac	1.80	-0.29	1.47	1.34	1.40	2.13	0.15	0.81
Average	1.27	-0.28	0.31	1.78	1.86	2.20	1.30	1.63
Capital adequacy (%)								
ANZ ²⁴	13.90	14.00	14.40	15.00	15.90	15.50	16.90	16.40
ASB ²⁴	13.60	14.00	14.20	13.90	14.80	15.10	14.50	14.60
BNZ	14.10	14.60	14.90	15.50	16.00	16.50	16.90	16.40
Heartland	12.90	12.70	13.40	14.00	14.40	13.90	14.00	14.00
Kiwibank	13.00	12.60	12.30	13.30	13.20	13.20	12.80	13.70
SBS	13.80	14.30	14.90	15.20	15.70	16.20	16.30	16.00
TSB	14.30	14.90	15.10	15.10	15.00	14.20	14.10	13.70
Co-op	16.30	16.90	16.90	17.00	16.90	16.80	16.10	16.90
Westpac ²⁴	15.90	16.60	17.10	17.60	18.20	18.80	18.60	19.00
Net profit (\$Million)								
ANZ	422	327	220	367	563	487	503	496
ASB	192	130	270	321	348	317	367	382
BNZ	129	187	209	303	357	318	344	356
Heartland	17	9	21	12	18	20	20	21
Kiwibank	17	-12	24	31	40	31	32	32
SBS	-4	8	10	12	12	13	11	10
TSB	-8	9	12	11	11	13	12	9
Co-op	-1	3	4	5	4	4	5	4
Westpac	132	107	238	300	290	249	219	305
Total	896	770	1,008	1,361	1,643	1,452	1,512	1,614

Entity	Profitability measures							
	31 Mar 20	30 Jun 20	30 Sep 20	31 Dec 20	31 Mar 21	30 Jun 21	30 Sep 21	31 Dec 21
Interest margin (%)								
ANZ	2.10	1.90	1.90	1.90	2.10	2.10	2.00	2.00
ASB	2.00	1.80	1.80	1.90	2.10	2.00	2.00	2.10
BNZ	2.10	2.00	2.00	2.00	2.10	2.00	2.00	2.00
Heartland	4.60	4.60	4.50	4.60	4.80	4.90	4.80	4.50
Kiwibank	2.00	1.90	1.90	2.00	2.10	2.10	2.10	2.00
SBS	2.50	2.40	2.40	2.50	2.70	2.90	2.80	2.70
TSB	1.80	1.60	1.70	1.70	1.80	1.80	1.80	1.90
Co-op	2.20	2.20	2.20	2.30	2.40	2.40	2.30	2.20
Westpac	1.90	1.70	1.80	2.00	2.00	2.00	1.90	2.00
Non-interest income/Total assets (%)								
ANZ	0.85	0.33	0.29	0.18	0.53	0.40	0.53	0.54
ASB	0.53	0.51	0.58	0.54	0.56	0.55	0.67	0.48
BNZ	0.65	0.40	0.35	0.42	0.72	0.50	0.66	0.61
Heartland	0.32	0.38	0.28	0.42	0.32	0.39	0.39	0.33
Kiwibank	0.92	0.53	0.63	0.27	0.26	0.15	0.22	0.19
SBS	0.70	0.68	0.74	0.82	0.65	0.74	0.71	0.66
TSB	0.25	0.22	0.22	0.22	0.20	0.22	0.28	0.19
Co-op	0.50	0.67	0.69	0.60	0.58	0.62	0.65	0.57
Westpac	0.59	0.32	0.35	0.28	0.48	0.33	0.42	0.40
Average	0.68	0.39	0.39	0.34	0.55	0.43	0.54	0.49
Impaired asset expense/Average gross loans and advances (%)								
ANZ	0.64	0.23	0.27	-0.03	-0.17	-0.10	-0.03	-0.03
ASB	0.65	0.59	0.15	-0.01	-0.06	-0.07	-0.04	-0.02
BNZ	0.53	0.46	0.31	-0.13	0.04	-0.06	-0.07	-0.03
Heartland	0.69	1.48	0.05	0.44	0.52	0.54	0.46	0.40
Kiwibank	0.28	0.56	0.03	-0.03	0.01	-0.31	0.05	0.06
SBS	2.44	0.39	0.09	0.09	-0.13	0.06	0.28	0.22
TSB	1.29	-0.01	-0.05	0.03	-0.11	-0.12	-0.31	-0.04
Co-op	1.03	0.12	0.09	0.05	-0.30	0.06	-0.06	0.01
Westpac	0.87	0.54	-0.04	-0.39	-0.05	0.04	0.02	-0.09
Average	0.67	0.44	0.17	-0.11	-0.07	-0.06	-0.02	-0.03
Operating expenses/Operating income (%)								
ANZ	33.93	43.97	54.60	44.39	34.29	38.88	39.25	39.19
ASB	38.09	49.46	38.55	36.97	37.66	44.62	37.77	32.43
BNZ	58.00	41.97	41.65	39.83	32.75	38.23	39.02	35.31
Heartland	40.78	48.39	40.28	61.61	43.47	42.93	42.53	43.40
Kiwibank	75.76	91.00	78.94	70.89	65.25	84.38	70.88	70.67
SBS	56.07	59.78	59.36	58.31	61.87	56.21	57.51	62.23
TSB	80.68	66.31	60.76	62.80	68.38	65.02	74.84	74.23
Co-op	75.77	74.52	74.65	70.59	81.61	71.86	72.41	72.65
Westpac	42.68	50.79	44.14	45.34	41.67	44.98	49.95	41.15
Average	44.25	48.95	47.85	44.13	38.53	43.97	43.07	39.69

Major banks – Quarterly analysis

8

MAJOR BANKS: NET PROFIT

9

MAJOR BANKS: INTEREST MARGIN

10

MAJOR BANKS: INCREASE IN GROSS LOANS AND ADVANCES

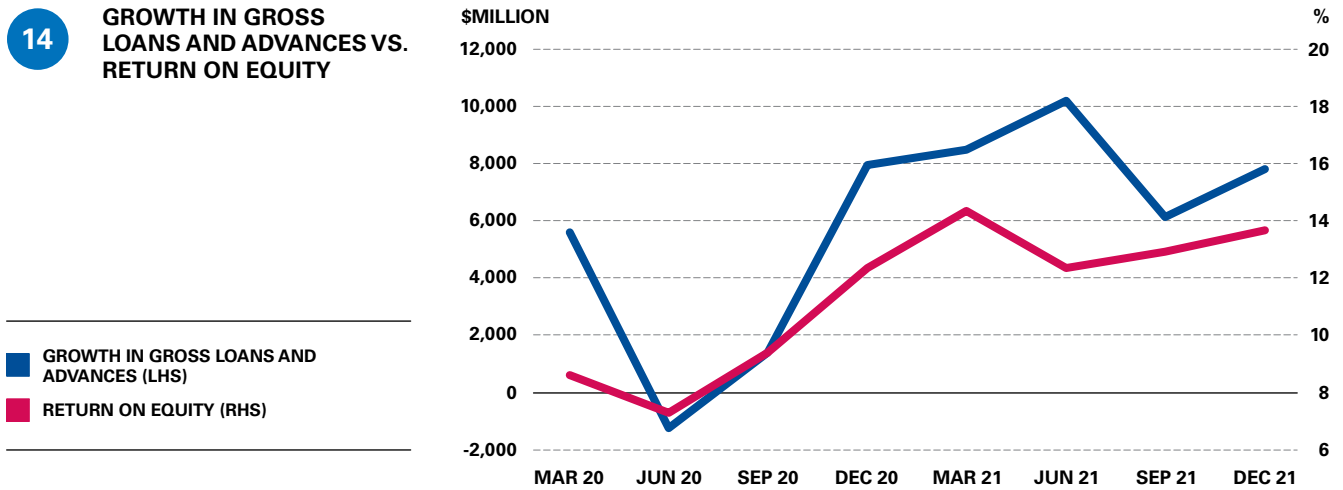
11 MAJOR BANKS:
NON-INTEREST INCOME/
TOTAL ASSETS

12 MAJOR BANKS:
OPERATING EXPENSES/
OPERATING INCOME

13 MAJOR BANKS: IMPAIRED
ASSET EXPENSE/AVERAGE
GROSS LOANS AND ADVANCES

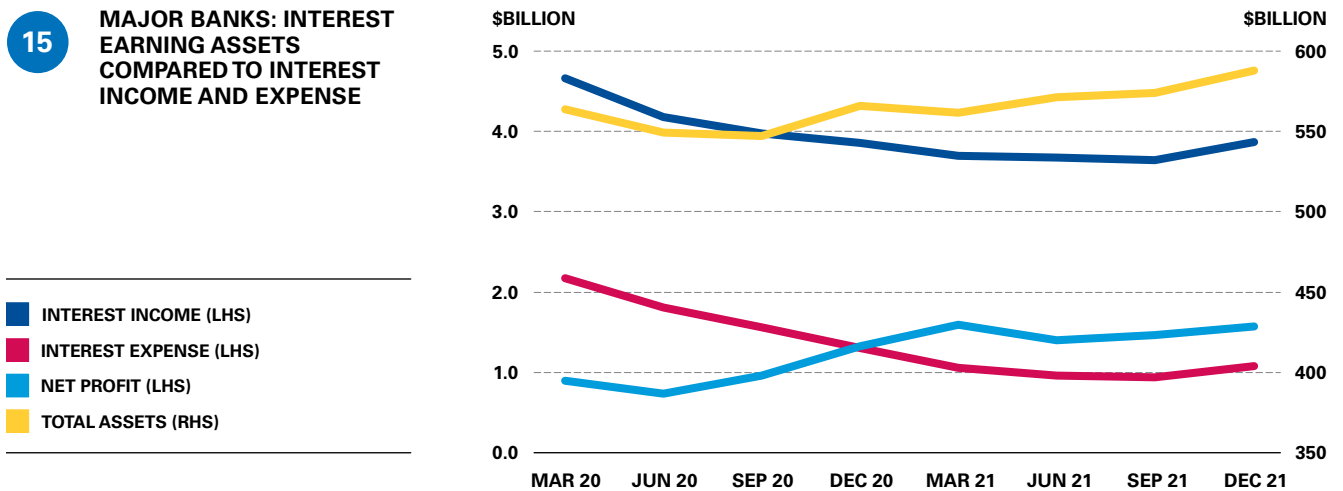
14

GROWTH IN GROSS LOANS AND ADVANCES VS. RETURN ON EQUITY



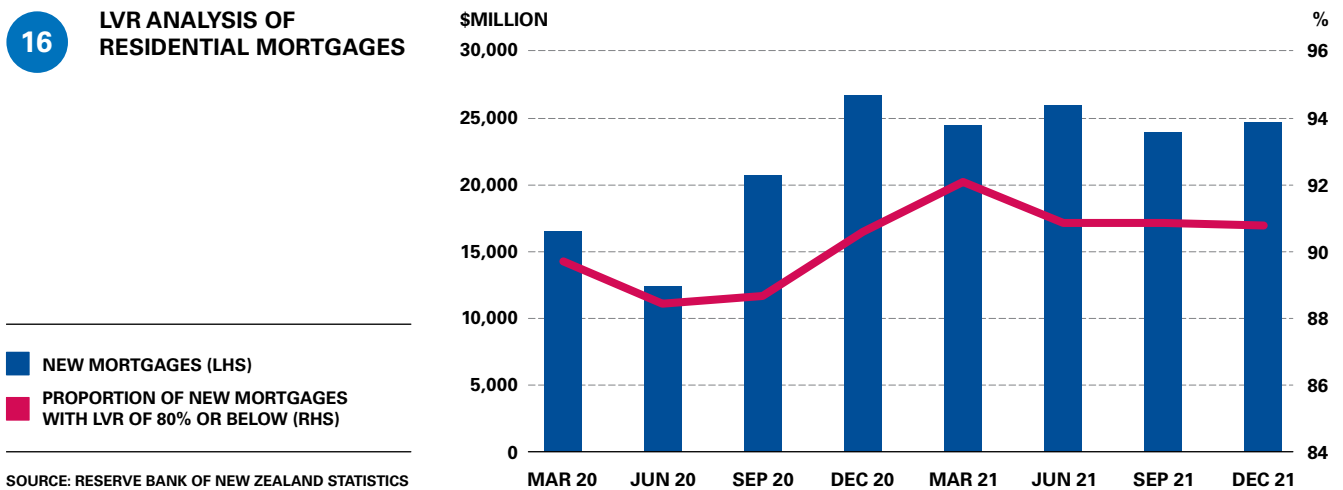
15

MAJOR BANKS: INTEREST EARNING ASSETS COMPARED TO INTEREST INCOME AND EXPENSE



16

LVR ANALYSIS OF RESIDENTIAL MORTGAGES



SOURCE: RESERVE BANK OF NEW ZEALAND STATISTICS



The credit market is tightening for the first time in a decade



Keith McLaughlin
Managing Director,
Centrix Group Limited



Keith McLaughlin is the Managing Director of Centrix Group Limited, New Zealand's only locally owned credit bureau. A highly experienced senior executive and director, Keith started Centrix with a vision to offer New Zealand businesses a superior and cost-efficient credit offering, with a focus on long-term relationships. Previously the founder and Managing Director of Baycorp Holdings Limited, his strengths include strong leadership skills with an emphasis on empowerment, and a proven ability to forge and sustain high performance teams. Keith has a wealth of finance experience in business process, requirements analysis, banking, IT strategy and professional services and holds a number of major awards, including Deloitte / Management Magazine NZ Executive of the Year.

For the first time since the economic recovery from the Global Financial Crisis a decade ago, we are seeing signs of New Zealand's credit market tightening.

This past decade was marked by low inflation, steady growth and falling interest rates, where financing was accessible and cheap. This helped to support business and economic growth.

Compounding this, the response to the pandemic only served to make the cost of borrowing cheaper.

As central banks around the world responded with expansionary monetary policy, interest rates fell to record low levels, which helped economies rebound strongly and confidently from the worst impacts of Covid-19.

Strong confidence and low-interest rates, however, resulted in spending and borrowing accelerating. This was seen particularly in New Zealand's property market, where peak monthly lending reached a record \$10.487 billion in March 2021.

The strong economy and buoyant employment market have also seen arrears fall to very low levels, with arrears on credit cards and vehicle loans reaching a record low level at the end of 2021, while mortgage arrears are also at historically low levels.

That is not to say that the pandemic has not had an impact on the credit market. In August 2021, for example, we saw consumer confidence plummet due to the Delta snap lockdown.

In similar trends seen in April 2020, credit demand fell sharply as the lockdown commenced, businesses across the country were closed, and discretionary spending fell as the increased economic uncertainty negatively impacted public confidence.

See Figure 17

This downturn lingers as we enter 2022. While auto loan demand in February appears to have recovered, personal loan and credit card demand remain down as the country faces challenges presented by Omicron and tightening monetary policy.

Responding to rising inflationary pressure

There are a number of significant economic changes underway. Supply constraints, very low unemployment and high demand for goods and services are all combining to drive up prices.

As a result, the Reserve Bank of New Zealand (RBNZ) has started a programme of tightening monetary policy, increasing the Official Cash Rate (OCR) and sending very strong signals that further increases are to follow.

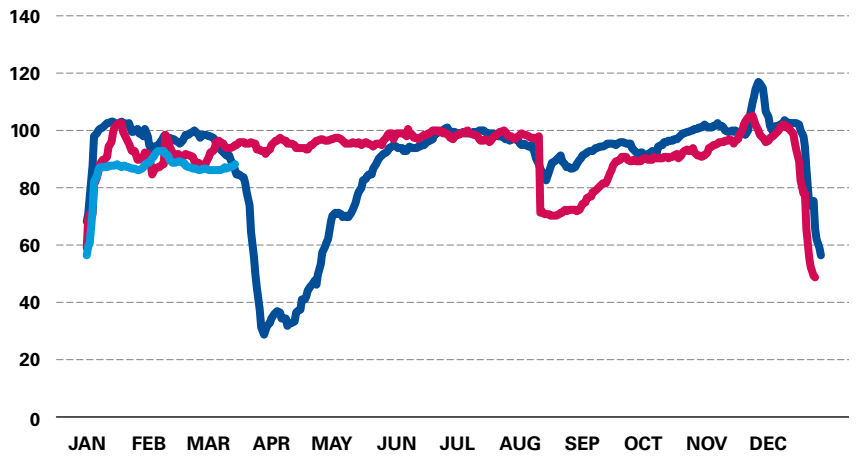
The message to both business and consumers is clear – the cost of borrowing is increasing. Already banks are raising their floating interest rates, and this is likely to dampen demand and slow the housing market.

The record growth experienced in the past 18 months is likely at an end. Already, we have seen a marked reduction in new mortgage lending, which was down 21% in January when compared to the year before.

See Figure 18

17 CONSUMER CREDIT DEMAND: 2020 TO 2022

ENQUIRY VOLUME INDEX

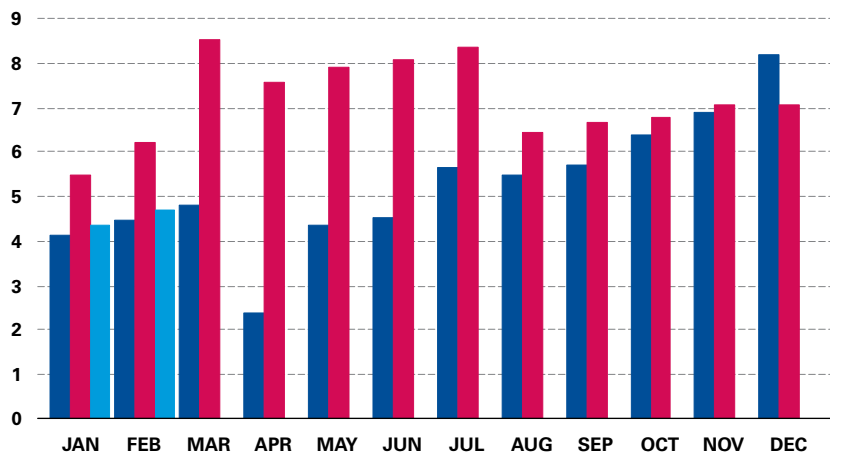


- 2020
- 2021
- 2022

SOURCE: CENTRIX

18 NEW LENDING EXPOSURE: MORTGAGES

NEW LENDING AMOUNTS (\$BILLION)

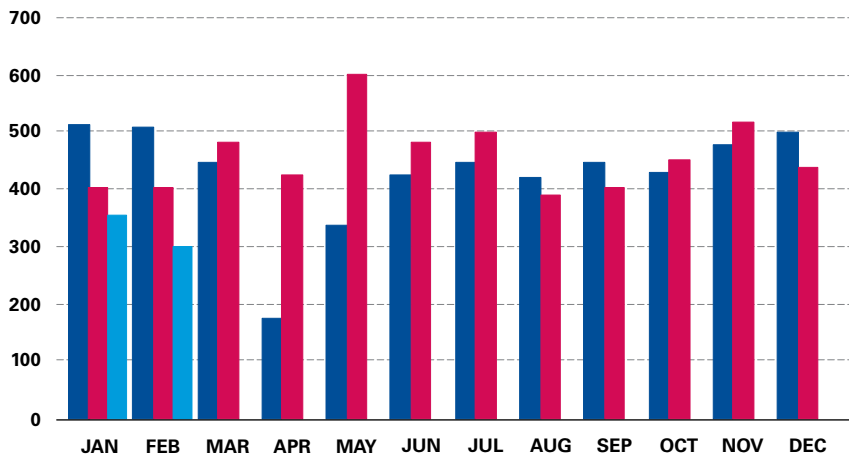


- 2020
- 2021
- 2022

SOURCE: CENTRIX

19 NEW LENDING EXPOSURE: CONSUMER FINANCE

NEW LENDING AMOUNTS (\$MILLION)



- 2020
- 2021
- 2022

SOURCE: CENTRIX

See Figure 19

But it is not just rising interest rates impacting the credit market, with recent regulatory changes also playing a role.

The impact of the CCCFA

In December, new provisions in the Credit Contracts and Consumer Finance Act (CCCFA) came into effect. The changes aimed to better protect consumers from predatory lending by placing increased legal obligations on lenders to ensure the loans they make are affordable and responsible.

As has been well publicised, it is clear that major lenders, including retail banks, have taken a cautious approach to the changes made to the CCCFA. As a result, they are being much more thorough and restrictive when it comes to making lending decisions. This is being reflected in the data we analyse on New Zealand's credit market each month.

What are the initial impacts of the CCCFA changes?

Credit approvals for both mortgage approvals and consumer finance have been negatively impacted since December 2021.

Our data shows the proportion of mortgage applications resulting in approval fell to just 34% in February, while consumer finance conversion reduced from 35% to 28% of applications.

See Figure 20

The loan conversion rate might be smaller than our data indicates, because some lenders have opted to assess affordability before running a credit check.

Who is being declined credit?

While the changes to the CCCFA were designed to protect more vulnerable consumers, our data suggests it is having a negative impact on those with a good lending history.

See Figure 21

Since December 2021, loan conversion rates have reduced sharply for those with a credit score above 700, which is widely considered to be a strong score. But, have remained largely unchanged for those with low credit scores, as many credit providers have had responsible credit policies in place for several years.

Overall, it appears lenders have declined about 5% of home loan applicants that likely would have qualified for mortgage approval in November 2021, prior to the CCCFA changes coming into effect.

We also saw marked reductions across a range of consumer financing products in December 2021, with successful credit card applications falling below 20% for the first time. By way of comparison, 32% of credit card applications were approved in October.

What does the future look like?

Rising interest rates and changes to the CCCFA are serving to tighten the credit market, and this will negatively impact both consumers and businesses.

Rising interest rates will impact household disposable incomes as fixed-mortgage rates start being renewed throughout the year. Inevitably, homeowners will need to renew their mortgages at a higher rate than they are currently paying, reducing money available to spend elsewhere in the economy.

While this will serve to weaken demand and reduce inflation overtime, this is also likely to have an impact on consumer-facing businesses, who will face tightening conditions as consumers begin reducing discretionary spending. This might see arrears increase from their historic lows.

This, alongside external economic shocks such as rising energy prices on the back of rising global tensions, all points to uncertain economic times in the year ahead.

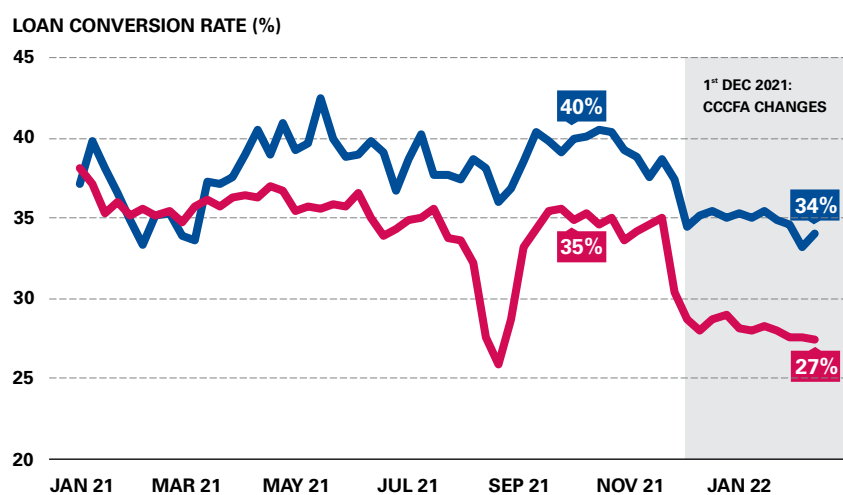
Find out more about Centrix and get New Zealand consumer and business insights at www.centrix.co.nz.

TABLE 5: Consumer loan type

	Jul 21	Aug 21	Sep 21	Oct 21	Nov 21	Dec 21
Home loans	38.5%	37.4%	39.4%	40.2%	38.6%	33.6%
Credit cards	32.3%	29.6%	30.8%	32.1%	30.0%	19.8%
Personal loans	31.4%	27.7%	30.8%	31.0%	31.2%	26.8%
Auto loans	42.5%	36.4%	42.7%	43.2%	42.4%	38.5%

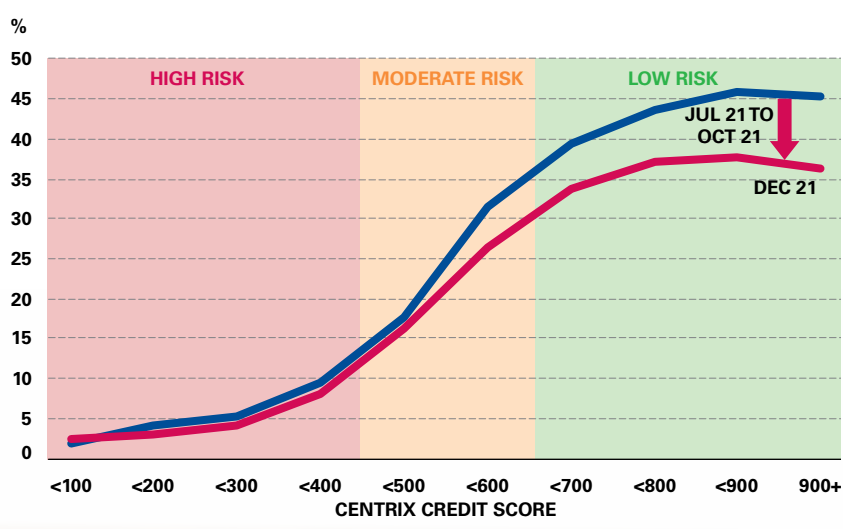
20 IMPACT OF NEW LENDING RULES ON LOAN CONVERSION RATES: CREDIT APPROVALS AS A PROPORTION OF APPLICATION ENQUIRIES MADE

■ MORTGAGES
■ CONSUMER FINANCE
 SOURCE: CENTRIX



21 LOAN CONVERSION BY RISK TIER

■ APPLICATIONS: JUL 21 TO OCT 21
■ APPLICATIONS: DEC 21
 SOURCE: CENTRIX



Business failures in a post Covid-19 environment



Leon Bowker
Partner – Deal Advisory
KPMG

Leon leads the KPMG Restructuring and Insolvency practice. Leon is a Chartered Accountant, Barrister and Solicitor and Licensed Insolvency Practitioner. He has extensive experience in a range of financial advisory, transactions and restructuring engagements. Leon and his team help stakeholders of underperforming businesses by providing independent reviews on performance, recovery options and value enhancement strategies. He has undertaken many financial analysis assignments, reporting to both management and financial institutions on cash flow, working capital, capital structure and financial performance.



Janet Sprosen
Director – Deal Advisory
KPMG

Janet heads the KPMG liquidation team for the North Island. Janet is a Barrister and Solicitor and Licensed Insolvency Practitioner. She has 20 years of debt recovery and insolvency experience across the public and private sector. In her roles at the Inland Revenue, Janet was responsible for identifying emerging debt and insolvency issues, designing and implementing recovery strategies, and providing technical and strategic advice. Janet has managed multiple insolvency assignments, including trading businesses, across a range of industries. Her focus is now on achieving the best outcomes for creditors.



Germaine Philippsen
Associate Director – Deal Advisory
KPMG

Germaine is an Associate Director in the Deal Advisory team and a Chartered Accountant. She has extensive experience in a range of financial advisory, transaction and restructuring engagements across Australasia, as well as in-house experience as Head of Finance for a major Australian-based credit agency. She has undertaken numerous engagements, advising directors, management and financial institutions on acquisitions, divestments, distressed sales, performance reviews and insolvency engagements.

Government and private sector measures have supported New Zealand businesses as they have navigated the pandemic, resulting in a relatively buoyant economy, but how long can we expect this to last?

We first explored this concept in our article *Business failures in a post Covid-19 economy* published in the *FIPS March 2021 Quarter Results*²⁵.

As of March 2022, nearly two years have passed since the Covid-19 pandemic hit our shores and changed our way of life and how we do business. Since the pandemic struck, certain businesses have seen a surge in demand and activity, driven by the housing boom and a redirection of funds previously destined for overseas travel while businesses in the hospitality, tourism and education sectors have faced significant economic challenges. With these challenges, many expected the pandemic would lead to a large rise in insolvency appointments. For instance, a 2021 survey of members of the Restructuring, Insolvency, Turnaround Association of New Zealand (RITANZ), highlighted that 93% of respondents expected to see an increase in insolvency appointments over the next one to two years.

With these challenges, many expected the pandemic would lead to a large rise in insolvency appointments.

While we all have heard anecdotal evidence of this issue, what are we seeing in the data?

- Despite the challenges many businesses have faced over the past two years, New Zealand has bounced back from the initial shock of the first lockdown in March 2020. Bank credit remains positive, with collective provisions peaking in the third quarter of 2020 totalling \$3,156 million, and winding down across 2021 to close at \$2,628 million at the end of December 2021. Individual provisions held by all major banks have also slightly declined across 2021, despite lengthy lockdowns in the fourth quarter of the year, reducing from \$577 million in December 2020 to \$387 million in December 2021.
- Unemployment rates are at historical lows with many industries facing critical labour shortages. The unemployment rate spiked from an average of 4.2% across 2018 and 2019 to 5.3% in the quarter ended September 2020, following the initial impact of the pandemic. Since then, however, it has consistently declined to historical lows of 3.2% at December 2021, as border closures have resulted in staff shortages and unemployed people are able to find re-employment in growth sectors. Despite employment data going back to 1986, the last time the employment rate was this low was 3.4% in December 2007.
- Retail sales have also recovered following the initial shock in the quarter ended June 2020, suffering only a slight dip in the latter part of 2021, with levels still above those of pre-Covid-19, buoyed by the shift to online retailing and an increase in consumer discretionary spending.

- The recovery in the New Zealand economy is further reflected in the volume of insolvency appointments. Insolvency appointments have generally been declining over the past five years, with significant declines experienced from April 2020 onwards. Overall appointments remained lower in 2021 than 2020.

Overall, the above statistics indicate that New Zealand's economy has fared relatively well to date. A number of factors have been crucial in helping prop up struggling Kiwi businesses since the beginning of the pandemic. These include Government wage subsidies and business grants, low interest rates, rising property prices, and a more empathetic approach to chasing overdue debts from both large corporates and the Inland Revenue.

While the support provided by both the Government and corporates (rent relief from landlords, payment holidays from creditors and mortgage holidays from lenders) alike was required during such testing and unprecedented times, financial lifelines have been extended to numerous businesses where recovery was highly unlikely. A number of businesses that we have been appointed as liquidator to had received a range of Government funding and generally had received relief from enforcement, despite being heavily indebted at the time they received these funds.

Many of these businesses have received funding and continued to trade when little hope of recovery existed for that business. As the borders begin to reopen, the threat of lockdowns abates and widespread Government support winds down, the following question must be asked: Will New Zealand businesses be able to recover sufficiently to pay back debts incurred and capitalise on the re-opening of our economy, or will we start to see liquidation appointments begin to rise?

Many of these businesses have received funding and continued to trade when little hope of recovery existed for that business.

With the Omicron outbreak causing significant disruption to many businesses, creditors now resuming enforcement activity, new loan obligations becoming due (loans under the Government's Small Business Cash Flow Loan Scheme are due two years after issuance), rising interest rates and general uncertainty around the housing market, there are threats on the horizon for Kiwi businesses. For those businesses that have been taking on debt or deploying capital to sustain operations any ability to weather ongoing disruptions to trading will be limited; also insolvency activity or voluntary closures will likely start to rise in 2022.

For businesses facing solvency issues, it is important to address those issues early and to undertake a realistic assessment of the business' ability to recover in order to avoid further risks both to creditors and to the respective board of directors. KPMG can help by assisting you to assess your options and providing expert guidance for your business to restructure, turnaround, negotiate with creditors or lenders, or manage insolvency processes. If you would like to speak to us about solvency issues then please reach out to Leon, Janet or Germaine.





Good customer outcomes in remediation: Redressing the impact



Adele Wallace

Director – Advisory
KPMG

Adele Wallace is a Director in KPMG’s Auckland practice specialising in conduct risk. Adele brings valuable insight and a rich range of experience in approaches to conduct risk across banking and general insurance through her extensive work in the regulatory practice at KPMG UK and her previous roles in the industry.



Poorva Ahooja

Manager – Risk Consulting
KPMG

Poorva Ahooja is a Manager within our Risk Consulting practice. Poorva is a regulatory compliance specialist and joined KPMG in 2021 from the Financial Markets Authority (FMA), where she worked in the Supervision team that is responsible for monitoring adherence to regulatory and legislative requirements by financial market participants.

In this final article in our series covering remediation, Adele and Poorva discuss the importance of taking a client-centric approach to any remediation programme. 2022 continues to see banks face into their customer remediation programmes, and with increased regulatory scrutiny and new conduct legislation on the horizon the pace and scale is only set to increase. In this article we discuss how the customer must be at the heart of every remediation programme and how truly delivering good customer outcomes in remediation can often mean looking beyond the immediate ‘dollar value’ and toward the impact on the customer.

As the banking sector continues to embed their conduct strategies, remediation programmes are continuing to grow in number and scale. This isn’t unexpected, far from being a negative reflection of an organisation, it demonstrates that those conduct frameworks that banks have worked so hard to embed over recent years are having the desired effect. Targeted risk data, insightful dashboards, improved product governance, better complaints analysis and more challenging senior management and boards has resulted in improved detection and resolution of past and current errors.

Increased remediation activity is a clear demonstration of an organisation's focus on delivering good customer outcomes. Ensuring the customer receives a good outcome or even the *right* outcome from your remediation efforts is the next challenge to face into though. We know the regulator requires it, we know the customer demands it and we also know that boards will be expecting it. But despite best efforts from proudly 'customer centric' organisations there are myriad examples where the focus on good customer outcomes has been lost in the desire to remediate at pace and mitigate losses. The result is subsequent 're-remediation'; significantly increasing costs and negatively impacting regulator and customer confidence.

Banks actually have the opportunity to increase customer advocacy through well managed remediation and being truly focused on putting the customer back in the position that they would have been in had the error not occurred. In other words, a key part of your remediation strategy is considering the impact of the error on the customer or the 'harms' it may have caused and making reparations for that harm in a meaningful way.

When setting out on remediation, you need to consider what 'customer harm' means in the context of the issue and your impacted customers, and address that harm as far as reasonably practical ...

In many instances, achieving a good outcome in customer remediation may seem to be straightforward, particularly where it's a simple case of refunding a one off fee, e.g. \$50 fee charged in error. Quickly refunding the fee and adding in compensation for lost use of monies for the period is likely to meet the brief. In this scenario, it may appear simple to do right by the customer, as the loss is only 'financial' and is arguably low value (although more on that point below), but there are almost always complexities to a fair and consistent calculation methodology and execution of remediation.

Broader considerations come into play though when the error is of a higher value or over a longer period. For example, Bank A charged their customers a \$1,000 fee for two years where they should have charged a \$500 fee. A simple calculation of differences should produce a basis for remediation payments of \$1,000, but it shouldn't end there. Has being without that \$1,000 impacted the customer in some way beyond that quantifiable dollar figure? Has Bank A's error possibly caused a material harm to that customer? Maybe it caused financial distress by sending them over their overdraft limit or resulted in being charged further fees? Maybe because that money wasn't available in their bank account they needed to take out additional credit? Your approach will need to consider a strategy to assess and remediate these additional harms at the outset.

Consider situations where there are some missing disclosure documents or where the customer hasn't been told a material piece of information at point of sale. It's easy to conclude that this is a simple 'regulatory breach' that had no material or financial impact on a customer, however consideration should be given to what a customer may have done 'but for' the missing information – is it likely to have affected their decision making or causing a lost opportunity?

In these circumstances quantifying the impact and customer harm is more complex. In the UK these considerations are a well-trodden path. The impact of poor sales of (e.g. interest rate swaps, mortgage endowments), or failure to address complaints fairly resulted in devastating effects for some customers who lost their homes or businesses, and banks were required to develop an approach for suitable remediation that went some way to address the consequential impacts of the error.

Banks aren't expected to own crystal balls or make efforts to remediate every customer for every 'what could have been' or go beyond the bounds of what is reasonable or foreseeable, but by the same token we can't ignore the fact that the impact of an error, while on the face of it seems to be just a case of dollars or a missing document, can be much more than that to customers.

A truly customer centric organisation will ensure that analysis of customer impact and fair and equitable remediation of harms is central to their remediation strategy.

The approach to take is not a 'one size fits all' and will need careful consideration based upon your risk appetite. What harm your customers may have suffered as a result of the error will differ for each type of remediation based on value, timeline, category of error and the characteristics of your impacted customers, so we recommend a targeted activity using data and other qualitative inputs to set out the potential impacts of the issue on specific customer cohorts. The approach to compensation (or justification for not compensating) will require a governance decision. This is where your organisation's Customer Advocate role can really help to bring the customer experience to life and provide independent challenge (and don't discount actually using a focus group of customers to determine how the experience had impacted them).

And finally, it's so important to realise that your customers will not have been impacted by the same error in the same way. That \$50 fee charged in error we mentioned above may seem like a minimal amount for most, but for low income or otherwise vulnerable customers it could have had a huge impact on their account conduct, available money for bills and essentials, resulting in financial distress or significant inconvenience.

At a minimum, vulnerable customers must be considered and made a priority in all remediations.

Remediating for a past error is perceived as a good customer outcome... but to truly ensure the outcome is good as well as equitable and is one that actually satisfies your customer you must go beyond redressing the bare minimum or simply fixing the regulatory rule breach and consider and remediate the immediate and material impact that an error may have had on your customer and prioritising those who may have been most materially impacted.

KPMG has experience working with banking clients across multiples types of remediations. If you would like to speak to us about remediation then please reach out to Adele or Poorva.



Endnotes

1. <https://assets.kpmg/content/dam/kpmg/nz/pdf/2022/03/fips-banks-2021-v2.pdf>
2. <https://www.rbnz.govt.nz/news/2022/02/more-tightening-needed>
3. <https://www.beehive.govt.nz/release/government-reopens-new-zealand-tourism>
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7. <https://www.westpac.co.nz/assets/Business/tools-rates-fees/documents/economic-updates/2022/Weekly/14.3.22-Weekly-Economic-Commentary-Westpac-NZ.pdf>
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20. <https://www.interest.co.nz/property/114901/drop-barfoot-thompsons-auction-numbers-suggests-we-may-be-past-summer-peak>
21. <https://bankdashboard.rbnz.govt.nz/summary>
22. https://www.oneroof.co.nz/news/41153?utm_source=nzherald&utm_medium=nzhapp
23. This data represents the top New Zealand level banking-licensed entity and is referred to using the brand in common usage, and as per the RBNZ Bank Financial Strength Dashboard. ANZ represents Australia and New Zealand Banking Group Limited – ANZ New Zealand; ASB represents Commonwealth Bank of Australia New Zealand Operations; Heartland represents Heartland Bank Limited; SBS represents Southland Building Society (trading as ‘SBS Bank’); TSB represents TSB Bank Limited; Co-op represents The Co-operative Bank Limited; and Westpac represents Westpac Banking Corporation – New Zealand Banking Group.
24. The capital adequacy ratios reported are for the local bank.
25. <https://assets.kpmg/content/dam/kpmg/nz/pdf/2021/06/fips-march-2021-quarterly.pdf>

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