

Institute of Professional Auctioneers and Valuers

Pre-Budget Submission (November 2006)

EXECUTIVE SUMMARY

The economic and fiscal background against which Budget 2007 will be presented is very favourable. The Irish economy is still growing very strongly, with GDP growth of around 5.3% in prospect this year and close to 5% in 2007.

The budget outturn in 2006 is likely to be close to €2.5 billion better than expected. With growth set to remain strong in 2007, the opening budget position for 2007 will be strong. The main vulnerability for the economy in general and the public finances in particular is the very heavy reliance on residential housing activity.

Activity in the housing market remains very strong but there is emerging evidence that the market is starting to reach equilibrium, with supply starting to match demand. Affordability is now deteriorating against a background of high house prices and rising interest rates. The problems are most acute for first-time buyers and they are likely to get worse over the coming year.

Residential housing market activity is now making a very significant contribution to the Irish economy through its direct and indirect employment creation, through its direct and indirect impact on tax revenues and through its wealth effect on consumer confidence and spending. Any significant downward correction to the market either in terms of completions or, more importantly, prices would have a very negative effect on the overall health and stability of the economy.

Any housing related measures in Budget 2007 should seek to alleviate the growing pressures on first-time buyers in particular and also to preserve the overall stability of the market.

The following are the key proposals for Budget 2007.

STAMP DUTIES

Radical changes are needed in the stamp duty regime.

Stamp duties should be abolished altogether for first-time buyers. From a cost point of view, such a move would be easily financed in an environment where the Exchequer finances are in such a strong position. It is estimated that €945 million is taken in by the Department of Finance on stamp duties relating to residential housing transactions. First-time buyers account for around €70 million of this tax take. The €70 million paid by first-time buyers is insignificant in the context of total tax revenues, but it is a very significant amount of money for first-time buyers.

ENCOURAGING GREATER MOBILITY IN THE RESIDENTIAL HOUSING MARKET

The current stamp duty regime acts as a major disincentive to labour market mobility. Lower stamp duty rates and wider bands would increase mobility and could prove self financing.

Stamp Duty should only be paid on the excess above each threshold and not on the entire price which is unjust.

IPAV proposes the following rates and threshold replace those currently in use:

Up to €250,000	Nil
From €250,001 - €500,000	3%
From €500,001 - €1,000,000	5%
In excess of €1,000,001	6%

In addition, for non first-time buyers, the various thresholds should be indexed every year in line with projected house price inflation.

MORTGAGE INTEREST RELIEF

A doubling of mortgage interest relief for first-time buyers would help alleviate the financial distress caused by rising interest rates and rising house prices. Given that the benefits would be spread over a number of years, it would not result in acceleration in house price inflation. A commitment should also be given to index mortgage interest relief for all mortgage holders in line with projected house price inflation.

RENT A ROOM SCHEME

The introduction of the rent a room scheme is a very effective method of keeping costs down when a first home is purchased and it also facilitates the purchase of a bigger home than originally intended. It is a very positive scheme for cash strapped first-time buyers.

The tax exemption under this scheme should now be doubled to give further much needed financial assistance to first-time buyers.

ECONOMIC BACKGROUND TO BUDGET 2007

The economic background against which Budget 2007 will be presented is still very favourable. The Irish economy continues to perform strongly, despite higher oil prices and higher interest rates. In 2005, gross domestic product (GDP) expanded by 5.5% and gross national product (GNP) expanded by 5.3%. This was well ahead of the EU average and once again showed Ireland to be one of the fastest growing economies in the OECD. The main characteristics of the economic performance in 2005 were a strong contribution from consumer spending and gross domestic physical capital formation, with residential house building making a major contribution to the latter.

All available evidence suggests that the positive economic momentum has been maintained in 2006. Official data show that in the first half of the year GDP expanded at an annual rate of 5.3%, while GNP expanded by a very strong 7.9%. Clearly, the growth background remains very solid.

In the first half of 2006, consumer spending continued to be a major driver of growth, expanding at an annual rate of 6.5%. House building also remains very strong, with completions set to reach another record level. The export performance is reasonably solid, expanding by 5.9% in the first 6 months but imports expanded more strongly at a rate of 7.1%.

Inflationary pressures have intensified during 2006. The annual rate averaged 3.8% in the first 9 months of the year, up from an average rate of 2.5% in 2005.

The labour market is still performing very strongly. In the two-year period to the second quarter of 2006, the economy generated 180,800 jobs and the employment level exceeded 2 million for the first time. However, there is cause for some concern in relation to the types of jobs that are being created. In the two-year period, 63% of the jobs created were in the construction and public sectors. Jobs cannot continue to be created at the same rate in those sectors going forward. On the other hand, 12,100 jobs were lost in the manufacturing sector over the same period.

The public finances remain in a healthy state. The exchequer returns for the first nine months of the year show that the exchequer deficit stood at just €136 million, which compares to a deficit of €1,123 million in the equivalent period in 2005 and a budgeted deficit of €2,927 million for the full year. Tax revenues were €1,807 million ahead of target in the first three quarters of the year, with Capital Gains Tax, VAT, Stamp Duties and Corporation tax all well ahead of expectations. On the spending side, total expenditure is lower than projected, particularly on the capital side. For the full year, the exchequer financial position is likely to be close to €2.5 billion better than budget expectations. While the overall situation with the public finances is very good, the excessive reliance on housing related taxes is a source of vulnerability for the public finances.

The ECB has increased its base rate from 2% to 3.25% over the past year and is likely to tighten further in the face of an ongoing and sustainable economic recovery in the euro zone. The ECB could well take its base rate up to 4% by the end of 2007.

GDP growth of around 5.3% and GNP growth of close to 6% looks achievable for 2006 as a whole. Looking ahead to 2007, the prognosis remains positive. GDP growth of close to 5% looks achievable in 2007. Despite rising interest rates, a significantly higher cost of living in general and the high levels of personal indebtedness, consumer spending looks set to be the key driver of growth once again. Consumer spending should be supported by the maturing SSIA's, the bulk of which will expire in the first half of 2007, strong growth in incomes, a solid labour market background and an expansionary fiscal background. Manufacturing activity and manufacturing exports will remain under pressure from increased competition and an ongoing loss of cost competitiveness. Despite a likely easing of housing starts to around 80,000, construction activity will also remain an important driver of economic growth, with public infrastructure set to be a key ingredient.

The big issues for the Irish economy going forward will be the heavy reliance on the housing market, the quality of employment creation and the control of business costs, the pressures on the manufacturing base, the quality of public services and the delivery of a first-world physical infrastructure.

MACRO-FORECAST FOR IRELAND

<i>(Annual avg.)</i>	<i>2005</i>	<i>2006f</i>	<i>2007f</i>
GDP	5.5%	5.3%	4.9%
GNP	5.3%	6.0%	5.0%
Consumption	6.6%	6.5%	6.0%
Investment	12.5%	8.0%	6.0%
Exports	3.9%	4.5%	4.5%
Imports	6.5%	7.0%	6.0%
Inflation	2.5%	3.9%	3.5%
Unemployment	4.4%	4.4%	4.5%

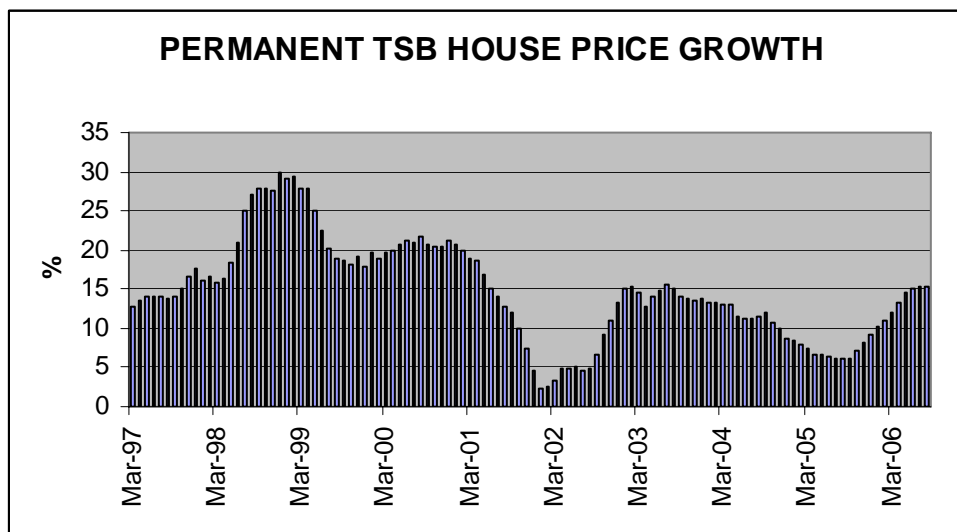
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THE CURRENT STATE OF THE HOUSING MARKET

Activity in the housing market remains very buoyant, with strong growth in mortgage credit, house prices and housing completions.

The latest house price data from Permanent Tsb show that national house prices increased by just 1% during August 2006, which was the third consecutive monthly decline in the growth rate. In the year to August, house prices nationally grew by 15.4%, which compares to an annual growth rate of 6.2% a year earlier. Prices increased by 10.2% in the first 5 months of the year, well ahead of the growth rate of just 4.4% in the equivalent period of 2005. While house prices are still growing strongly, there is emerging evidence from this particular data series that rising interest rates and strong housing supply are at last starting to dampen price growth.

Permanent Tsb estimates that the average price of a house nationally stood at €306,173 in August 2006, and in Dublin it stood at €412,877.



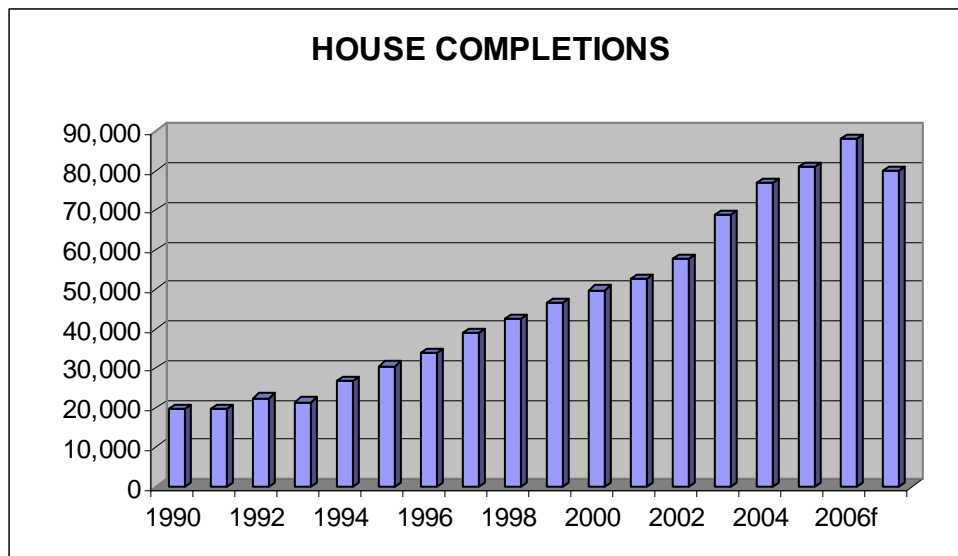
SOURCE: Permanent TSB

Demand for mortgage credit remains very strong. Taking account of securitizations and reclassifications of term loans to residential mortgages, starting in September 2005, the annual rate of growth for mortgages stood at 27.1% in August. This is down from a high of 28.1% in March.

In the first 8 months of 2006, mortgages adjusted for securitizations and reclassifications, jumped by €16.2 billion, compared to €12.5 billion in the equivalent period in 2005. Mortgage lending increased by €2 billion during August. Mortgage credit outstanding stood at €115.1 billion at the end of August, equivalent to around 65% of projected GDP in 2006.

Housing completions hit another record high of 80,957 in 2005. However, the true number of completions is closer to 86,000. At the end of 2005 there was a one-off backlog of 5,000 in applications for electricity connections for dwellings that were completed in 2005 but which were not connected until 2006. Accordingly, the completions total in the early months of 2006 would have been exaggerated as these houses completed in 2005 were connected in the first and second quarters of 2006 and became part of the 2006 completions total.

Figures from the Department of the Environment, Heritage & Local Government show that in the first 8 months of 2006, completions totaled 58,613. This represents an increase of 22.8% on the corresponding period in 2005. It now appears clear that completions in 2006 will be around 90,000. Such a total would mean that since 2000, over 425,000 houses will have been built in Ireland. The rate of house building currently stands at 21 per thousand of the population, compared to less than 5 in the EU.



SOURCE: Department of the Environment, Heritage & Local Government

Against a background of rising interest rates and strong housing supply, there is now some evidence emerging that the housing market is showing greater signs of stability, suggesting that the forces of demand and supply are now approaching a situation of equilibrium. This would be very desirable. House prices nationally are likely to increase by around 12% in 2006 and growth of around 5% looks likely in 2007. The housing market now appears to be on the way to achieving a soft landing. This would be the most desirable outcome because, given the inordinate dependence of the Irish economy on residential housing activity, a hard landing for the housing market would cause serious economic difficulties. Consequently, it is incumbent on policymakers to facilitate a soft landing for the market.

HOUSING RELATED ISSUES FOR BUDGET 2007

Residential housing market activity is now making a very significant contribution to the Irish economy through its direct and indirect employment creation, through its direct and indirect impact on tax revenues and through its wealth effect on consumer confidence and spending. Any significant downward correction to the market either in terms of completions or more importantly prices would have a very negative effect on the overall health and stability of the economy.

Any housing related measures in Budget 2007 should seek to alleviate the growing pressures on first-time buyers in particular and also to preserve the overall stability of the market.

FIRST-TIME BUYERS

While activity in the housing market remains very strong there are some grounds for caution. In the face of rising interest rates, affordability is starting to come under pressure, particularly for first-time buyers. Every 0.25% increase in mortgage rates adds around €15 to a €100,000 mortgage. The latest data from the Department of the Environment, Heritage & Local Government show that in the second quarter of 2006 the average mortgage nationally stood at almost €210,000.

The latest data on housing affordability from EBS/DKM does indicate that affordability is deteriorating. In October 2006, this index estimates that nationally, mortgage holders required 29.6% of net income to meet net mortgage repayments. This is up from 22.6% in July 2005. For first time buyers the percentage has increased from 19.8% to 26.2%, and in Dublin the percentage for first-time buyers has jumped from 29.2% to 38.4%. With interest rates set to rise further, housing affordability will continue to deteriorate.

There are a number of ways that the Government could alleviate the growing pressures on first time buyers.

STAMP DUTIES

First-time buyers are exempt from stamp duty on a new home which they will live in for 5 years and which is no greater than 125 square metres in size. In Budget 2005, first-time buyers purchasing a second-hand house to live in were made exempt from stamp duty up to a price of €317,500.

A 3% rate is applied to houses between €317,501 and €381,000. A 6% rate is applied to houses priced between €381,001 and €635,000, and a 9% rate is applied to houses priced above €635,000. Unfairly, for houses priced above €317,500, the various stamp duty rates are applied to the full price and not just the component above the exemption limit.

These stamp duties place an enormous burden on first-time buyers who are already struggling with the high price of houses and the consequent size of the mortgage. They cannot borrow on their mortgage to pay the stamp duty bill, so it imposes a major financial burden on them. The problems are particularly pronounced in areas where house prices are particularly high, such as in Dublin.

AVERAGE HOUSE PRICES

Q2 2006	NEW- HOUSE PRICE	SECOND-HAND HOUSE PRICE
WHOLE COUNTRY	€308,302	€379,011
DUBLIN	€397,337	€516,589
CORK	€314,696	€368,016
GALWAY	€279,059	€329,369
LIMERICK	€298,878	€255,352
WATERFORD	€271,284	€284,724
OTHER AREAS	€277,465	€291,376

SOURCE: Department of the Environment, Heritage & Local Government

Radical changes are necessary in this stamp duty regime.

Stamp duties for first-time buyers should be abolished altogether. The stamp duty regime is distorting the purchasers' house buying decisions and is forcing them to buy smaller houses and in locations that necessitate a socially damaging and expensive commute.

From a cost point of view, such a move would be easily financed in an environment where the exchequer finances are in such a strong position. It is estimated that €945 million is taken in by the Department of Finance on stamp duties relating to residential housing transactions. First-time buyers account for around €70 million of this tax take. The €70 million paid by first-time buyers is insignificant in the context of total tax revenues, but is a very significant amount of money for first-time buyers.

For non-first time buyers, the various thresholds should be indexed every year in line with projected house price inflation.

The proposed measures would help first-time buyers get on the housing ladder and would alleviate some financial pressures. Furthermore, first-time buyers would get greater access to the second hand market. This would alleviate some of the commuting problems for first-time buyers.

One of the dangers in any changes to the stamp duty regime is that it could just add to house price inflation, thereby offsetting the benefits of the stamp duty change. The risks of this happening at this juncture are lessening as the market appears to be approaching supply-demand equilibrium and there is now greater purchaser price resistance in evidence than for quite some time.

ENCOURAGING GREATER MOBILITY

A properly functioning housing and rental market is essential for mobility of labour. Labour mobility is in turn essential for balanced regional economic development. Availability of rental property and greater housing turnover are essential to encourage workers to move around for work, either within or between countries. Research has shown that workers will become more mobile if there is a supply of affordable rental properties and if housing transaction costs are moderate. The current Irish stamp duty regime is penal and acts as a serious disincentive to turnover of housing. The reduction in Capital Gains Tax from 40% to 20% increased the turnover of capital assets, improved economic efficiency and resulted in a higher tax take under this heading. An across the board reduction in stamp duties on residential property could have a similar effect, by leading to older people trading down and freeing up larger properties for younger families. The current stamp duty regime acts as a major disincentive to trading down and consequently undermines mobility.

The increased activity resulting from a restructuring of the stamp duty regime should ensure that the tax take would be maintained and, if carefully chosen, a lower rate of stamp duties could actually result in an increased tax take.

IPAV proposes the following rates and threshold replace those currently in use:

Up to €250,000	Nil
From €250,001 - €500,000	3%
From €500,001 - €1,000,000	5%
In excess of €1,000,001	6%

In addition, for non first-time buyers, the various thresholds should be indexed every year in line with projected house price inflation.

MORTGAGE INTEREST RELIEF

For financially stretched first-time buyers the mortgage interest relief regime is not adequate.

At the moment the maximum amount of interest allowable at the standard tax rate for a single first-time buyer is €4,000 and €8,000 for a married couple. Consequently, it is possible for a single first-time buyer to get relief up to a maximum of €66.66 per month (€133.33 for a couple), which works out at a maximum of €800 per year for a single first-time buyer for the first 7 years of the mortgage. Thereafter the annual saving falls back to €508 euro. Given the size and increased burden of mortgages for first-time buyers, this relief is totally inadequate.

A doubling of mortgage interest relief for first-time buyers would help alleviate the financial distress caused by rising interest rates and rising house prices. Given that the benefits would be spread over a number of years, it would not result in acceleration in house price inflation. A commitment should also be given to index mortgage interest relief for all mortgage holders in line with projected house price inflation.

RENT A ROOM SCHEME

Where a room in a person's principal private residence is let as residential accommodation, gross annual income of up to €7,620 is exempt from tax and does not affect an individual's entitlement to mortgage interest relief or Capital Gains Tax exemption for a principal private residence.

The introduction of the rent a room scheme is a very effective method of keeping costs down when a first home is purchased and also facilitates the purchase of a bigger home than originally intended. It is a very positive scheme for cash strapped first-time buyers.

The tax exemption under this scheme should now be doubled to give further much needed financial assistance to first-time buyers.