2014 Pre-Budget Submission

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OBJECTIVE OF PRE-BUDGET SUBMISSION

A properly functioning mortgage and housing market is an essential ingredient for a properly functioning economy and a stable society. It is essential that those who want to purchase a home and have the earnings capacity to do so should have access to a functioning and competitive mortgage market in order to buy a home. It is also essential that the housing market is functioning properly – meaning that there should be an adequate supply of suitable housing that would facilitate those who want to trade up to a bigger house and those who want to trade down to a smaller house are able to do so. It is also important that there is an adequate supply of good quality rental properties for those who do not want to buy.

At the moment, the mortgage and housing markets are not functioning properly and this is preventing many of those who want to purchase a home from doing so. From a social and economic perspective, this is not a good situation and it would be very beneficial to rectify it.

The objective of this pre-budget submission is to identify measures that could be considered by the Minister for Finance in Budget 2014 that would go some way towards getting the market functioning properly and ensuring that there is an adequate supply of housing in areas where there is a demand from purchasers or from those who want to rent.

The benefits of achieving these objectives would be numerous – families would be able to move to homes suitable for the family size; greater labour market mobility would be facilitated; employment would be created in construction and refurbishment activities; valuable revenues would be raised for the Exchequer; and some alleviation of the excess supply problem could be achieved in some parts of the country.

There is no silver-bullet solution that would solve all of the problems in the market, but there are measures available that could make a contribution towards ensuring a better market.

This submission sets out the current status of the housing, mortgage and rental markets and suggests a number of policy proposals that could make some contribution towards getting the market functioning more efficiently in the short-term and making the market more sustainable in the longer-term

THE CURRENT STATUS OF THE HOUSING MARKET

After a dramatic collapse in all aspects of the housing market from 2007 onwards, some evidence of a stabilisation and recovery in the market has started to emerge, both in terms of residential house building activity, prices and rents.

- In the first half of 2013, housing completions totalled 3,700, which is 5.8 per cent lower than the first half of 2012. However, this is the lowest rate of decline in more than 5 years.

- The housing completions number is a backward looking indicator, but leading indicators of future housing activity are also suggesting some modest recovery in the market. Residential housing planning permissions at 2,308 in the first quarter of this year were 70.3 per cent higher than a year ago; new home registrations at 627 in the first half of the year were 85 per cent higher than the first half of last year; and new home commencements in the first half of the year at 1,665 were marginally ahead of last year.

- During July, national average house prices increased by 1.2 per cent and were 2.3 per cent higher than a year ago. Average house prices nationally have increased every month since April, which does represent a significant change in trend. The main growth is being experienced in Dublin, where prices increased by 3.3 per cent in July, and were 8 per cent higher than a year ago. House prices in Dublin have increased by 5.8 per cent since March. Outside of Dublin the story is not as strong. Prices actually declined by 0.1 per cent during July, and are still 1.5 per cent lower than a year ago. It is important to recognise that the number of market transactions is still very low and in such a thin and illiquid market, price movements can be exaggerated.

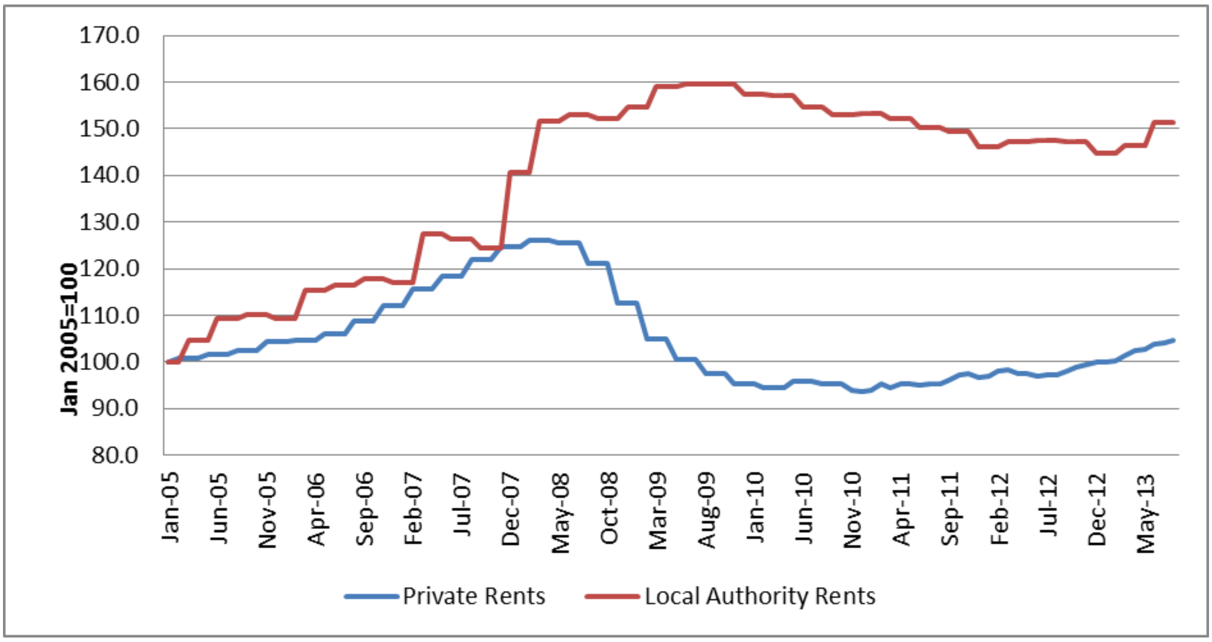
- In discussing the national housing market, it is not sensible to talk of one market. Rather, the national market is characterised by many local markets that have very different characteristics, not least the supply of finished but vacant properties, and of course unfinished properties. Looking ahead, it is clear that the outlook for the various micro-markets is uncertain but is also likely to be very varied across the country.

- At the local level, issues such as housing supply and the health of the local economy will clearly be important influencers. However, there are also important macro factors at the national level. These include the overall health of the Irish economy and particularly the labour market; the impact that the Local Property Tax might have on monthly affordability and the price that potential buyers are willing to pay; and most importantly the availability of mortgage credit; and the cost of that credit. The interest rates paid by borrowers, excluding those on fixed or tracker mortgages, is not closely related to what the European Central Bank (ECB) might do with official interest rates as the financial institutions are still intent on pushing up mortgage rates where possible in an effort to rebuild margins and profitability and subsidise the loss-making Tracker Mortgage book.

- It is still too early to conclude that the overall market has turned the corner in a sustained way, but there are small pockets of the market where demand will be strong, supply limited and prices are consequently set to rise strongly.

- It is important to remember that all of these improvements are coming off an extremely low base, but from an economic perspective, it is positive for the overall economy to see some life returning to the sector as it is a pre-requisite for an improvement in consumer sentiment and willingness to spend. Furthermore a recovery in the housing market would boost employment, consumer spending and make a significant contribution to Exchequer revenues.

Figure 1: Trend in Rents



Source: CSO, CPI Detailed Sub-Indices

- The Rental market is also starting to show signs of growth. The latest Daft.ie National Rental Index shows that in the second quarter of 2013, rents nationally were 4.5 per cent higher than a year earlier. In Dublin, rents expanded by 7.5 per cent on average and rents increased by 0.9 per cent on average outside of Dublin. The CSO rent index contained in the Consumer Price Index shows that in August, private rents showed year-on-year growth of 7.5 per cent. From the bottom of the market at the end of 2010 to August 2013, private rents have expanded by 11.5 per cent.

- The latest rent index from the Private Residential Tenancies Board (PRTB), which is regarded as the most accurate and authoritative rent report on private accommodation sector in Ireland, shows that national rents increased by 1.3 per cent during the second quarter of 2013 and by 0.7 per cent compared to the second quarter of 2012. In Dublin, rents increased by 3.5 per cent during the quarter and by 4.7 per cent compared to the second quarter of 2012. Outside of Dublin, rents declined by 0.3 per cent and by 1.3 per cent on an annual basis. It is clear from this index that rents in Dublin are starting to grow strongly, mainly reflecting a lack of suitable rental properties. This is a cause of concern and should become a key focus of policy towards the overall housing market in Dublin in particular.

THE CURRENT STATUS OF THE MORTGAGE MARKET

In both value and volume terms, the mortgage market has experienced a precipitous decline since 2006.

Table 1 shows the breakdown and trend in new mortgage lending since 2005. Between 2006 and 2011, the value of the market declined by 93.8 per cent.

Table 1: **Value of New Lending in Mortgage Market**

(€m)	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**H1 2013**
First Time	7,717	8,448	7,250	4,833	2,671	2,037	1,100	1,351	382
Mover	10,359	11,368	8,687	5,572	2,355	1,539	916	1,032	386
Investor	6,283	7,950	6,512	4,096	798	216	78	84	23
Re-Mortgage	5,038	6,067	6,675	5,295	1,129	461	174	64	22
Top-Up	4,717	6,039	4,684	3,253	1,123	493	195	105	36
Total	**34,114**	**39,872**	**33,808**	**23,049**	**8,076**	**4,746**	**2,463**	**2,636**	**849**

Source: IBF

Table 2 shows the number of new mortgage loans granted between 2005 and the first half of 2013. The number of mortgages paid down declined by 93 per cent between 2006 and 2011.

Table 2: **Number of Residential Mortgage Loans**

(€m)	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**H1 2013**
First Time	37,879	37,064	30,469	19,946	12,684	10,619	6,300	8,648	2,528
Mover	46,760	45,585	32,864	20,444	9,395	6,533	4,241	4,921	1,922
Investor	25,856	28,141	20,861	13,226	3,018	1,161	509	591	210
Re-Mortgage	25,944	26,565	25,937	21,374	5,774	2,722	1,137	455	131
Top-Up	64,821	66,598	47,967	35,315	14,947	6,631	2,005	1,266	506
Total	**201,260**	**203,953**	**158,098**	**110,305**	**45,818**	**27,666**	**14,192**	**15,881**	**5,297**

Source: IBF

- The weakness in mortgage lending has carried over to 2013.Mortgage lending expanded strongly in the final quarter of 2012. A total of €999 million was lent during the quarter, which represents strong lending relative to what has been seen over the past three years. The mortgage market totalled €2.64 billion for the full year, which represents an increase of 7 per cent on 2011. Much of this growth was spurred by the ending of mortgage interest relief at the end of 2012, and lending has weakened in the first half of 2013. €849 million was lent in the first half, which is 12.8 per cent lower than the first half of 2012. In numerical terms, 5,297 mortgages were drawn down, which is a decline of 9.5 per cent on the first half of 2012. In numerical terms, 5297 mortgages were drawn down, which is a decline of 9.5 per cent on the first half of 2012.

- The foregoing data applies to mortgages that are actually paid down by the mortgage lenders in the Irish market. The IBF also publishes a Mortgage Approvals Report. In July the number of mortgage approvals for house purchase at 1,734, was 15.1 per cent higher than July 2012.

- The IBF Housing Market Monitor for Q2 2013 shows that in Q2 2013 the national residential property price index showed its first year-on-year increase since Q4 2007, with a 1.2 per cent increase.

- The mortgage arrears situation continues to deteriorate. At the end of June 2013, there were 770,610 private residential mortgages outstanding in the Irish market, with outstanding balances of €109.1 billion. There were 148,529 buy-to-let mortgages with outstanding balances of €30.6 billion. At the end of June, 97,874 private residential mortgages were in arrears for over 90 days (12.7 per cent of the total), with outstanding balances of €18.6 billion. In addition, 30,326 buy to let mortgages were in arrears for more than 90 days (20.4 per cent of the total) with outstanding balances of 8.7 billion. At the end of June, 79,357 mortgages were classified as re-structured, with 76.5 per cent of those deemed to be meeting the new terms. This represents a major challenge for the banking system over the next couple of years.

- The mortgage market is still very weak and quite dysfunctional. Given the pressure on the banking sector to reduce the loan to deposit ratio; re-build profitability; reduce costs; address the serious level of mortgage arrears; and ensure adequate levels of prudential capital, it will take a long time to restore a functioning mortgage market that will satisfy the demand for housing finance, particularly from first-time buyers.

BUDGET 2014 AND THE HOUSING & MORTGAGE MARKET

It is clear from the foregoing analysis, that while the housing market has bottomed out and is showing modest signs of improvement in both price terms and activity terms, the market remains very weak and is coming off a very low base. Likewise, while the mortgage market is showing very modest signs of improvement, it is still operating at very low levels.

A properly functioning housing market where supply is broadly in balance with demand; where there is adequate mobility between different types of housing units; and where there is a high quality and affordable rental market, is essential from an economic and from a social perspective.

A properly functioning mortgage market, where aspiring home buyers who have sufficient earnings capability can get a mortgage of sufficient size is socially and economically desirable.

There are currently many blockages in the housing and mortgage market. If left to its own devices the market would not correct itself at a sufficient pace. Hence the following measures are suggested in order to seek to eradicate the blockages in the market and get it functioning more efficiently.

CREATION OF A MORTGAGE INSURANCE MODEL

Mortgage lenders are under significant pressure to re-build profitability, reduce the size of the balance sheet and hold adequate levels of prudential capital. High Loan to Value (LTV) mortgages are much more expensive from a bank's perspective, because they are more risky and consequently the banks are forced to hold higher levels of expensive capital.

Hence there is no incentive for lenders to engage in high LTV lending, but such lending is necessary for worthy borrowers, particularly those who have strong earnings capacity, but cannot get a sufficient deposit together. This is particularly the case for first-time buyers.

The creation of a universal mortgage insurance model would impose a mandatory requirement for all lenders providing high LTV mortgages and enable those financial institutions insure the portion of the high LTV mortgage above a certain level, such as 75 per cent. This would mean that the financial institution would not have to hold expensive capital and thereby would be in a position to offer lower interest rates to borrowers.

Under such a model, the insurer would have an external role in assessing the mortgage credit, thereby creating better oversight; lenders would not have to hold expensive prudential capital and could offer lower interest costs; higher lending standards would be enforced through the higher level of oversight; the solvency of the financial system would be helped through greater risk diversification; and most importantly first-time buyers in particular would be helped on to the housing ladder, which is important from a social cohesion perspective.

The universal mortgage insurance model operates successfully in many countries across Europe and helps ensure a more prudent, stable and liquid housing and mortgage market. In the UK earlier year, the Government introduced a 'Help to Buy' scheme. The UK Government directly insures lenders for the risk in that part of the mortgage between 80-95 per cent LTV, with lenders retaining a maximum of 0.75 per cent exposure on the loan. This has to date proved very successful in reinvigorating the UK housing market. However, the UK government is carrying some of the risk. With the proposed Universal Mortgage Insurance Model, this would not be the case.

MORTGAGE RECONCILIATION PLEDGE

The US approach to the financial crisis in the aftermath of the collapse of Lehman Brothers was the speed and decisiveness of the response. This approach stands out in marked contrast to the much slower approach that has characterised the Euro Zone response. That is particularly the case here in Ireland, where we are still talking about the crisis and are still far from an acceptable solution. The Troika has recently specified that Irish banks would have to finalise arrangements with 25 per cent of distressed mortgage borrowers by the end of March 2014. Finalisation could mean that loans will have to be either modified so that distressed borrowers will face new lower repayments, or enter a resolution process, which could involve sale of the home to trade down or face repossession.

Mortgage lenders should pledge to make sure that for every three mortgages that have been resolved, one new mortgage should be granted. The whole focus of mortgage lenders cannot be just about finding final resolutions to problem mortgages, binding commitments must be given on new lending.

RELEASE NAMA SITES FOR DEVELOPMENT

NAMA is now in possession of many sites with development potential all around the country. Some of these sites are in areas where housing and rental shortages are now starting to become very apparent. Dublin is the most obvious example at the moment. A mechanism should be established to hand the sites over to 'solid' developers in order to have them developed quickly to satisfy home ownership and rental requirements.

DEVELOPMENT OF CITY CENTRE SITES

Incentives should be considered to get city centre sites developed as quickly as possible in order to address the emerging shortage of supply in both the owner-occupier and rental markets. Penalties should be considered for those who do not move to develop.

UNDERMINE THE INFORMAL ECONOMY IN THE CONSTRUCTION SECTOR

Tax credits of up to €25,000 should be made available for refurbishment of housing to improve the physical quality of the housing stock and improve the energy efficient. To avail of these credits, the home owner will have to certify that the builder is fully legitimate and in the formal economy.

CREATION OF A PROPERTY COUNCIL

The property and construction sector is in a state of turmoil at the moment. Serious damage has been done to the sector since 2008, but it is clear that a properly functioning economy will require a vibrant, highly skilled and efficient property and construction sector in the future. There will be a requirement to build houses for home owners and for those who want to rent, hospitals, schools, roads, offices, industrial units in the future, and refurbishment of the existing stock of public and private infrastructure will be essential on an on-going basis.

IPAV would like to see the setting up of a dedicated Property Council to oversee the future of the property industry in Ireland. The Council would be made up of experts from a variety of different fields within the sector. It would seek to formalise a plan to address issues such as planning, density levels, building standards, demand and supply, the rental market and so on. Such a Council would formalise a sector that has been too informal in the past.

CONCLUSIONS

None of the above measures would in themselves be sufficient to solve all of the problems that currently characterise the sector. However, they would contribute to making the sector function more efficiently in the short-term and more sustainable in the long-term.

Housing activity has a very significant impact on the overall economy. House building generates employment; sales of material for house building; sales of furniture & fittings; tax revenues for the Exchequer; and indirect employment.

It is worth considering the impact that 10,000 extra housing transactions could have on the overall economy and the public finances. This would of course depend on whether the transactions involved new or second hand housing.

Scenario 1: 10,000 Extra New Homes

- The construction of 10,000 new houses would generate 21,000 jobs in the economy during the construction phase;
- The 21,000 jobs would contribute €697 million to the Exchequer in the form of employment taxes and lower social welfare payments;
- Assuming an average house price of €200,000, the Exchequer would collect an extra €238 million in VAT revenue from the completion of 10,000 new houses. Stamp duties would also contribute €20 million. Development Levies could result in revenues of up to €120 million for local authorities.

Scenario 2: 10,000 Extra Mortgages for Second-Hand Homes

- 1% Stamp duty on housing transactions up to €1 million. The sale of an extra 10,000 second-hand houses would result in an extra €20 million for the Exchequer.

Houses that are completed but where the electricity has not been collected have a VAT liability. The VAT is paid over to government when the house is sold. Hence the sale of a house that is built but not yet sold would result in the significant VAT contribution to the Exchequer.

The sale of a house whether new or second-hand would also make a significant contribution to the broader economy through refurbishment; painting & decorating and fitting out.

From a social perspective, a recovery in housing activity would be very important, but the economic and financial benefits would also be very significant.