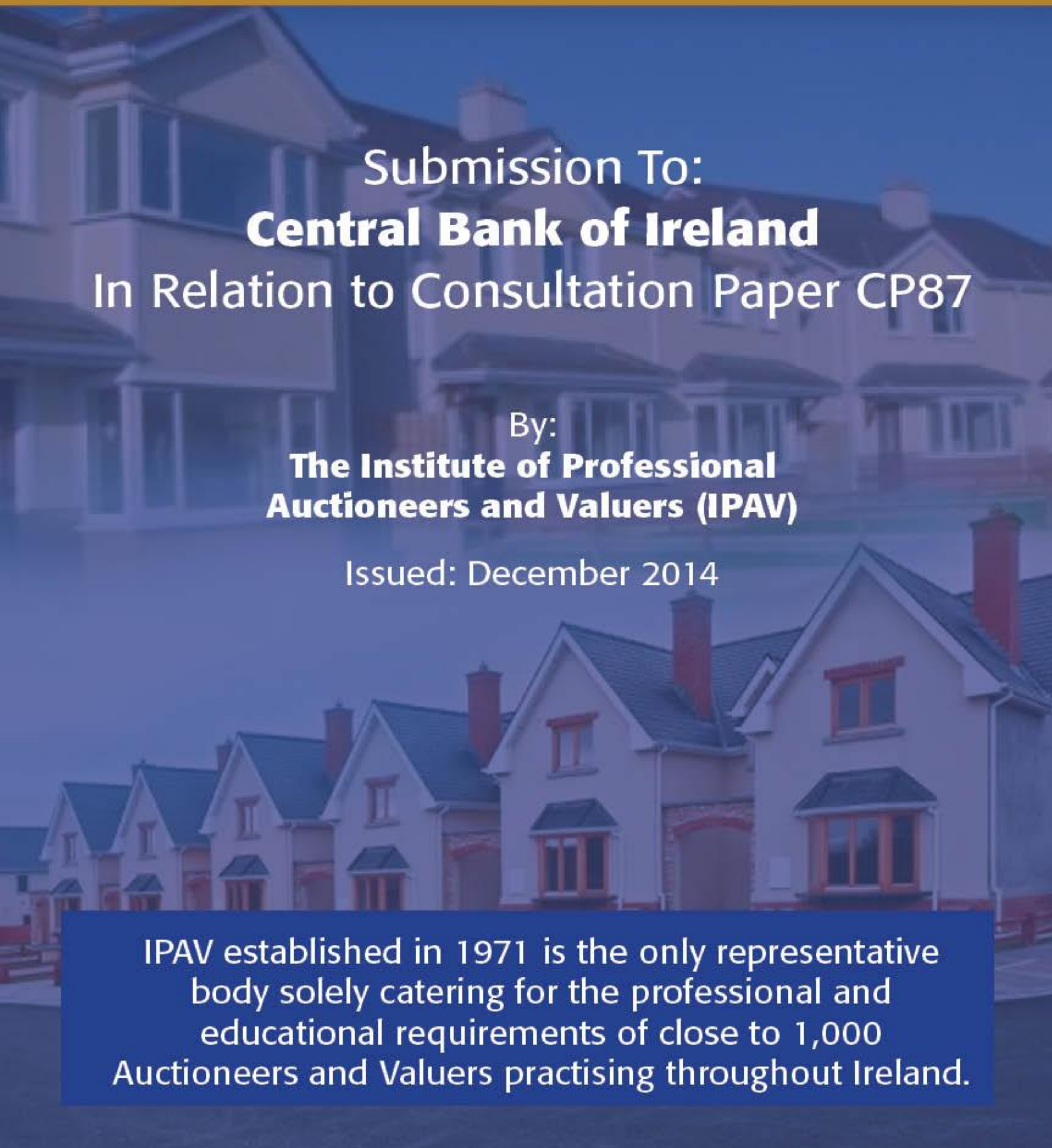
ipav Institute of Professional Auctioneers & Valuers



Submission To:
Central Bank of Ireland
In Relation to Consultation Paper CP87

By:

The Institute of Professional Auctioneers and Valuers (IPAV)

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IPAV established in 1971 is the only representative body solely catering for the professional and educational requirements of close to 1,000 Auctioneers and Valuers practising throughout Ireland.

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1. Foreword

Mr Patrick Honohan
Director
Central Bank of Ireland
Dublin 2

Re: Macro Prudential Policy for Residential Mortgage Lending
Consultation Paper CP78

Dear Mr Honohan

Further to the above consultation paper and the announcement of the details of same, I wish to make the following observation on behalf of IPAV (The Institute of Professional Auctioneers and Valuers) who are the only Professional Institute solely catering for the professional, disciplinary and educational requirements of close to 1,000 Auctioneers throughout Ireland.

IPAV believe that the proposal of limiting LTV to 80% at this very early stage in the life of the resurged property market to be a misguided one, likely to have severe unintended consequences. The property market in Ireland is, as IPAV call it, “an imaginary one”, at a very delicate stage and in its infancy of recovery. Recent figures show property prices have gone up by 40-45% in the city of Dublin in the past two years. Despite much public commentary to the contrary this is still not a big increase , since property prices have fallen by at least 60% between 2006 and 2012 and to return to 2006 levels, prices would have to increase by a minimum of 120%. IPAV Auctioneers want to see a steady sustainable property market without these highs and lows and an independent market that is able to stand on its own feet in times of prosperity and hardship. We believe what we are seeing at the moment is a property spike and not a property bubble.

Nobody better than Auctioneers know the property prices of 2006 were too expensive and unsustainable. When prices fall so dramatically, and then start to recover, all markets will not recover to the same strength or at the same time, due to supply and demand in any one area.

A large number of the sales in the past two years transacted by anything from 50 - 100% with own cash. We see the emergence of many different local property markets throughout the country. Practically in every major town there are varying prices throughout different parts of the town. There is still an overhang of properties from the Celtic tiger years and until these properties are all sold, there will be no new properties built as they are being sold below cost. The Country market has picked up very slowly, way behind the major cities, which is to be expected. In theses areas we are witnessing price increases of 15 - 25%. Again these price increases are still nowhere near the level where builders are attracted to build new properties to fulfil a demand from first time buyers (FTB) in particular.

Your proposed Loan-to-Value (LTV) measure would stagnate the building of new properties in the country at a time when the property market is undergoing a very delicate resurgence, when what is really needed is;

A) **Government action of making development finance available to developers to build more stock; and**

B) **Bring an end to NAMA and other Financial Institutions selling blocks of apartments to large International funds. These same international funds I would say, are rubbing their hands together, wishing the CBI would make prospective buyers require not alone a 20% but a 30% deposit as it would result in fewer buyers and more renters, facilitating them in raising rents by probably another 22% as has happened in the past 2 months.**

When official figures emerge for the September to December period of this year we are confident they will show a drop back in the numbers of would be purchasers. We believe property prices in the City of Dublin are stabilising and we further believe figures will ultimately show that the deadline of 31st December 2014 for the ending of the 7 year CGT incentive by Government will have had a discernible impact.

The CBI proposed intervention will see the first time buyer's market impacted in a major way, many will simply be unable to come up with the 20% deposit required to purchase a property. Someone buying a starter house in Dublin City for €250,000 to €300,000 would have to come up with €50,000 to €60,000. This is achievable for those from wealthy backgrounds whose parents can support them but not all first time buyers are in this fortunate position. Those who cannot get their hands on such a deposit will be at a disadvantage. They may try to borrow from other sources, putting themselves under serious financial pressure.

IPAV believe these proposals will have the following effect;

1. Builders who typically build FTB homes will not build properties if FTB are not able to purchase them. Among this grouping, from conversing with IPAV members throughout Ireland, the most in demand property are three to four bedroom family private houses. If builders cannot make a profit building such properties, the flow of new houses we all hoped for will simply not happen.

2. If FTB's cannot save the required deposit to obtain a mortgage, they will be forced into, or continue life as a tenant as opposed to a home owner. This will push the price of rental properties even further, creating a false rental market and making it more difficult for would be long term tenants who prefer to rent.

3. Make it virtually impossible for prospective FTBs currently renting to save sufficient money for a 20% deposit.

In England, HM Treasury: The Financial Services Bill: the Financial Policy Committee's macro-prudential tools section 5 relating to LTV and LTI states:

Loan To Value and Loan To Income Ratios

5.9 The interim FPC's statement following its March 2012 meeting recognised the potential benefit in having a direction power to set maximum LTV/LTI ratios but stated that the Committee feels that it would require a mandate from Parliament, following a thorough public discussion, before asking for a direction power over a tool with such ramifications for individuals and businesses.

5.10 The Government notes that other countries' experiences of tightening mortgage terms and conditions (including setting maximum LTV/LTI ratios) suggest this had been a somewhat effective way to limit financial instability. However, this tool has rarely been implemented in isolation from other measures, such as mortgage insurance. The Government also notes that this type of requirement can prevent borrowers who would otherwise be considered creditworthy from receiving mortgage financing.

Norway seems to be the most talked about example of LTV's in Europe, where property prices in Norway fell from 1988 to 1993, by 33%. Some of the first discussion of a 90% LTV was introduced by a new Government in March 2010, Since then, the Central Bank have further introduced an 85% LTV in December 2011. (IMF-Macro-Prudential rules) This strategy operates in a property market with enormous house price appreciation. Even in such a market the introduction of LTV was on a measured and eased basis, not as a dramatic and blunt instrument.

Homeownership in Norway stands at over 80%. In the age group 30-34 year-olds; 74% own their own home. In the group 25-29 year-olds; 52% and even in the age group 20-24 year-olds 19% are homeowners (source: NIBR). According to the latest review of bank lending practises from 2013 (see Finanstilsynet, in Norwegian), the loan-to-value ratio exceeds 85% in 35% of mortgages to under 35 year-olds. In 12% of the youth's mortgages, the loan-to-value ratio exceeds 100%. IPAV are not sure what other facts and statistics the CBI are looking at to demonstrate the importance of the Norwegian market and the similarities of it to the Irish property market. There is one certainty, the Irish Property market post financial crisis has not experienced prolonged and sustained increases of the magnitude of those in Norway.

This proposed policy change is in complete isolation of the property market. IPAV believe, unfortunately, that a free property market is not reality and hence have been calling on the Government for the past number of years to set up a Property Council, so all stakeholders can join in and give their views on measures affecting the property market.

This proposed CBI intervention in the property market will affect young FTB's with the most productive decades of their lives right in front of them. They will pay the price for these actions now and in future years. IPAV believes these proposals, if implemented, will create inequality by leaving those without large savings and/or financial help from parents dependent on the rental market. We further believe one is always better off owning a property rather than renting long-term. As a nation young people should be helped to enter the market as early as possible, inculcating responsible financial planning and taking ownership of their financial futures with one, an important one, of the investment tools available to any citizen in a modern democracy – provided the State through its overall policy facilitates the development of a sustainable property market.

Stefan Gerlach, Deputy governor of CBI has said "These proposals were not designed to limit or steer house prices" but added that that is a likely side effect. Hence, it is safe to say that CBI is aware of the potential impact of such an intervention in the property market. If CBI wants to make the banks more compliant, there are many other ways in which to do this. Mortgage interest rates in Ireland are amongst the highest in Europe. : Irish banks are borrowing money from the European Central Bank at 0.15% and charging between 4% and 5% to Irish consumers. We believe this practice to be altogether wrong. The CBI holds that it would like to wait for European competition to come into the market to sort out, what is, in effect, morally wrong. Imposing a 80% LTV will, in one fell swoop, stymie international competition in the Irish market. It will leave Irish consumers exposed to what could be considered a banking cartel where, while different product offerings give the visage of competitiveness, in reality they are merely slightly different formulae for skinning the captured cat.

The CBI as regulator of the Irish Banks should not wait any longer, Irish banks should be made to charge a fair and equitable rate for borrowing and give Irish consumers an opportunity to get long term loans at the equivalent of what is available in other European countries like Germany where a 20 year fixed loan is available for 2.5% or 2% fixed for 5 years in the UK. Carrots offered by banks to new mortgage participants, like free house insurance, free stamp duty, free valuation reports should stop immediately. If Banks were compelled by the regulator to charge fair and equitable interest rates to Irish borrowers they could not afford such nonsensical carrots.

The following is a presentation of IPAV views and proposals for the property market.

We would be delighted to meet with the CBI to elaborate further

and contribute to the current seminal debate, the policy outcome of which is likely to transform the shape of how current and upcoming generations live their lives in this country.

Yours sincerely

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Pat Davitt FIPAV REV MCEI

CEO, IPAV

2. The Context of the Housing Market:

- The escalation in house prices seen in the decade up to 2007 was dramatic but was not desirable. As house prices rise, larger mortgages have to be taken out, and this in turn fuels wage demands as mortgage holders seek to sustain the affordability of the mortgage. This has the effect of undermining the cost competitiveness of the economy; it undermines internal mobility; and undermines internal migration into the country.

- Over the past 10 years property prices have seen very large highs and lows, some years showing massive increase and decrease swings. A properly functioning mortgage and housing market should not see such swings and it 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 earning 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. Such mobility is an essential part of a properly functioning labor market and economy. It is also important that there is an adequate supply of good quality rental properties for those who do not want to buy.

- The Irish property market is currently between cycles. It is exiting from the recession of the past six years and beginning to grow again. However, due to large hangover of houses and unfinished estates, many of which are now controlled by NAMA, we are currently in what could best be described as an “Imaginary Property Market”. This is made up of a spike in the Dublin property market where property is scarce and low prices in the country where there is a surplus of property in many towns and counties. A recent ESRI report showed that six counties will not need any new houses in the period to 2021 if all vacant properties were in locations that matched the projection population growth. Of course this is not the case. What is clear is that in order for a proper functioning market to be restored, there must be a clear-out as quickly as possible of NAMA and other Financial Institutions houses either by sale, rent or demolition in some cases. Until the sale price of houses matches the cost of building we will continue to be in an “Imaginary property market”.

3. The Macro Picture:

All recent data releases are suggesting that the Property and Construction sector is experiencing an improvement. IPAV believe that this price increase is not another property bubble but a spike in the price of houses caused mainly by:

1) The shortage of property in the city and especially in the South side of the city where there are more services mainly like transport hence greater demand for that area.

2) The emergence of International investors to purchase properties with cash, as they feel the property market in Dublin was oversold.

3) There were practically no properties built in Dublin within in the last 7 years.

4) Property prices were talked down by every commentator, hence the market was oversold and prices reduced dramatically.

5) The employment growth in Dublin city, resulting in the need for people to work and live in the city and commutable area.

6) Properties selling below the cost of building.

7) The availability and now the ending of the 7 year GGT allowances by the Government.

8) The proposed introduction of an 80% LTV by the Central Bank.

According to CSO data, which is based on houses that have sold and on which a mortgage has been granted, national average property prices have increased by 16.3 per cent in the year to October 2014. Outside of Dublin, property prices have increased by 8.3 per cent in the year to October.

- According to IPAV agents research Dublin house prices are now an average of 45 per cent off the lows of 2012 and Country house prices are now 25 per cent off the lows of 2012.

3. Cont. The Macro Picture:

In interpreting all of these price statistics, it is important to recognise that the number of market transactions in Dublin are still very low at approx. 1% representing approx. 4,200 units and in such a thin and illiquid market, price movements can be exaggerated. A normal operating market should expect to trade up to 3/4% of its stock in any one year.

- Furthermore, the CSO house price index only captures housing transactions that have an associated mortgage transaction attaching. It is estimated that over 50 per cent of housing transactions over the past couple of years have been cash based rather than mortgage based.

- Notwithstanding these caveats, it is clear that activity levels and prices are picking up. There is considerable demand after some years of stagnation, and there is not enough supply to meet that demand.

4. The Micro Picture:

- Over the past two year IPAV have carried out a number of property surveys throughout its national membership base which point to increasing prices in the country as well as in the city of Dublin though not as dramatic. Building has almost stopped countrywide with the exception of one off housing and it is unlikely to start again until all the back stock is cleared and builders and the market can charge the price it costs to build. This will mean an immediate price increase for country properties to bring them to the building level per sq foot that encourages a builder to start building again. There are many property markets outside of the capital, even in small towns you may have a two tier property system with properties on the East side more valuable that ones on the West side of the town. This is repeated throughout the country. In some areas of Dublin, house prices have shot up by as much as 45%. IPAV has also interviewed a FTB who has set alerts on the major property websites like Daft, OnView and Myhome and have found a noticeable change in property prices and expectations since September of 2014. Some of these alerts have shown that the AMV's have been reduced to sell the properties and also that some properties are still for sale.

- IPAV believes from our members there has been a slowing of the property market since September 2014 and without the 7 year CGT scheme we feel property prices would actually show same at year end a 15 to 18% increase and not the 24% that's estimated. All one has to do to find evidence of this is the first ever two day auction by AllsopSpace in early December 2014 with almost 300 properties and a 57Mill price tag.

- Commentators are now talking up property prices but IPAV believes the only real way property prices can be gauged is through agents who are actually selling properties on the ground. Figures from property web portals are only AMV's, CSO are linked to mortgages, the PRSA property price register is itself hard to match up figures as there is very little information on same, and commentators are normally months behind what is actually happening on the ground.

5. House/Building Growth:

- It is clear that house building activity levels especially in Dublin have increased somewhat even if it's a small amount.

- The national policy imperative is to take measures to re-establish a functioning property market where there is an adequate supply of suitable affordable residential properties for both rental and owner-occupier demand.

- To achieve this, it will be necessary to re-build a sector that has been decimated and stripped of a vital skills base.

- In this context the 2012 publication of the Forfais report on Irelands 'Construction Sector' and noting its 36 findings, that are all sensible (but nothing has happened since its launch), and *Construction 2020,* both should be given a guarded welcome. The Construction 2020 report contains 75 action points for the sector; some are quite vague and aspirational, others are short-term and very political in their slant, but many of them make perfect sense if one really does believe that we should re-build the sector and that it can make a very strong contribution to growth in the future. Again very little has happened with any of the 2020 recommendations as of yet.

- Both submissions focus on a number of key areas. However, it is essential that if demand is to be given a boost, there must be sufficient supply to meet that demand. If not, any demand-side measures in isolation would just lead to undesirable house price inflation.

- The proposed measures seek to achieve a balance between demand and supply.

6. Mortgage Insurance:

- 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 may be 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 who more than likely are renting right now.

- The creation of a universal mortgage insurance model would impose a mandatory requirement for all lenders providing high LTV mortgages to put mortgage insurance in place. This would oblige the financial institutions to insure the portion of the high LTV mortgage above a certain level, such as 75 per cent. This would mean that the financial institutions 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.

6. cont. Mortgage Insurance:

- The universal mortgage insurance model operates successfully in some countries across Europe and helps ensure a more prudent, stable and liquid housing and mortgage market. In the UK, 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 should not be the case.

- **It would not make sense for the State to guarantee any component of the mortgage. Rather, this should be left to the private sector through a mortgage insurance model.**

8. European Country Review

- **IPAV hosted in late November 2014 a European Estate Agents Conference. Among other question that were discussed was "Is there a LTV in your Country" the answers are below:**
- **Ireland :** Not yet, proposed from Jan 2015: 20%
- **France:** None. Loans are based on revenues with banks focusing on about 35% of revenues.
- **Romania:** None
- **Austria:** None
- **Slovakia:** A proposed plan exists not to loan any more than 90% of the property purchase price from March 2015
- **Greece:** None
- **England:** None
- **Italy:** None
- **Portugal:** None
- **Netherlands:** 105% at the moment declining 1% each year has to be 100% by 2018. The LTI is approx. 3 to 3.5 times gross income lowered from approx. 6.
- **Italy:** None

8. cont. European Country Review:

- **Germany:** Not going over the European Regulations of Basil 2 or the solvency regulations of the CCR. Experts believe these European regulations are sufficient for market conditions so there should be no need for LTV Restrictions.
- I also note an article in the Wall Street Journal online-Germany on Friday 28th November its is as follows: It states that in one third of all real estate financing since 2009 the mortgage has been higher than the mortgage loan value. This means that one third of the properties purchases have been financed only by banks and not using own funds from clients." - In the article it is further mentioned that German Bundesbank does not see any complications with this situation.

9. Creation of a Property Council:

- **Forfais 2012 and *Construction 2020* suggested the creation of an overview authority. This should be progressed.**

- The property and construction sector is in a state of turmoil at the moment. Serious damage has been done to the sector, 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, for 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. This property council, should be headed up by a full minister with special responsibility for the housing and construction sector.

- Stakeholders or Interested parties can no longer work in isolation. This proposed property council will give the opportunity for joined up thinking , as opposed to a single body acting independently without proper due diligence to recognise the knock on effect of their actions in the market place. Independent policy making creates uncertainty, especially in the long term and causes fire fighting in other areas.

- **For the past three years IPAV has been advocating the setting up of such 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 would mean that immediate steps could be taken, if required, for the betterment of the property sector. Such a Council would formalise a sector that has been too informal in the past. It could also make a significant contribution to the overall regulation of the sector.**

10. Conclusions:

- For tenants paying rent and applying for a mortgage; their track record and ability to pay is the crucial part. Payment of rents should be taken as proof of ability to save, at least in part.

- If there is to be an enforced LTV, IPAV believe that the process should be eased in very slowly, and start by moving from the current maximum limit of 92% to 90%. IPAV also believes that the current evidence points to the need for a two speed LTV, higher for properties purchased in Dublin as opposed to ones purchased in the wider country, as the country wide property market is far more subdued.

- Those getting a mortgage below 50 - 70% of the purchase price should be charged a smaller interest rate than those obtaining a larger mortgage like over 70 to 90%.

- Longer term fixed rate mortgage, for periods like 10, 15 and 20 years should be introduced to bring stability into the mortgage market and peoples lives, and at the same lower interest rates that are available in other European Countries.

- A vacant site Levy needs to be implemented for all vacant usable sites in our capital city, regardless of who owns this site, be they in Public or private ownership.

- NAMA should stop selling blocks of properties to International Property Funds and engage and offer these properties for sale individually to the open Irish property market.

- Members evidence obtained by IPAV shows that the policy of Financial Institutions ramping up property portfolio sales to International Property Funds is having a detrimental effect of local markets. IPAV believes this policy should come to an end and agents should continue to be instructed to sell these properties individually in the open market.

- The creation of a universal mortgage insurance scheme.

- A full minister for housing and construction should be created to reinforce and implement the above and other ideas from a Property Council.

- The decision on LTI should take account of net rather than a gross income.

- Any one proposal should not be introduced in isolation but rather as part of a cohesive analysis followed by an urgent action plan for a sustainable property market.

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