PROPERTY INDUSTRY IRELAND

Submission to the Central Bank of Ireland
On the Loan-to-Value and Loan-to-Income Regulations

August 2016

Policy context

In a submission to the Central Bank of Ireland ahead of the introduction of macro-prudential lending rules, Property Industry Ireland welcomed the concept of protecting lenders and households against the worst excesses of house-price fluctuations by limiting the availability of credit into the domestic residential mortgage market.[1]

The primary tools which were introduced in 2015 were loan-to-value (LTV) rules which set a minimum deposit requirement for the purchase of property, and loan-to-income (LTI) rules which set a maximum mortgage value which can be borrowed, measured against the purchaser's gross salary. Specific LTV and LTI limits were introduced for purchasers of their principal dwelling houses (PDH) including separate rules for first-time buyers, as well as those purchasing buy to let (BTL) properties.

Similar policy tools have been introduced in other jurisdictions including New Zealand and Canada. A recent review of the rules in New Zealand was broadly-based and took into account the impact of lending rules on the wider property system. A similarly evidence-based and broad approach should be taken by the Central Bank of Ireland in this review to ensure that the Irish model is in conformity with international best practice.

Eighteen months after the rules were introduced in Ireland, PII believes that the macro-prudential policy framework should remain in place, albeit in a slightly amended format in response to a changing housing market and domestic macro-economic environment.

In the 2014 submission, PII recommended that lending policy should be kept under review and reformed when necessary to achieve a successful balance between delivering the

[1] Property Industry Ireland *Consultation Paper: Macro-prudential policy for residential mortgage lending: Submission to the Central Bank of Ireland* (5 December 2014). Available at www.propertyindustry.ie

policy's primary goal with the broader societal benefits of creating a functioning housing system.

In 2014, PII raised four potential second-round impacts of the lending rules on the wider housing system:

- Impact on First-Time Buyers – at disadvantage to cash-buyers and investors
- Impact on rented sector – exacerbate supply-side problems
- Impact on potential development – removal of key house-buying cohort
- Impact on borrowing from other sources – recourse to unsecured credit

In the 2014 submission, PII recommended that the macro-prudential rules should have the following characteristics in order to mitigate against those four second-round effects of the policy:

1. Introduce and set LTI and LTV limits on graduated basis, thereafter the rates and thresholds should be varied on a dynamic basis, responding to objective KPI in the housing market;
2. Temporary lesser restrictions for the purchase of new homes in areas where demand significantly outweighs supply;
3. Treat FTB, low-value and low-risk borrowers differently from those who may be at greater risk from fluctuations in house prices;
4. Consider the introduction of mandatory Mortgage Indemnity Insurance to add a further layer of protection;
5. The rules should not be introduced until a Credit Register is produced to ensure that borrowers are not having recourse to unsecured forms of credit to raise their deposit.

Data from the housing and mortgage sectors in 2015 and 2016 have shown that many of these unintended consequences have taken place. The current review must be taken against the context of the original aim of the policy, and the impact of that policy on those four wider issues.

Housing market since 2015

House-price growth was beginning to moderate ahead of the introduction of the mortgage lending rules in early 2015. Since then, house prices have moderated, especially in the Greater Dublin Area.[2] A study by the Central Bank in 2016 suggests that between 2010 and 2014, around half of all homes bought in Ireland have been financed without recourse to a mortgage.[3] Data from estate agents confirm this ongoing trend.

Thus some 50% of sales have therefore taken place outside the remit of these lending rules. With limited liquidity in the Irish economy, the continued performance of the housing market

[2] In this submission, Greater Dublin Area refers to Dublin City, Dun Laoghaire Rathdown, Fingal, South Dublin, Meath, Kildare and Wicklow
[3] Central Bank of Ireland *Quarterly Bulletin 03* / July 16

has largely been due to the so-called “cash buyer” who are likely to continue to play an important role in the future direction of the housing market.

The moderation in price trend cannot be said for private rents. In 2016, house-prices are generally expected to increase by 5% year-on-year. Private rents, meanwhile, are likely to exceed 10% growth year-on-year. Data from daft.ie in August 2016 suggests that rents in the Greater Dublin Area have reached an all-time high. It is arguable that had Government not introduced legislation to prevent rent reviews in 2016, it is certain that rents would have escalated further.

It is important to note that mortgage arrears continue to be a feature of the primary dwelling-house (i.e. owner-occupied) while some 20% of buy-to-let mortgages are now in arrears.

Data from the Central Bank shows that at end-March 2016, there were 743,700 private residential mortgage accounts for principal dwelling houses (PDH) held in the Republic of Ireland, to a value of €100.9 billion. **Of this total stock, 85,989 accounts (or 11.5%) were in arrears**.

The outstanding balance on all lenders’ (PDH) mortgage accounts in arrears of more than 90 days was over €11.9 billion at end-March, equivalent to 12% of the total outstanding balance on all PDH mortgage accounts.

At end-March 2016, there were 136,295 residential mortgage accounts for buy-to-let (BTL) properties held in the Republic of Ireland, to a value of €25.6 billion. **Of this, some 20.5% were in arrears**. The outstanding balance on all BTL mortgage accounts in arrears of more than 90 days was €6.2 billion at end March, equivalent to 24% of the total outstanding balance.[4]

Given that there has been little wage inflation in the economy in 2015/16, potential first-time buyers (FTBs) are renting for longer as they save to meet the LTV rules. Requiring home-buyers to have saved a substantial deposit before seeking a mortgage is a practical way of protecting homeowners from fluctuations in price, but it does place additional burdens on the private rented sector as the potential buyer saves their deposit.

Thus, there is now a situation in the Greater Dublin Area where a tenant may be able to pay a rent which would be far in excess of a monthly mortgage repayment, but is unable to obtain a mortgage because of an inability to meet the deposit requirement. It is important, in determining whether a prospective purchaser has the capacity to service a mortgage, to have regard to that borrower’s track record in servicing a similar rent.

PII will be making a separate submission to Government to support potential FTBs reach the LTV threshold without recourse to unsecured credit.

In their current format, the macro-prudential rules require the potential first-time buyer of a property valued up to €220,000 to raise a 10% deposit. Current housing supply statistics

[4] Central Bank of Ireland *Residential Mortgage Arrears and Repossessions Statistics: Q1 2016* (June 2016)

suggest a dearth of new homes with a market value of c. €220,000, especially in the Greater Dublin Area. The bulk of first-time buyers in the Greater Dublin Area and the other urban areas of Ireland are therefore subject to the 20% deposit rule.

The tables given in the appendix of this submission show the impact of moving the entry point of the 10% deposit rule from the current position (€220,000) to (a) €300,000, (b) €350,000 and (c) €400,000 on the necessary deposit to be raised and the mortgage repayment.

In support of a revised LTV limit level, we are very conscious of the original objective of the mortgage lending regulations “to increase the resilience of the banking and household sectors to the property market and to reduce the risk of bank credit and house price spirals from developing in the future”. Our view is that the risk inherent in house prices is much lower now than during the build up to peak house-prices of 2007 as current house values remain c. 35% below peak levels but importantly for large parts of the country far below the replacement cost of the house.

We believe a higher LTV limit of €400,000 within GDA and €350,000 for the rest of the county would continue to support the principle of seeking to reduce risk to both lenders and borrowers of inflated house prices with LTV limits being set at levels that more closely aligned with the economic value or replacement value of the house.

From a lender stability and borrower affordability perspective, the move towards tiered variable rates in the lending market is already leading to better pricing of risk, with individuals charged higher interest rates for higher LTV advances. In turn their ability to repay is stressed at these higher interest rate levels supporting the higher LTV origination level. These loans are also likely to have a higher capital risk weighting also based on their origination level and thus requiring further capital buffers to protect the lender if there was a future economic downturn. These areas act as important safeguards to support a revision of the €220,000 LTV level.

Thus, we can see from the tables in the appendix Scenario B that the impact of introducing a 10% LTV ratio for houses purchased above €350,000 is the required deposit is reduced by some €13,000 but monthly repayments increase by only €58 per month.

The real impact of this LTV rule is that many purchasers will opt to raise the required deposit through further (unsecured, possibly high-interest) loans, or through gifts and loans from family members. Reliance on family members simply creates segregation in the house-buying cohort, between those fortunate people whose family circumstance allows them access to finance, and those who have more limited borrowing power because of a lack of available family support.

Work by the Society of Chartered Surveyors Ireland in 2016 has set out some of the cost and regulatory barriers to the development of new homes with a market price below €300,000.[5] Until these barriers are removed by Government, PII believes that the entry point

[5] Society of Chartered Surveyors Ireland *The Real Cost of New House Delivery: Analysis of Real Market Data to Evaluate Viability & Affordability of New Housing Development* (May 2016)

for the 20% deposit rule should be increased to €350,000 and thereafter reviewed to follow trends in the supply of housing.

Recommendations:

Property Industry Ireland recommends a minor readjustment of the point at which the lending rules are introduced:

1. **Currently, mortgage loans are subject to a limit of 3.5 times loan to gross income (LTI)**

   Property Industry Ireland recommends that mortgage loans be subject to a limit of 4.5 times loan to gross income. This would especially assist potential house-buyers in the Greater Dublin Area where the relationship between average prices and average salaries are most acute. It would also assist single-income purchasers avail of a mortgage many of whom have a proven capacity to service a rent of a similar – if not higher – amount.

   Further, PII recommends that where a loan to income rule is introduced, the reference point should be calculated on the potential buyer's net income rather than gross income. Reference to net salary would better reflect the actual capacity of the potential buyer's ability to service a mortgage and be consistent with the measure used by the lending institutions themselves when determining whether to provide a loan.

   Reference to net income would most accurately monitor the purchasing potential of buyers in each year, as the relative tax position changes with each annual Budget.

2. **Currently, for first time buyers of properties valued up to €220,000, a maximum LTV of 90 per cent will apply. For first time buyers of properties over €220,000 a 90 per cent limit will apply on the first €220,000 value of a property and an 80 per cent limit will apply on any excess value over this amount.**

   Property Industry Ireland recommends that this rule is amended so that the LTV rule changes at €350,000 outside the Greater Dublin Area and €400,000 within the GDA to better reflect current house prices; thereafter these thresholds should be reviewed on an ongoing basis to reflect changing trends in average house-prices.

3. **Currently, the cumulative monetary value of loans for principal dwelling purposes which breach the loan to value limits should not exceed 15 per cent of the euro value of all PDH loans on an annual basis. Similarly, the loan to income limit should not be exceeded by more than 20 per cent of the euro value of all housing loans for PDH purposes during an annual period.**

   It is important that banks have a degree of discretion to provide mortgages to those who narrowly miss one or other of the lending criteria, especially those who can readily demonstrate a capacity to service a mortgage through their monthly rental payments.

There is a societal benefit to ensuring that this discretionary capacity is spread as broadly as possible in order to have the maximum benefit for the greatest number of potential buyers.

To that end, PII recommends that, in addition to setting a maximum breach of the macro-prudential rules in value terms, the Central Bank should also set volume-based rules to ensure that lenders ensure that the discretionary breaches of the rules are spread as widely as possible.

Conclusion

Property Industry Ireland would welcome the opportunity to meet with the Governor and senior management of the Central Bank to brief them on trends in the housing market, and discuss current housing demand and supply patterns. This information will provide a significant evidential base on which to formulate policy reforms.

Property Industry Ireland believes that the framework of the 2015 macro-prudential rules remain an important part of the Irish housing system, subject to the reforms mentioned in this submission. The threats which the rules pose to the functioning of the wider housing system remain, and the policy review must therefore be broadly-based.

It is important that if, following this consultation exercise, either the LTI or LTV rules are amended, the new rules are implemented as speedily as possible. Until any such changes to lending policies are implemented, purchasing decisions will remain on hold. This is likely to cause further stresses on the recovering housing system.

About Property Industry Ireland

Property Industry Ireland (PII) was founded in 2011 as a forum for debate and policy development amongst businesses operating in the Irish construction and property sectors.

Working as the Ibec sector for the property industry, PII is a member-led representative organisation which engages regularly with state agencies and policy-makers to drive innovation in construction, property and the built environment. PII organises a calendar of briefings, seminars and conferences on issues of relevance to the future of the sector.

Member firms represent the entire spectrum of the sector, including legal, financial and accountancy practices, property and asset managers, developers and contractors, as well as professional service providers such as planners, architects, engineers and surveyors.

In 2015, Property Industry Ireland became a sectoral association of Ibec, the leading business representative organisation in Ireland.

Membership of PII is open to all businesses with an interest in the Irish property and construction sectors.

Our mission:

Through evidence-based research, we inform and influence property strategy in Ireland. Our mission is to create a sustainable, property industry for the benefit of the people of Ireland.

What we do:

We are an independent and inclusive representative organisation for all sectors of the Irish property industry.

Our aims are to:

- Develop, propose and support national property strategy, policies and solutions to problems
- Create and maintain a central database for the industry that provides an evidence-based foundation for making decisions
- Be the go-to organisation for government on all aspects of property
- Work with all stakeholders in the industry to restore it to a sustainable position in the economy
- Support job creation and retention of professional industry capacity and skill

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Recent publications:

- *The Property Industry – Rebuilding Ireland's Economy* (2011)
- *Development of Infrastructure Bonds* (2011)
- *Real Estate Investment Trusts for Ireland* (2012)
- *Putting the Residential Property Market on a Sustainable Footing* (2012)
- *Planning a better future: a report on reform of the Irish Planning System* (2012)
- *Towards a National Property Strategy* (2013)
- *Delivering Ireland's Property Needs* (2014)
- *A National Spatial and Development Plan for Ireland* (2014)
- *The Cost of Construction in Ireland: A European comparison* (2014)
- *Investing in Social Housing* (2014)
- *Housing Manifesto* (2015)
- *Planning a Better Future: Planning legislation reform* (2016: forthcoming)

Scenario A: Impact of 90% LTV for €300,000

estimated PII assumptions

	Current
House Price	€300,000
Opening LTV	87%
Mortgage	€262,000

90%	80% balance	
€ 220,000	€ 80,000	
€ 198,000	€ 64,000	€ 262,000

Term (years)	Rate 3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
20	1,493	1,506	1,519	1,533	1,547	1,560	1,574	1,588
25	1,284	1,298	1,312	1,326	1,340	1,354	1,369	1,383
30	1,147	1,162	1,176	1,191	1,206	1,221	1,236	1,251

	90% LTV
House Price	€300,000
Opening LTV	90%
Mortgage	€270,000

Deposit Change - €8,000

Term (years)	Rate 3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
20	1,538	1,552	1,566	1,580	1,594	1,608	1,622	1,636
25	1,323	1,337	1,352	1,366	1,381	1,396	1,410	1,425
30	1,182	1,197	1,212	1,228	1,243	1,258	1,274	1,289

Cashflow Differential

Term (years)	Rate 3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
20	- 46	- 46	- 46	- 47	- 47	- 48	- 48	- 48
25	- 39	- 40	- 40	- 40	- 41	- 41	- 42	- 42
30	- 35	- 35	- 36	- 36	- 37	- 37	- 38	- 38

Scenario B: Impact of 90% LTV for €350,000

estimated PII assumptions

	Current
House Price	€350,000
Opening LTV	86%
Mortgage	€302,000

90%	80% balance	
€220,000	€130,000	
€198,000	€104,000	€302,000

Term (years)	Rate 3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
20	1,721	1,736	1,751	1,767	1,783	1,798	1,814	1,830
25	1,480	1,496	1,512	1,528	1,544	1,561	1,577	1,594
30	1,323	1,339	1,356	1,373	1,390	1,407	1,424	1,442

	90% LTV
House Price	€350,000
Opening LTV	90%
Mortgage	€315,000

Deposit Change -€13,000

Term (years)	Rate 3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
20	1,795	1,811	1,827	1,843	1,859	1,876	1,892	1,909
25	1,543	1,560	1,577	1,594	1,611	1,628	1,645	1,663
30	1,380	1,397	1,414	1,432	1,450	1,468	1,486	1,504

Cashflow Differential

Term (years)	Rate 3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
20	-74	-75	-75	-76	-77	-77	-78	-79
25	-64	-64	-65	-66	-66	-67	-68	-69
30	-57	-58	-58	-59	-60	-61	-61	-62

Scenario C: Impact of 90% LTV for €400,000

estimated PII assumptions

	Current
House Price	€400,000
Opening LTV	86%
Mortgage	€342,000

90%	80% balance	
€220,000	€180,000	
€198,000	€144,000	€342,000

Term (years)	Rate 3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
20	1,948	1,966	1,983	2,001	2,019	2,037	2,054	2,072
25	1,676	1,694	1,712	1,731	1,749	1,768	1,786	1,805
30	1,498	1,517	1,536	1,555	1,574	1,594	1,613	1,633

	90% LTV
House Price	€400,000
Opening LTV	90%
Mortgage	€360,000

Deposit Change - €18,000

Term (years)	Rate 3.30%	3.40%	3.500%	3.60%	3.70%	3.80%	3.90%	4.00%
20	2,051	2,069	2,088	2,106	2,125	2,144	2,163	2,182
25	1,764	1,783	1,802	1,822	1,841	1,861	1,880	1,900
30	1,577	1,597	1,617	1,637	1,657	1,677	1,698	1,719

Cashflow Differential

Term (years)	Rate 3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%
20	- 103	- 103	- 104	- 105	- 106	- 107	- 108	- 109
25	- 88	- 89	- 90	- 91	- 92	- 93	- 94	- 95
30	- 79	- 80	- 81	- 82	- 83	- 84	- 85	- 86