



Housing equity withdrawal in Ireland: 2000 - 2011

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Abstract

At the peak of the Irish property boom in the mid-2000s, housing equity withdrawal by existing homeowners accounted for around one-third of residential mortgage loans issued. This collateral-based lending was typically issued at a significant discount to other forms of personal lending, often at tracker rates. By the end of 2011 the value of equity release borrowing was down 97 percent from the peak (2006). This *Economic Letter* summarises the trends in housing equity withdrawal over the last decade, both in terms of the extent of lending that occurred and the reasons for borrowers taking out such loans. We find that whilst the majority of housing equity withdrawal was used for housing investment, there is also a strong correlation between equity release patterns and spending on certain large-scale consumer durables such as motors and furniture.

1 Introduction

The use of housing equity as collateral means that it is a potentially important source of credit for many borrowers. It is therefore useful to have an understanding of the links between housing equity, borrowing and spending. This *Economic Letter* summarises the results from a forthcoming Central Bank *Research Technical Paper* which analyses housing equity withdrawal trends in Ireland over the last decade and considers the impact on the domestic economy.²

Housing equity withdrawal can occur via three main channels: (i) During a housing transaction,

i.e. the buying or selling of a house; (ii) from a remortgage of an existing loan; or (iii) through a mortgage “top-up” or taking out a second mortgage. For data reasons, the analysis here focuses mortgage top-ups and second loans, which account for a large proportion of equity withdrawal during the period. The data used in the analysis is loan level data collected by the CSO and the CBI.

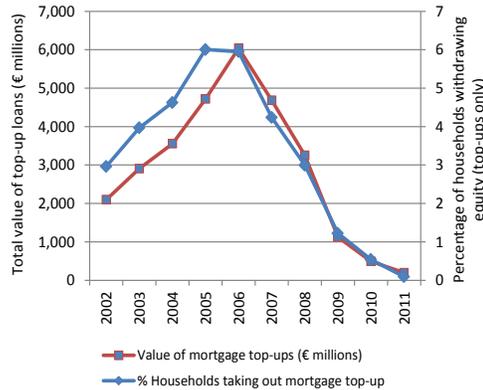
Trends in housing equity withdrawal in Ireland largely reflect overall levels of activity in the housing market. This is shown in Figure 1 which plots both the value of mortgage top-ups and the propensity for households to take out a mortgage top-up from 2002 onwards. At the peak of

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²“Housing Equity Withdrawal, Property Bubbles and Consumption”, by Reamonn Lydon and Niall O'Hanlon (CSO). Paper forthcoming in the Central Bank of Ireland *Research Technical Paper Series*.

the boom, in 2005-2006, one-third of mortgages drawn-down were top-up loans, accounting for 15 per cent, or €5.5 billion, of lending per annum. Coincident with the collapse in the housing market, the value of top-up loans was down 97 per cent from 2006, to just €195 million in 2011. Between 2005 and 2006, 6 per cent of owner-occupier households took out a top-up on an existing mortgage.

Figure 1: Trends in housing equity withdrawal



Source: CBI and Irish Banking Federation data (from 2005)

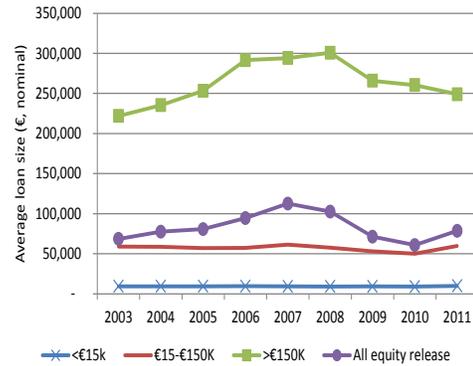
2 Who withdraws equity and what is it used for?

Figure 2 shows the average size of equity withdrawal loans in three loan size brackets: less than €15,000, €15,000 to €150,000 and greater than €150,000. The bulk of equity release lending (73 per cent) is in the €15,000 to €150,000 bracket. Throughout the period, the largest category grew steadily to reach just over €300,000 in 2008, accounting for one-quarter of equity release loans drawn-down. Trends in the overall average, which peaked at just over €100,000 in 2007, were driven almost entirely by the increase in very large loans.

Within the mid-size loan bracket, the average loan fluctuated between €50,000 and €60,000 for entire period. This is roughly double the figure for equity withdrawal loans in the UK for the mid-2000s.³ However, as a proportion of post-tax household income, equity withdrawal in Ireland is

lower than the UK, 6 per cent compared with 8.9 per cent. The lower figure for Ireland might be explained by the fact that we only look at top-ups and second mortgages, whereas the UK figure includes equity release from remortgages and transactions.

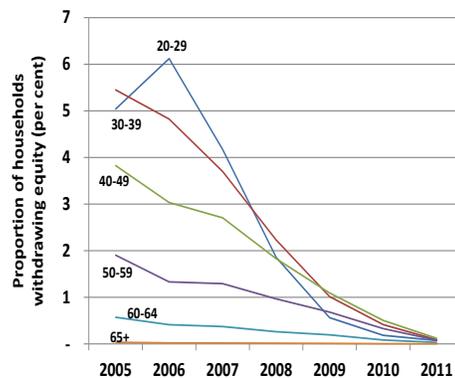
Figure 2: Equity withdrawal loan size 2003-11



Source: Central Bank and CSO data

Figure 3 shows the proportion of households withdrawing housing equity by age group. Consistent with the standard life-cycle model – which predicts that equity withdrawal should be more prevalent in younger households – we observe a significantly higher proportion of households in the 20 to 39 age-bracket withdrawing equity. This is particularly evident during 2005 to 2006, when between 5 and 6 per cent of younger households withdrew housing equity.

Figure 3: Proportion of households with each age group withdrawing equity



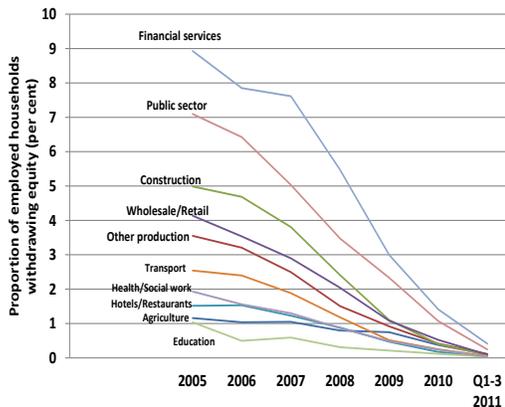
Source: CSO, loans in €15,000 to €150,000 bracket.

³See Andrew Benito (2009), "Who Withdraws Housing Equity and Why?," *Economica*, London School of Economics and Political Science, vol. 76(301), pages 51-70.

Whilst we find that younger borrowers are much more likely to withdraw housing equity, the average loan size tends to be significantly smaller for this group. The average equity withdrawal loan for borrowers aged 39 or less was just €50,000 between 2005 and 2011. The same figure for borrowers aged 40 and above was €63,000.

Figure 4 shows the proportion of households withdrawing housing equity by sector of work of the head of household. There is a greater tendency for borrowers who work in financial services, the public sector and construction to withdraw housing equity. Again, the rate of equity withdrawal is highest between 2005 and 2006.

Figure 4: Proportion of households within sector withdrawing equity

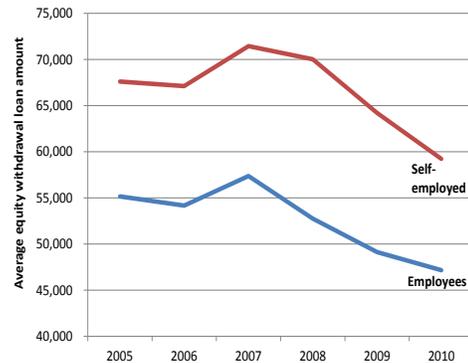


Source: CSO, loans in €15,000 to €150,000 bracket.

Practically all equity withdrawal borrowers are in some form of employment, with an approximate 80:20 split between employees and self-employed. Housing equity withdrawal by self-employed borrowers increased slightly during 2008 and 2009, which may indicate housing equity being used as a financial buffer, before falling back. As noted in Lawless and McCann (2011), from 2007 onwards, Irish small and medium enterprises found it increasingly difficult to obtain bank financing.⁴ We also observe that owner-occupier households where the head of household is self-employed withdraw significantly more on average over the period (Figure 5). The largest difference is in 2008, when the aver-

age home equity withdrawal loan for self-employed borrowers was €70,000, compared to €53,000 for employees.

Figure 5: Loan size by employee/self-employed



Source: CSO, loans in €15,000 to €150,000 bracket.

The existing research on equity withdrawal points to three main uses for this type of borrowing: financing consumption of durables or luxury items; housing investment, either in the same property or other properties; and home equity as a capital buffer against an adverse financial shock.

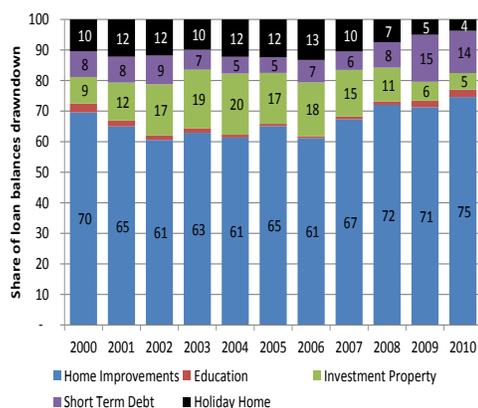
For a sample of 52,000 loans from one bank, borrowers provided information on the purpose of the housing equity withdrawal loan.⁵ Figure 6 shows the share of housing equity withdrawal by self-reported loan-purpose. Two-thirds of borrowers report the purpose of the equity release loan as "Home Improvement", similar to patterns in other countries such as the UK and Netherlands. Just over a quarter of loans are described as being for either "Investment Property" (15 per cent) or a "Holiday home" (11 per cent). The average loan size for the latter is significantly higher, peaking at over €120,000 in 2008 (Figure 7).

Two other categories of loan purpose are reported: "Education" and "Short-term debt". Interestingly, the use of equity release for the latter grew significantly in 2009 and 2010, which could be indicative of the use of housing equity as a financial buffer. The loan size averages at €46,000 and €53,000 for "Education" and "Short-term debt" loans respectively over the 2000 to 2010 period.

⁴Martina Lawless and Fergal McCann (2011), "Credit Access for Small and Medium Firms: Survey evidence for Ireland", Central Bank of Ireland Research Technical Paper 11/RT/11.

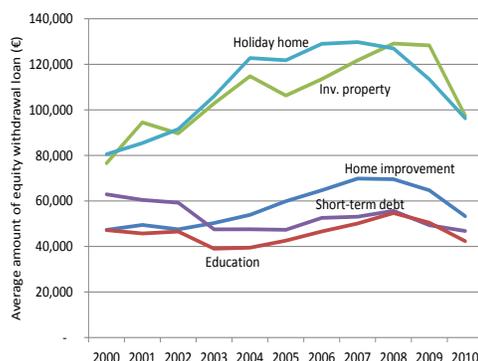
⁵As part of the 2012 Financial Measures Programme, loan purpose information has been provided by all lenders. A comparison with the data used in this note shows a similar overall pattern for the use of housing equity withdrawal loans.

Figure 6: Purpose of housing equity withdrawal



Source: Central Bank data.

Figure 7: Size of loan by purpose



Source: Central Bank data.

3 The economic impact of equity withdrawal

Housing equity can be an important driver of consumer spending via its collateral value – particularly if housing equity withdrawal relieves a credit constraint that would otherwise be present. Financial accelerator models of the relationship between house prices and consumption also assign a key role to housing equity withdrawal.⁶

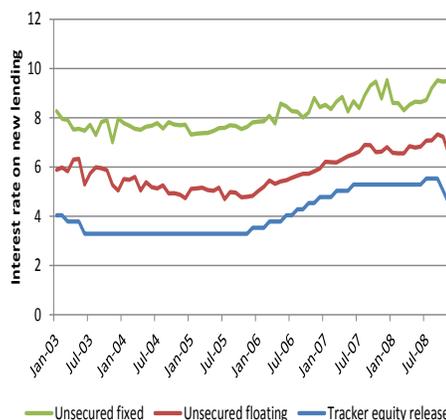
The collateral value of housing is illustrated in

⁶See, for example, the extensive discussion in Aoki, K., Proudman, J. and G. Vlieghe (2004). “House prices, consumption, and monetary policy: a financial accelerator approach,” *Journal of Financial Intermediation*, Elsevier, vol. 13(4), pages 414-435, October.

⁷It makes little difference here whether we look at tracker or Standard Variable Rates (SVR) equity release loans. As shown in other CBI research, tracker and SVR interest rates were almost identical up to the beginning of 2009. See Goggin, J., Holton, S., Kelly, J., Lydon, R. and K. McQuinn (2012). “The financial crisis and the pricing of interest rates in the Irish mortgage market: 2003-2011”. Central Bank of Ireland Research Technical Paper 1/RT/12.

Figure 8, which compares consumer interest rates for secured (equity withdrawal) and unsecured borrowing over time. The interest rate on tracker equity withdrawal loans (60 to 70 per cent of equity release loans in the mid-2000s) is between 2 and 4 percentage points cheaper than other forms of unsecured consumer lending, depending on whether the unsecured lending is on a variable or a fixed rate.⁷

Figure 8: Interest rates on equity withdrawal



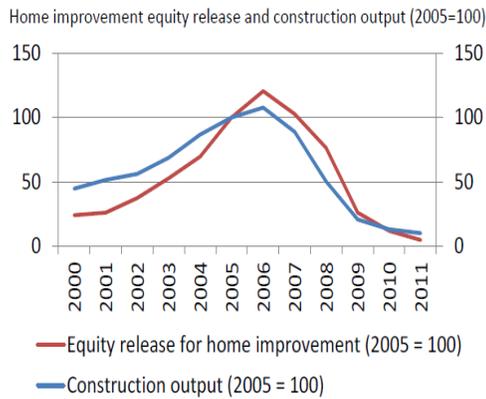
Source: Central Bank of Ireland calculations.

The self-reported loan purpose data indicates that over 90 per cent of the value of housing equity withdrawal loans was used for further investment in housing – split 66 per cent for investment in the same house (home improvement) and 25 per cent in other housing (buy-to-let and holiday homes).

These figures imply that main *direct* effect of equity withdrawal is likely to be on housing demand and housing construction output. The relationship between housing equity withdrawal and housing investment is further illustrated in Figure 9, which plots trends in construction output and equity release since 2000. As expected, the two series move closely together. To the extent that there are multiplier effects associated with housing investment – for example, through employment effects – housing equity withdrawal might *indirectly* affect consumer spending. There may also be trickle-down effects

to the purchasing of durable household goods, such as furniture or large white goods.

Figure 9: Equity releasing and residential construction output



Source: Central Bank of Ireland & CSO.

The literature on uses of housing equity withdrawal also shows that purchasing of luxury goods such as cars can account for a large portion of the non-housing investment uses.⁸ In the accompanying *Research Technical Paper* we run a series of regressions to try and quantify the relationship between housing equity withdrawal and consumer spending at an aggregate level. The estimation framework we employ, which is called an error correction model, controls for both the long-run and short run relationships between economic variables. The results of the analysis can be summarised as follows:

- The positive correlation between equity withdrawal and housing output is confirmed by the regressions. We observe both a significant short run (0.70) and long-run (0.98) elasticity between changes in equity withdrawal and changes in housing construction output.
- Changes in equity withdrawal borrowing impact on several categories of retail spending in the short-run, including electrical goods, household equipment and other non-food categories. However the largest impact is

observed for spending on two large durable items: furniture and motors

- The results from the furniture regression imply that a 10 per cent change in equity withdrawal leads to a 2.5 per cent change over the longer-term (long-run elasticity of 0.25). This could be a direct or an indirect effect, where the latter derives from the relationship between equity withdrawal and home improvement expenditure.
- In motors, a 10 per cent change in equity withdrawal leads to a 2.2 per cent change in spending on motors over the longer-term (long-run elasticity of 0.22).

As noted above, full details of the models and results are available in the accompanying technical paper.

4 Conclusion

We have shown that housing equity withdrawal is most prevalent amongst younger households. We also observe a greater propensity for equity withdrawal where the head of the household works in Financial Services, the Public Sector or Construction. We show that the average equity withdrawal loan is considerably higher where the borrower is self-employed.

Between 2000 and 2011, over 90 per cent of the value of housing equity withdrawal was reported to be re-invested in property. Most of this was for repair, maintenance and upgrading of the same property, with the remainder used for investing in other property. We conclude that the main direct effect of housing equity withdrawal over the last decade was likely to be boosting domestic construction output. In support of this, we observe a strong correlation between equity withdrawal and residential construction output.

Housing equity withdrawal also impacts on certain categories of non-housing consumer spending. Our analysis shows that changes in housing equity withdrawal affects the consumption of certain large-scale, or luxury, consumer durables such as motors and furniture.

⁸Benito (2009, see reference in Footnote 3), uses household panel data which links the equity withdrawal decision to subsequent consumption decisions, to analyse this type of behaviour at the level of the individual borrower. The CBI and CSO loan-level data not allow us to link borrowing behaviour with subsequent consumption behaviour at the individual level. Hence we look at the correlation between equity withdrawal trends and consumption at an *aggregate* level.