Residential Mortgages: Borrowing for Investment

*By John Kelly and Aisling Menton**

ABSTRACT

Irish household debt has risen sharply in recent years, driven by strong demand for residential mortgages. Borrowing to buy investment properties has played a role in this but since adequate data on the relative importance of different buyer categories were not available, much of the analysis of investor participation in the Irish property market has been based on survey or anecdotal evidence. In an attempt to fill this gap, the Bank has begun to collect a breakdown of outstanding residential mortgages into three sub-categories: principal dwelling houses, buy-to-let properties and holiday homes/second houses. The breakdown of mortgage lending can only be obtained for mortgages on an institution's balance sheet, and therefore the new data series excludes securitised mortgages. Consequently the opportunity is taken to clarify the statistical differences between the balance sheet or 'unadjusted' and the more comprehensive 'adjusted' measures of residential mortgage lending.

The main aim of this article is to introduce the new data, which are available from December 2003 on a quarterly basis. The most interesting development is the marked increase in the share of borrowing going to the buy-to-let sector. Other data sources on investor activity in the Irish housing market are also discussed, as are concerns expressed by the IMF and OECD that the buy-to-let sector in Ireland may present risks to the stability of the housing market. In addition, a brief comparison is made between developments in the buy-to-let sector of the mortgage markets in Ireland and the UK.

1. Introduction

Household debt has risen to record levels in many developed countries over the past decade. While the timing and extent of the increase varied across countries, two main causal factors have been identified: a decline in interest rates, both real and nominal; and an easing in liquidity constraints arising from financial liberalisation and innovation.

The rise in household debt in Ireland has been amongst the most rapid. When Ireland joined Economic and Monetary Union (EMU) in 1999, household debt was about 60 per cent of personal disposable income; by end-2006 this ratio had more than doubled to 147 per cent, despite a strong rise in income. Borrowing for residential mortgages has been the main driving force behind this increase, with mortgage debt increasing its share of household debt from 75 per cent to 83 per cent over the period.

* The authors are Head and Economist, respectively, in the Bank's Statistics Department. The views expressed are the sole responsibility of the authors, and are not necessarily those held by the CBFSAI or the European System of Central Banks. They would like to thank colleagues in the Statistics Department for their assistance with data preparation and presentation.

The expansion in mortgage debt has been associated with rapidly rising house prices. Empirical research on the causes of house price inflation has examined the contribution of a range of factors such as demographics, income, interest rates and credit market conditions. Although housing is an asset-of-choice for saving in Ireland, it has not been possible to empirically examine the role of investors' demand since adequate data on the relative importance of different buyer categories were not available. In an attempt to fill this gap, the Bank has begun to collect a breakdown of outstanding residential mortgages into three sub-categories: principal dwelling houses (PDHs), buy-to-let (BTL) properties and holiday homes/second houses. These data are being published for the first time in Table C8 of *Quarterly Bulletin No. 2, 2007*, and will be updated quarterly in the web-based note, *Sectoral Developments in Private-Sector Credit.*

The main objective of this article is to present the newly collected data, which show trends in lending for BTLs by Irish credit institutions over the past three years. Other sources of information on developments in this sector, such as the Irish Banking Federation (IBF) data on new lending, are also discussed. In the light of the growth in importance of the BTL sector, some of the factors which influence investors are examined. The opportunity is taken at the outset to clarify the statistical differences between the balance sheet or 'unadjusted' measure of residential mortgage borrowing and the more comprehensive 'adjusted' measure which includes securitisations, since these differences are relevant to the interpretation of trends in the BTL data in Section 3.

2. Measuring Mortgage Debt

The rise in mortgage debt in Ireland, in common with a number of countries, has been driven by a combination of favourable financial conditions and a buoyant housing market. Strong competition in mortgage markets, product innovation and a lengthening of mortgage terms have enhanced the affordability of mortgages and eased access to credit. These developments, it is generally agreed, have raised the sensitivity of the household sector to changes in interest rates, house prices and incomes [see, for instance, Debelle (2004)]. As a consequence, developments in mortgage debt are closely watched and have become the subject of significant comment and analysis.

Definitive figures for the stock of outstanding mortgage debt are published each month in the CBFSAI *Monthly Statistics.* Two series of data are provided: the unadjusted level, which records the net stock of residential mortgage lending on credit institutions' books; and the adjusted level, which adds to this the outstanding amount of securitised mortgages (see Box 1 for details). In addition, some reclassifications of lending from 'other personal' and 'term loan' categories into residential mortgages need to be excluded in calculating the percentage year-to-year change. These reclassifications arose from a detailed examination of the items included by credit institutions in the various categories of the sectoral distribution of lending (see Box 2). In any economic analysis of residential mortgage lending it is the more comprehensive adjusted levels and growth rates which are most relevant; securitisation removes mortgages from credit institutions' books but it does not cancel the debt — from the perspective of the borrower, the loan is still outstanding. The unadjusted series, therefore, underestimates borrowing by the household sector. Similarly, the securitisation of a block of mortgages in a given month can cause volatility in year-to-year growth rates if an adjustment is not made for this.

Box 1: Securitisation of Residential Mortgages

The term 'loan securitisation' denotes a process whereby non-tradable assets, such as mortgage loans, are pooled and repackaged as marketable securities that can be sold to investors (ECB, 2005). There are two ways in which residential mortgages can be used to raise funds for further lending: through the sale of asset-backed securities (ABS) — also known as 'true-sale' securitisation — and through the issue of covered bonds or asset-covered securities (ACS). The key distinction, from the point of view of monetary analysis, is that in the former case the mortgage loans are removed from a credit institution's balance sheet. As a result, data for total mortgage loans collected from credit institutions will underestimate mortgage borrowing by the household sector. To correct for this, net securitisations are added back to give the 'adjusted' residential mortgage lending series. While ACS provide an important source of funds, the mortgages which 'cover' these securities remain on credit institutions' balance sheets and, consequently, lending data are not distorted.

1. Asset-Backed Securities

Under an ABS transaction, a credit institution transfers a block of mortgages to a special purpose vehicle (SPV), which finances the purchase by issuing securities backed by these loans. This involves a switch on the assets side of a credit institution's balance sheet, with a fall in mortgage loans being offset by a rise in cash (or balances with the Central Bank). How an ABS affects the balance sheets of the credit institution and the SPV are shown in the T-accounts below:

A	Credit Institution	L
Loans	−100	
Cash*	+100	

A	SPV	L
Loans	+100	Debt Securities +100

*or balances with Central Bank.

By removing mortgage loans from credit institutions' books, ABS reduces both the stock and the flow of mortgage lending and can give rise to volatility in year-to-year growth rates which is unrelated to demand for mortgage loans. In order to provide a more accurate picture of developments, data on securitisations are collected from credit institutions and added to their on-balance sheet lending to give the more comprehensive adjusted level of residential mortgage lending in Table A2.2 of the Bank's *Monthly Statistics* and *Quarterly Bulletins*. Allowance is made for the amortisation of the pool of securitised mortgages in making this adjustment.

Table A: Asset-Backed Securities Issued by Irish Credit Institutions, 1999-2006

Date	Credit Institution	Amounts Securitised (€ million)
June 1999	First Active	250
October	First Active	300
November	Irish Permanent	600
February 2000	First Active	300
June	Bank of Ireland	500
July	EBS	495
September	First Active	350
May 2001	IIB Home Loans	650
May	EBS	525
October	First Active	489
April 2003	EBS	750
July	First Active	750
November 2005	First Active	1,750
June 2006	permanent tsb	2,145
July	EBS	1,500
August	First Active	1,790
December	Ulster Bank	3,850

Gross annual issues of ABS since 1999 are shown in Table A, where it can be seen that there was a marked increase in ABS since late 2005. This has resulted in low or negative changes in the unadjusted volume of mortgage lending in the months concerned (see Chart 1).

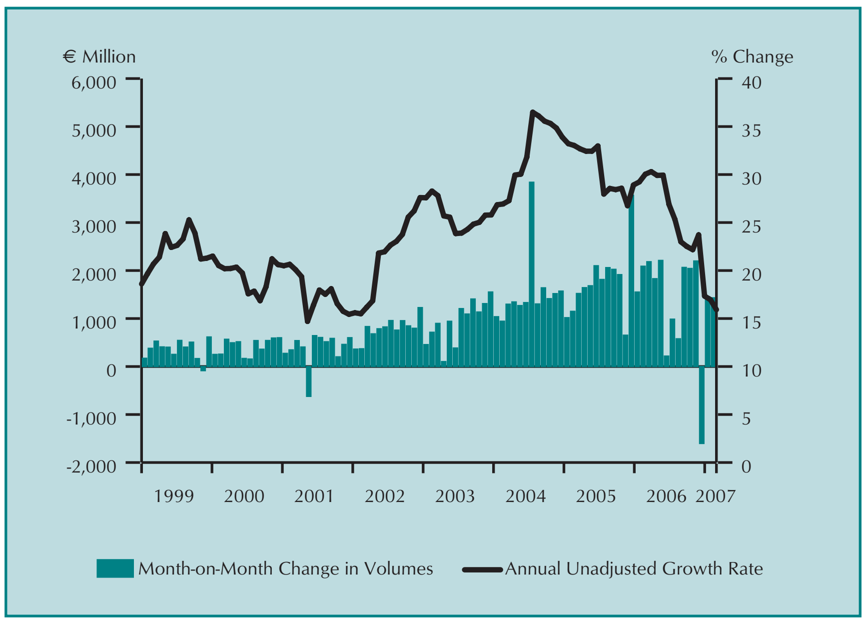
2. *Asset-Covered Securities*

Securitisations of mortgages which remain on credit institutions' balance sheets are known as Asset-Covered Securities (ACS) and are regulated under the Asset Covered Securities Act 2001.[a] ACS are included under debt securities issued on the liabilities side of credit institutions' balance sheets — item 6 in Tables C3 to C7 of the Bank's statistics. They are generally in the 'over 2 years' category. Residential mortgage lending totals are not affected, however, by ACS.

The market for ACS has been growing in size since the introduction of the Act, with a number of large banks participating in the market. In fact, both Bank of Ireland and AIB established new institutions in order to issue ACS — Bank of Ireland Mortgage Bank and AIB Mortgage Bank — and transferred a substantial proportion of their mortgage books to these new banks, which are registered as credit institutions under the Act. International banks in Ireland, such as Depfa ACS and WestLB, are also active in the ACS market.

[a] The provisions of this Act are extended in the Asset Covered Securities (Amendment) Bill 2007, which provides for the securitisation of commercial mortgages.

Chart 1: Trends in Unadjusted Mortgage Lending



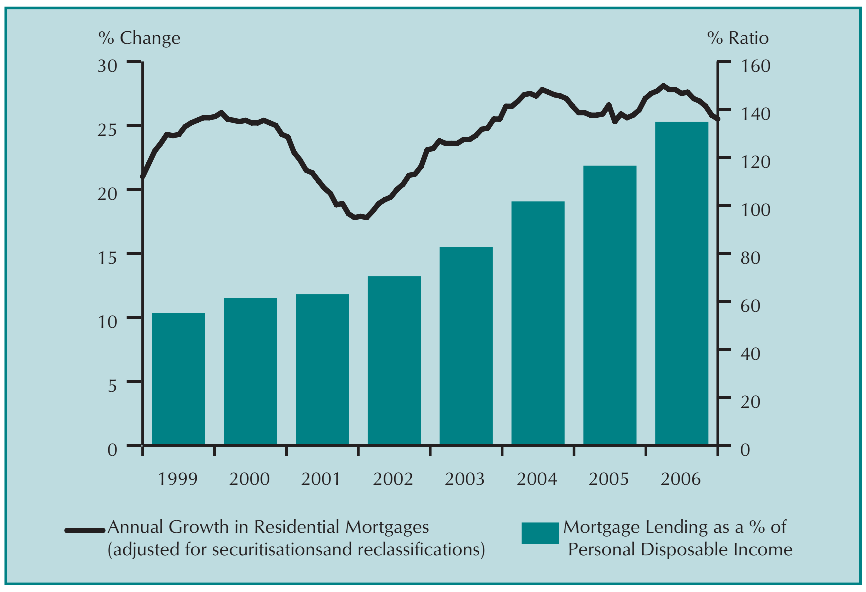
Source: CBFSAI.

These points are illustrated in Chart 1, which shows the annual unadjusted growth rate and month-on-month change in volumes of residential mortgage lending. Reclassification of credit into residential mortgages overstates the level of new lending, while the removal of securitisations from the series understates it. Both give rise to erratic month-on-month changes and growth rates. As a result of this volatility the economic usefulness of this chart as an indicator of developments in mortgage debt is reduced.

When a credit institution securitises a block of mortgages, the balance of outstanding residential mortgages that is reported to the Bank will be reduced. It is easy to identify in the chart the months in which securitisations have taken place, as these are the months with very low or negative changes in volumes. For example, in December 2006, one institution performed a securitisation of €3.9 billion. As this securitisation was larger than the aggregate increase in mortgages over the month, the unadjusted change in residential mortgages was minus €1.6 billion.

Similarly, a reclassification of credit into residential mortgages will overstate the change in mortgages in that month. The transfer of some €2 billion in residential mortgages to an Irish credit institution from its parent institution abroad in July 2004 caused a large spike in the month-on-month change in Chart 1. The second large spike, in December 2005, was also caused by reclassifications of almost €900 million into residential mortgages, along with very strong demand for mortgages during that month.

Chart 2: Trends in Adjusted Mortgage Lending and Ratio to Personal Disposable Income



Sources: CBFSAI and CSO.

Box 2: Reclassifications

The aim of presenting adjusted growth rates for residential mortgages in the *Monthly Statistics* is to present a truer picture of the *flow* of new lending to Irish residents. The two items that affect the growth rate of residential mortgages are securitisations — described in Box 1 — and reclassifications. The first major reclassification to affect the year-to-year growth rates of residential mortgages occurred in July 2004, when some €2 billion in residential mortgages was transferred to an Irish credit institution from its parent institution abroad. While these mortgages had been taken out by Irish residents, they were not *new* lending in July 2004. To include these mortgages in the calculation of the annual growth rate would, therefore, have significantly overstated the flow of new mortgage lending. In order to give a more accurate picture, this amount was excluded in the calculation of adjusted growth rates between July 2004 and June 2005.

Efforts to improve the sectoral allocation of credit institutions' lending, published in the *Sectoral Distribution of Advances* (Table C8, Quarterly Bulletin), have been a second source of reclassifications of residential mortgages. During 2004, credit to the Other Personal sub-sector began to expand rapidly. The causes of this were investigated during 2005 and it was found that some credit institutions had included large investment-type loans to high net worth individuals in this category, while some buy-to-let mortgages had also been wrongly classified as term loans. Revisions arising from this investigation have largely boosted lending for Real Estate Activities and Lending for House Purchase and reduced annual growth in Other Personal credit.

Table B below depicts how residential mortgage growth rates are affected by reclassifications, with reference to the July 2004 transfer of mortgages and how the adjusted growth rate in the final column of Table A2.2 in the *Monthly Statistics* is calculated.

1. Starting with the unadjusted level of residential mortgages, net securitisations are added to the series to give the adjusted level in Table A2.2.

2. However, if no further adjustments were made to the series this growth rate would be artificially high for the months affected by the reclassification. For example, the net increase in mortgage lending would appear to be some €2 billion larger than it actually was in July 2004, and the annual growth rates for the twelve months to June 2005 would be boosted by the inclusion of the €2 billion.

3. Therefore, the reclassified mortgages were removed from the series to give the 'underlying' annual year-to-year change, which was published in the final column of Table A2.2.

Table B: Adjusted Annual Growth Rate for Residential Mortgages

Date	Unadjusted Res. Mortgages € million	Net Sec. € million	Res. Mortgages + Sec. € million	Adjusted Y-on-Y Change %	Reclass. € million	Res. Mortgages + Sec.-Reclass. € million	Underlying Y-on-Y Change %
Jun-04	61,837	4,283	66,120	27.3		66,120	27.3
Jul-04	65,676	4,212	69,888	31.7	2,095	67,793	**27.8**
Aug-04	66,979	4,147	71,126	31.5	2,095	69,031	**27.6**
Sep-04	68,618	4,081	72,699	31.1	2,095	70,604	**27.4**
Oct-04	70,031	4,027	74,058	31.1	2,095	71,963	**27.3**
Nov-04	71,549	3,987	75,536	30.8	2,095	73,441	**27.1**
Dec-04	73,120	3,909	77,029	30.0	2,095	74,934	**26.5**
Jan-05	74,137	3,844	77,981	29.5	2,095	75,886	**26.0**
Feb-05	75,286	3,804	79,090	29.4	2,095	76,995	**26.0**
Mar-05	76,807	3,746	80,553	29.2	2,095	78,458	**25.8**
Apr-05	78,449	3,691	82,140	29.0	2,095	80,045	**25.8**
May-05	80,131	3,634	83,765	29.2	2,095	81,670	**25.9**
Jun-05	82,230	3,572	85,802	29.8	2,095	83,707	**26.6**
Jul-05	84,043	3,506	87,549	25.3		87,549	25.3

Trends in mortgage credit growth and the ratio to personal disposable income in Chart 2 are based on the adjusted mortgage lending series. Annual increases in this series are much smoother, while the more comprehensive measure of household borrowing gives a better indication of how households' mortgage debt is growing relative to disposable income.[1] Credit institutions, however, can only provide details of loans on their books; consequently, any breakdown of mortgage lending must be based on the unadjusted series. It is therefore only possible to identify the share of lending going to investors in an unadjusted format. Since net securitisations account for a relatively small portion of total mortgage lending, they will not have a major influence on how investors' share of the market has evolved but there may be some distortions in year-to-year growth rates.

3. Buy-to-Let Activity

From time to time, concerns have been expressed that investors are contributing to the inflation of house prices and that, as a result, first-time buyers are being crowded out of the housing market. Such concerns were raised in the first 'Bacon Report' and led to changes in stamp duties and the abolition of interest deductibility from rental income by investors for tax purposes. While these measures were effective in reducing house-price inflation, which dropped from 20.6 per cent in January 2001 to 2.4 per cent in January 2002, they led to very sharp increases in rents and the interest offset against rent was restored in the 2002 Budget. More recently, investors have again been cited for fuelling house-price increases in 2006 and making it difficult for first-time buyers to get onto the property ladder.

The possibility that investors may present risks to the stability of the Irish housing market has also been widely discussed. In its first *Financial Stability Report* (Central Bank, 2002), the Bank expressed the view that new investors might "be particularly vulnerable to any fall in property and/or rental values". The IMF and the OECD have also expressed concerns that the rental market is dominated by small — individuals who own one to three properties[2] — and "mostly inexperienced investors" (Rae and van den Noord, 2006), who might attempt to sell if interest rates rose and/or house price increases stalled.

Despite the interest in investors, comprehensive data relating to their activity is scarce. In order to obtain more information

1 These ratios in Chart 2 differ from the ratios of housing finance to disposable income in Kelly (2006) as (i) the latter did not include securitised mortgages and (ii) revised figures for disposable income were published by the CSO in *National Income and Expenditure, 2005* in September 2006.

2 The 2006 Gunne/EBS Survey found that 82 per cent of landlords owned between one and three properties.

on their impact on the residential mortgage market, mortgage lenders have been asked to provide the Bank with a breakdown of outstanding residential mortgages between loans secured on PDHs, BTLs and other properties. These data are now being published for the first time and provide a quarterly series from December 2003 to December 2006.[3]

The New Data Series

It is now possible to identify the proportion of mortgage lending that is accounted for by BTLs. Details of developments are provided in Table 1, which shows quarterly and annual rates of increase as well as the percentage of total residential mortgage lending accounted for by BTLs.

Table 1: Buy-to-Let Mortgages, 2003-2006

		Outstanding Level (€ million)	% Change Q-on-Q	% Change Y-on-Y	Share of Residential Mortgage Lending (%)
2003	Dec.	9,131	–	–	16.7
2004	Mar.	10,144	11.1	–	17.5
	June	11,196	10.4	–	18.1
	Sept.	12,472	11.4	–	18.2
	Dec.	13,771	10.4	50.8	18.8
2005	Mar.	14,781	7.3	45.7	19.2
	June	16,212	9.7	44.8	19.7
	Sept.	17,724	9.3	42.1	20.1
	Dec.[a]	20,260	14.3	47.1	21.5
2006	Mar.	21,727	7.2	47.0	21.7
	June	23,653	8.9	45.9	22.7
	Sept.	25,589	8.2	44.4	23.7
	Dec.	27,190	6.3	34.2	24.6

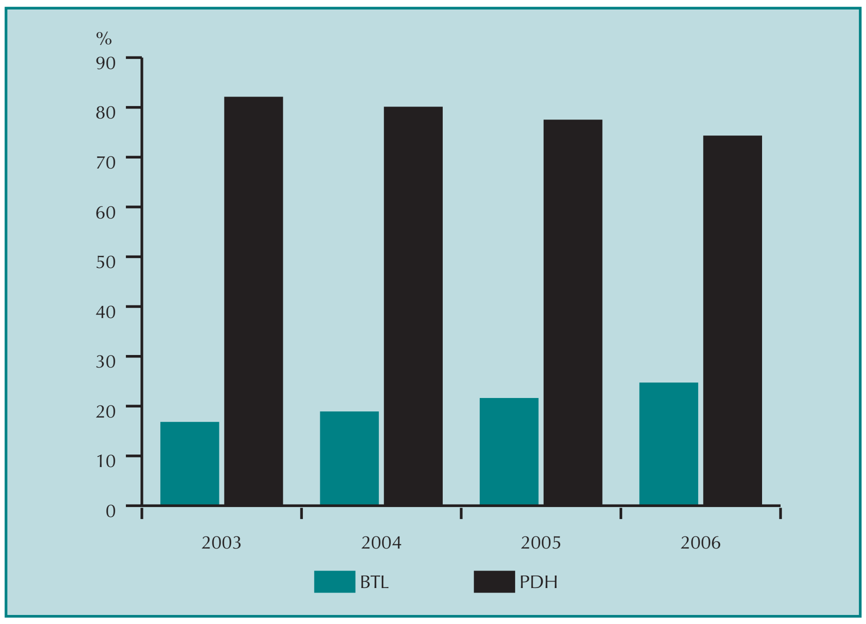
[a]The quarterly growth rate for BTLs was boosted by reclassifications in Q4, 2005, as were annual growth rates from Q4, 2005 to Q3, 2006.

Source: CBFSAI.

Borrowing for housing investment was extremely strong over the three years to end-2006, with the amount outstanding rising by a factor of three, from €9 billion to €27 billion. Annual increases exceeded 50 per cent in 2004 and thereafter remained in the 42-47 per cent range until December 2006, although for the four quarters starting in December 2005 it was boosted by reclassifications. The quarterly rates of increase show that demand for BTL mortgages slowed a little in 2006, following strong quarter-on-quarter increases of close to 10 per cent in the preceding two years. The BTL share of total lending continued to increase, however, and registered a substantial gain of nearly 8 percentage points in market share over this period. Residential property investors have grown in importance and now account for almost one-quarter of all outstanding mortgage lending.

3 The full data is available on the Bank's website at www.centralbank.ie/sta_late.asp.

Chart 3: Percentage Share of BTL and PDH Mortgages



Source: CBFSAI.

Further evidence of the growing importance of the BTL sector in mortgage lending can be found in the IBF quarterly data series on new mortgage lending, dating from Q1, 2005 (IBF, 2007).[4] This data series breaks new mortgage lending down into five categories, including first-time buyers (FTBs) and residental investment letting (RIL) purchase.[5] Re-mortgages, or 'switcher' mortgages, are also separately identified. Since movement of loans between institutions does not add to total net lending, these 'switcher' mortgages are deducted from total new loans before the market share for RILs shown in Chart 4 is calculated. On this basis, RILs increased their share in the value of new loans at the expense of both FTBs and mover purchasers since Q1, 2005. RILs accounted for 21.6 per cent of all new business in 2005, increasing to 23.5 per cent in 2006. The value of new RIL mortgages rose by 83 per cent between Q1, 2005 and Q4, 2006, while average loan size increased by 38 per cent from €223,554 to €308,234.

The IBF data also confirm that FTBs are losing market share. In Q4, 2006, there was a fall of over 20 per cent in the number of loans attributable to FTBs compared with the previous year. FTBs' share of loans by value also declined between 2005 and

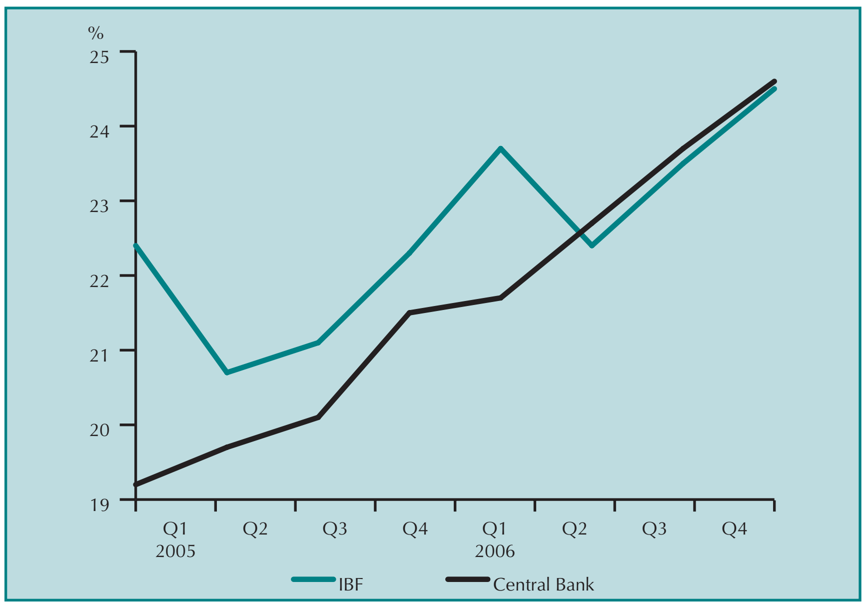
4 The terms 'buy-to-let' (BTL) and 'residential investment letting' (RIL) properties may be used interchangeably. The term BTL is used by the Bank, while RIL is used in the IBF data. The IBF definition of RILs differs slightly from the Bank's in that it includes holiday homes.

5 The IBF series for the value of new residential mortgages differs from the Central Bank's figures for new business in residential mortgages, published in Table B2.2 in the *Monthly Statistics*. The difference arises from how the figures are compiled. The Bank, using the definition of new business as defined by the ECB, collects data on any new agreement between the customer and the credit institution and therefore include changes from variable to fixed rate agreements (or vice-versa) within an institution. The figures used by the IBF are drawdowns of new residential mortgages.

2006. At end-2005, FTBs accounted for 27.1 per cent of new loan values, but this had dropped to 24.9 per cent by end-2006.

Data from the Department of the Environment, Heritage & Local Government (DEHLG) on the purpose of loan approvals also indicate the strength of activity by investors in the market and give similar results to the IBF series. Investors accounted for 20 per cent of all loan approvals in 2006, up from 19 per cent in 2005, and were more active in the second-hand market than the new houses market.

Chart 4: BTL Mortgages' Share of IBF New Loans and Central Bank Outstanding Loans



Sources: CBFSAI and IBF.

In addition, an analysis of sales by estate agents points to increased investor interest in housing, but care should be taken in generalising such findings as they may be based on small or unrepresentative samples. For instance, while Sherry Fitzgerald find an increase in investor activity in both the new and second-hand market between 2005 and 2006[6], their finding that investors accounted for 37 per cent of all new homes bought in 2006 may be influenced by their share of sales of tax-incentive properties.

The principal demographic results of Census 2006 also show that the number of households classified as rented has been increasing. The number of households in the State increased from 1.28 million to 1.46 million between 2002 and 2006, while those classified as rented increased from 141,459 to 195,797, or by 39 per cent, over the same period. Inward migration appears to have played a part; Census 2006 found that 14.7 per cent of usual residents in the State were born

6 Sherry Fitzgerald reported that investors accounted for 37 per cent of new home sales and 20 per cent of sales of second-hand properties in 2006, up from 31 per cent and 17 per cent, respectively, in 2005.

outside Ireland, an increase from 10.4 per cent in 2002. In 2000, Ireland had one of the lowest share of dwellings in the total stock of housing classified as rented, at 16 per cent, compared to, for example, 60 per cent for Germany (ECB, 2003). Considering the results of the Census, there is little doubt that this figure will have risen since then.

Table 2: Percentage Share of Housing Units by Occupancy Status

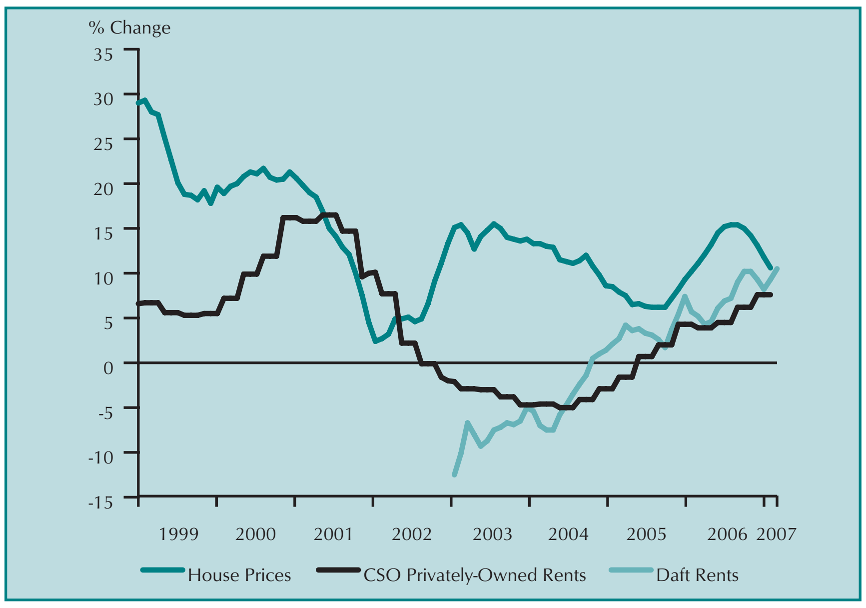
Occupancy Status	2002	2006
Local Authority Rented	6.9	7.3
Other Rented	11.1	13.4
Owner Occupied	77.4	74.7
Other	4.6	4.7
Total	100.0	100.0

Source: CSO.

Factors Influencing Investor Borrowing

Why was investor demand for residential mortgages so strong during the past three years? Essentially, the main influences on investor behaviour are prospects for capital appreciation, the level of interest rates, rental returns and the returns available on other savings/investment assets.

Chart 5: Annual House Price Inflation and Annual Change in Rents



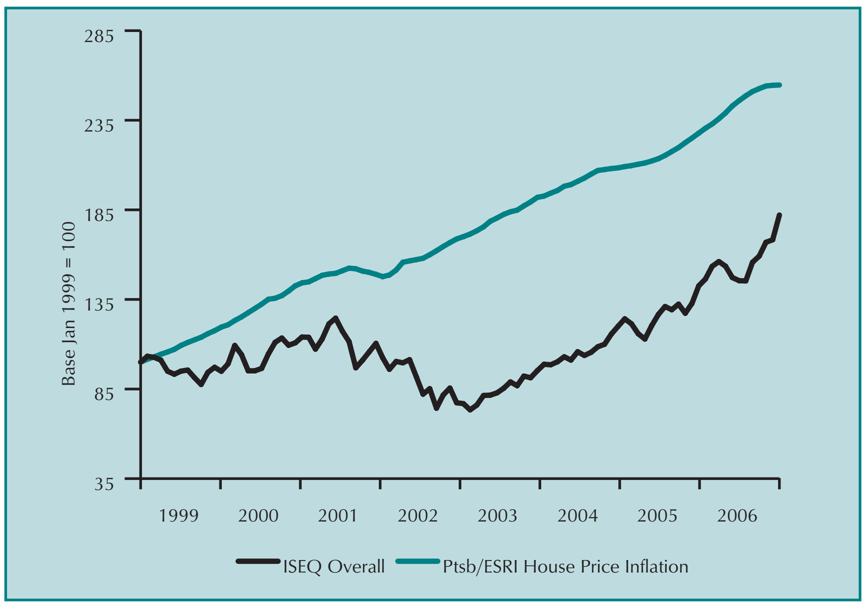
Sources: CSO, Ptsb/ESRI and Daft.ie.

Two of the main drivers of activity in the investor sector — capital appreciation and rental income — are summarised in Chart 5. CSO data show that the annual increase in rents reached a high in early 2001 and that, following declines in 2003 and 2004, rents began to increase again in 2005. The March 2007 *Daft.ie* report on rents also shows a recovery in recent years. Since the commencement of this series in 2002, rents declined annually between January 2003 and September 2004. However, the annual change in the *Daft.ie* rent index turned positive in 2004, and reached a high of 10.5 per cent in February 2007.

House prices rose sharply towards the end of 2002 and remained strong for most of the 2003 to 2006 period. The return of house price inflation to double digits in mid-2005 surprised many. With strong demographics and unexpectedly high inward migration underpinning the rental market, these two factors may have worked to attract investors into buying BTL properties. Interestingly, the *Daft.ie* rental index shows that rents began to recover in May 2004, the same month as EU enlargement.

The widespread availability of interest-only loans has also made the BTL sector more attractive. Most credit institutions offer a mortgage tailored for the BTL investor, with interest-only periods ranging from 1 year to 10 years. Data from the DEHLG show that the number of interest-only loans has been increasing. Some 13.5 per cent of loan approvals in Q2, 2006 were for interest-only loans, up from 7.3 per cent in Q4, 2004. While not all of these loan approvals are necessarily for investors, their availability helps to make BTL mortgages more affordable.

Chart 6: ISEQ and House Price Indices



Sources: Irish Stock Exchange and Ptsb/ESRI.

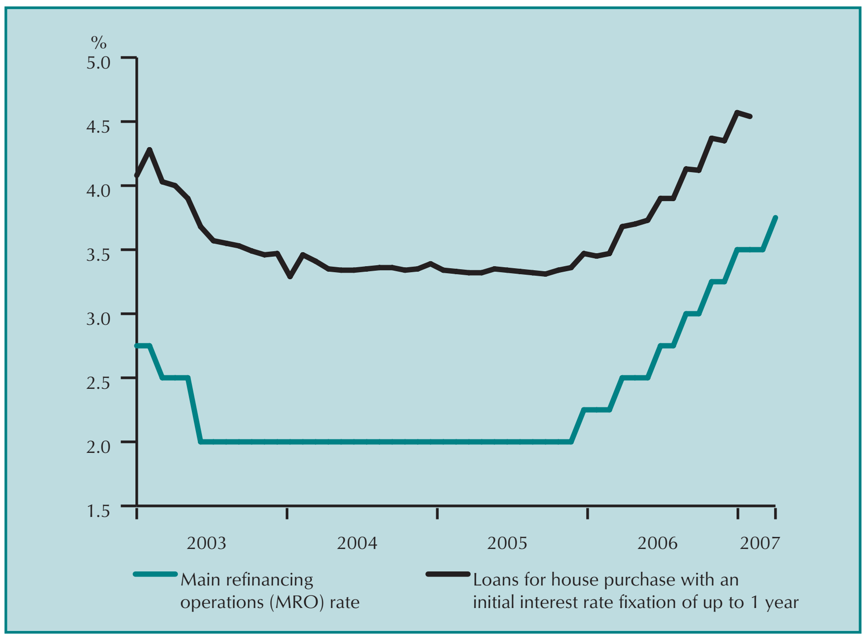
The attractions of the housing market are further highlighted by considering other asset classes available to small investors, for example, equities or bonds. The ISEQ and permanent tsb/ESRI house price indices are shown in Chart 6, taking

January 1999 as a base. Although the ISEQ index reached record levels in recent times, the rise in this index has not matched that of the house price index. In addition, while the house price index experienced a downturn in 2001, and a moderate increase in 2005, it has not experienced the same volatility as the ISEQ index. The experience of many small investors in the wake of the Eircom flotation, during which many first-time investors lost money, may also have led to reluctance by some to invest in equities, and such investors may have turned to the housing market instead. Finally, it is easy to take a geared position in the housing market — borrowing to buy equities is more difficult and expensive — while interest costs can be offset against rental income.

Risks to the Housing Market

One of the concerns raised by the IMF in their 2003 assessment of the Irish economy is that credit risks within lenders' mortgage portfolios might rise because of "loans to small investors to acquire rental properties" (IMF, 2003). Investors, they felt, might be less committed to the housing market than owner-occupiers and might as a group attempt to sell if interest rates rose, rents fell or house price increases stalled.

Chart 7: ECB MRO Rate and Irish Mortgage Interest Rates



Source: CBFSAI.

Two of the developments which the IMF felt presented risks to the housing market have now come to pass — month-on-month increases in house prices have been virtually flat since November 2006 and, as Chart 7 shows, mortgage interest rates have risen sharply since the ECB began to tighten monetary policy in December 2005. In this context, surveys of landlords give some comfort in that they support the view that investment in housing is not a short-term activity. A survey by Gunne/EBS points to the long-term view of many investors, who see their properties as pensions or nest-eggs for their children. Similarly, Hooke and McDonald found that almost three-quarters of investors plan to hold onto their property for more than 5 years.

In a survey by Goodbody Stockbrokers, published in March 2007, it was also found that investors viewed property as a long-run investment and were unlikely to react to short-term developments. Almost 90 per cent of investors did not plan to sell in the next twelve months. Attitudes towards further investment, however, were more negative with 78 per cent of the respondents saying that they did not plan to add further to their Irish housing portfolio over the next twelve months (Goodbody, 2007).

The *Financial Stability Report, 2006* looked at the importance of capital appreciation to investors. Using the average house price in August 2006 and taking a number of assumptions for annual house price inflation (15.4 per cent), vacancy rates, etc, it was shown that while income exceeded the expenditure (including start-up costs like stamp duty and legal fees) of an investment property at that time, this was in large part due to capital gains. Since August 2006, there has been a slowdown in house price inflation. Consequently, the current level of capital appreciation would be much lower. In addition, while rents have risen strongly, interest rates have also increased.

Investor activity in the housing market is at an interesting juncture. With rents rising quite strongly and with equity markets experiencing volatility, existing investors may have little incentive to leave the market. The absence of capital appreciation, however, reduces the attraction of the market for new investors at a time when rental returns in general will not cover borrowing costs and there is uncertainty regarding possible changes in stamp duty. How events unfold remains to be seen but data are now available to monitor developments. Investor demand for new mortgages can be seen in the IBF data on new mortgage lending, while any significant withdrawal by existing investors would be reflected in a decline in BTL mortgages outstanding in the Bank's new series.

Comparison with the UK

Ireland is not the only country to experience large growth in lending to the BTL sector. While the ECB does not collect any information regarding investors, a breakdown of mortgage data for the UK is available from the Council of Mortgage Lenders. These data show the rising importance of the investor sector in the UK mortgage market. In 1996, a BTL mortgage scheme was introduced which revolutionised the sector (Thomas, 2006).

The structure of the UK housing stock differs from Ireland. Unlike Ireland, the proportion of owner-occupied dwellings in the UK has been increasing, and rose by 3.3 percentage points between 1996 and 2005. There was a smaller (0.7 percentage point) increase in the proportion of private-rented dwellings over the same period, to 10.8 per cent in 2005. These increases were at the expense of local authority rented dwellings, whose proportion almost halved over the period.

Outstanding BTL mortgages experienced high growth rates in recent years, with an annual increase of 40.6 per cent in 2005, moderating to 29.2 per cent in 2006. By end-2006, there were around 850,000 BTL mortgages outstanding, worth £94.8 billion. Despite the strong growth in lending to this category, BTL mortgages only accounted for 9 per cent of total outstanding mortgages in the UK at end-2006; this compares with 24.6 per cent in Ireland.

4. Conclusions

All indicators point to an increase in investor interest in the residential property market in recent years. In this context, new data collected by the Bank for the period 2003 to 2006 reveal a marked rise in the share of BTL lending in total residential mortgages. This trend is consistent with IBF data for new lending in 2005 and 2006 as well as with sales figures from estate agents.

Concerns have been expressed that investors may pose a greater risk to the housing market than owner-occupiers, as they may choose, or be constrained, to exit the market at short notice in response to higher interest rates or slowing house price increases. To date there is little evidence of such an exodus, but expectations regarding capital appreciation may have changed and risks may have increased with the rise in the proportion of mortgage loans accounted for by BTL investors. At almost 25 per cent of outstanding residential mortgages at end-2006, this share was nearly three times that of BTL lending in the UK.

Strong house price increases in the first half of last year have now given way to virtually static prices since November 2006 while loan interest costs have been increasing faster than rents. Surveys of landlords suggest that most investors take a long-term perspective on housing investment and are unlikely to leave the market because of short-term setbacks. It will be interesting to monitor developments through changes in both new and outstanding borrowing for BTL properties in the IBF and new Bank data series.

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