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Ms Anne-Marie Lynch
Joint Committee on Housing, Local Government and Heritage
Leinster House
Dublin 2

Re: Pre-Legislative Scrutiny of the General Scheme of the Affordable Housing Bill

Dear Ms Lynch,

I refer to your letter dated 22 February 2021 relating to "Pre-Legislative Scrutiny of the General Scheme of the Affordable Housing Bill". Governor Makhlouf has asked me to reply.

We welcome the opportunity to submit views on the General Scheme of the Affordable Housing Bill, which covers a number of important proposed policies in relation to the housing market and housing supply.

The Central Bank is acutely aware that the current state of the Irish housing market poses real challenges for people, especially younger generations. Affordability pressures are evident in the level of both rents and house prices relative to incomes, especially in urban areas of the country. In recent years, the supply of housing has not kept up with growing demand and construction of new housing units has been below its long-term average for about a decade.[1]

The Bill provides for the introduction of different schemes by the Government. Of these, the proposed Affordable Purchase Shared Equity Scheme (Section 96A) has the most direct connection to the mortgage market and, therefore, interacts most closely with the Central Bank's own mandate. As such, our comments are limited to the proposed Affordable Purchase Shared Equity Scheme.

As a general principle, given our mandate, the Central Bank would always consider the implications of policy interventions in the housing market, with a particular focus on those that interact closely with the mortgage market. We would typically assess the implications of such interventions through three lenses: first, financial stability (including the interaction with the mortgage measures); second, consumer protection; and, finally, broader housing market dynamics.

[1] See, for example, Kennedy and Myers (2019) 'An overview of the Irish housing market', Conefrey and Staunton (2019) 'Population Change and Housing Demand in Ireland'. Donnery (2019) 'Perspectives on the Irish Housing Market – the past five years'.

Consistent with this approach, we outline our current considerations on each of these dimensions below. It is important to flag that, to our knowledge, some of the key parameters of the proposed scheme have yet to be finalised. So our response outlines the framework through which we will be considering the scheme, and flags some of the key issues that will be particularly important to inform our assessment.

Financial stability and interaction with the mortgage measures

Mortgages are the single largest form of debt owed by households in Ireland and the single largest loan exposure on Irish banks' balance sheets.[2] Therefore, developments in the housing and mortgage markets have a material impact on the financial position of both borrowers and lenders, with potential implications for financial stability.

In that context, the Central Bank introduced in 2015 a set of measures that act as 'guardrails' to lending standards in the mortgage market (henceforth referred to as the 'mortgage measures'). The objective of these measures is two-fold. First, to strengthen the resilience of lenders and borrowers to negative economic and financial shocks; and, second, to dampen the pro-cyclicality of credit and house prices, so that a damaging credit-house price spiral does not emerge. The Central Bank reviews the operation and calibration of the mortgage measures on an annual basis, in the context of wider housing and mortgage market developments.[3]

The stated intention of the Affordable Purchase Shared Equity Scheme is that the "State would provide equity support to households seeking to purchase homes in the private market, but unable to secure the full mortgage to do so". In effect, this additional financing provided by the State, and any other parties that participate in the scheme, would allow households to purchase a property in the private market by taking on a smaller mortgage than they otherwise might have needed.

A full financial stability assessment of the Affordable Purchase Shared Equity Scheme will require finalisation of a number of key design features, which do not explicitly form part of the General Scheme of the Bill. The Central Bank will be considering three specific dimensions from a financial stability perspective: (i) the impact of the additional financing through the scheme on households' ability to withstand income shocks and avoid excessive indebtedness or negative net wealth; (ii) any additional risks to the banking sector, which in turn may be adequately mitigated through capital-based prudential regulation, and (iii) the potential for any additional credit facilitated by the scheme to result in pro-cyclical house price dynamics.

Within this broad framework, from the perspective of the Central Bank's financial stability mandate and the interaction with the mortgage measures, there are two key dimensions of the design of the scheme that will be particularly important:

- **First, the precise characteristics of this additional form of financing and the extent to which these result in more 'equity-like', rather than 'debt-like', financing of households**. This relates to the precise contractual obligations of those in receipt of this financing, for

[2] See, for example, Central Bank of Ireland (2020) 'Household Credit Market Report' and Lyons, Nevin and Shaw (2020) 'Real-estate concentration in the Irish banking system'.
[3] For the outcome of the latest review, see Central Bank of Ireland (2020) 'Financial Stability Review, 2020:II'.

example with respect to repayments, either over the course of the financing agreement or upon its expiry. The scheme is described as providing 'equity support' to households, but – at this stage – there is little detail around the contractual obligations on those that might receive this financing. The closer those contractual obligations are to equity-like financing for households, the more limited the risks stemming from this source of financing to borrower resilience due to additional indebtedness – a key dimension of the Central Bank's mortgage measures.

- **Second, the participation – or otherwise – of regulated mortgage lenders in the financing of the scheme**. The text of the General Scheme of the Affordable Housing Bill suggests that *that "parties other than the Exchequer/Minister may provide support to the scheme"*. This is potentially a key difference to a similar scheme that is already in operation in the United Kingdom, where the UK Government is the sole provider of financing of the equivalent scheme. If these additional parties were to include regulated domestic mortgage lenders, this would create an additional risk exposure of lenders to the housing market (over and above exposures related to mortgage lending). To mitigate any associated risks to lender resilience, these exposures will need to be capitalised appropriately.

Depending on the above, there is also potentially a more direct implication in considering the interaction of the scheme with the mortgage measures. The Statutory Instrument on which the mortgage measures are based (S.I. No.47/2015) includes an 'anti-avoidance' clause. This sets out that lenders shall not engage in a practice; enter into an arrangement or transaction; execute a document; or structure or restructure a loan, for the purpose of, or having the effect of, avoiding their obligations under these Regulations. Depending on the precise design of the scheme, including the issues set out above, lenders' participation in the scheme could potentially be interpreted as being in contradiction with that anti-avoidance clause. This arises as the effect of the scheme is to effectively enable a higher purchase price through the provision of more external finance to the borrower.

Upon finalisation of the scheme design, the Central Bank would need to consider in a holistic way the potential financial stability implications of the scheme. The materiality of any financial stability risks, and the ability to appropriately mitigate them, will inform any decision by the Central Bank on any changes to the mortgage measures regulations, including any decision to alter this anti-avoidance clause to clarify the ability of mortgage lenders to participate in the scheme.

Consumer protection

A second key dimension will relate to protections for consumers. It is important that consumers who avail of the proposed Affordable Purchase Shared Equity Scheme are adequately and appropriately protected. Indeed, one of the issues that has been flagged in the context of the UK scheme has been that the financing is provided as an unregulated financial product, with potential implications for the protection afforded to consumers.[4]

[4] See House of Commons Public Accounts Committee (2019) 'Help to Buy: Equity loan scheme'.

There is a strong consumer protection regulatory framework in place for the provision of mortgages by regulated entities. At this stage, further clarity is required as to the intended status of the SPV as a regulated entity for the purposes of that framework, and/or, as mentioned above, whether regulated mortgage lenders will also be involved in the provision of the Scheme. These are important considerations for the design of the Scheme.

More generally, in the context of consumer protection, given this would represent a new, and a relatively more complex, product to the Irish mortgage market, the providers of this financing will need to ensure sufficient and understandable information for consumers on the differences to current mortgages in the market, overall costs and borrower obligations, including in particular, with respect to any payments of interest, and repayment of the equity facility. In addition, further consideration and clarification will be required on the implications for mortgage switching.

Broader housing market dynamics

As mentioned previously, a key challenge with the current state of the Irish housing market is the continued imbalance between the demand for, and supply of, housing. Construction of new housing units has been below its long-term average for about a decade, and it remains below measures of structural housing demand. With a muted supply response to strong growth in housing demand in the years preceding the pandemic, affordability pressures have increased.[5]

The Affordable Purchase Shared Equity Scheme operates mainly by increasing the purchasing power of households. Effectively, the scheme is likely to operate mainly by shifting the demand for house purchases. The eventual impact on the construction of new units and house prices will depend on the responsiveness of housing supply to price changes. In that context, there is evidence that the supply of housing has been more sluggish to increasing prices, both domestically[6] and in some other countries.[7] If there are structural reasons, such as labour skill shortages in the construction sector, tighter land-use regulation or insufficient incentives to guard against land hoarding, which impede this supply response, a scheme that results in higher levels of demand – depending on its size – could result in upward pressure on house prices.

Evidence from a similar scheme in the United Kingdom suggests that the introduction of the scheme did lead to increased housing supply in aggregate.[8] However, we are not aware of evidence that this was due to a shift in the housing supply curve itself (as opposed to a shift in the demand for housing and, so, a higher number of units at higher prices). Indeed, some of the studies suggest that any positive supply response more likely arose in areas where broader supply constraints and more

[5] See, for example, Kennedy and Myers (2019) 'An overview of the Irish housing market', Conefrey and Staunton (2019) 'Population Change and Housing Demand in Ireland'. Donnery (2019) 'Perspectives on the Irish Housing Market – the past five years'.
[6] See Kennedy and Myers (2019) 'An overview of the Irish housing market'.
[7] See Aastveit et al (2020) 'Changing supply elasticities and regional housing booms' for evidence from the US housing market. See IMF (2016) 'Global House Prices: Time to Worry Again?' for a broader discussion on supply constraints driving house prices across different countries.
[8] See National Audit Office (2019) 'Help to Buy: Equity loan scheme – progress review'.

acute demand and supply imbalances were not present beforehand. [9] More broadly, other factors from international experience include the findings that such schemes – depending on their design – may also benefit those who had no need for them to purchase housing, but rather just facilitated those beneficiaries in buying more expensive housing.[10]

In principle, some of these challenges may be mitigated through the precise design of the scheme. This would include the absolute amount devoted to the scheme, the time period over which it is allocated, the focus on particular buyer and property categories, and accounting for regional variation in the level of support provided. The timing of the scheme also warrants consideration, as further support to housing demand in the future could arise from the release of accumulated household savings, which have increased substantially during the past year.

Overall, taking a broader housing market perspective, the proposed scheme – in isolation – is likely to have a limited impact on the ultimate supply-side problem in the Irish housing market. We would, therefore, encourage a continued effort to focus on policies on the supply side of the market – including, but not limited to, some of the other elements of the Affordable Housing Bill. Such supply measures, of course, are longer-term in nature, and there may be a place for a targeted scheme that alleviates near-term challenges for certain potential homeowners. Still, we would encourage those considering the detailed parameters of the scheme – including its size, the time period over which it is allocated, eligibility criteria and the eventual exit strategy – to be mindful of the potential implications of increased demand for house purchases in a supply-constrained market.

I hope this response is helpful for the Committee's deliberations. We remain available to discuss any of the issues set out in this response further.

Vasileios Madouros
Director of Financial Stability

[9] See Carrozzi, Hilber and Yu (2020) 'On the Economic Impacts of Mortgage Credit Expansion Policies: Evidence from Help to Buy'.
[10] See Benetton et al (2019) 'Housing consumption and investment: evidence from shared equity mortgages'.