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Feedback Statement on call for submissions: Review of residential mortgage lending requirements

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1. Introduction

The Central Bank of Ireland ("Central Bank") introduced limits on high loan-to-value (LTV) and loan-to-income (LTI) lending in the Irish mortgage market on 9th February 2015 under Statutory Instrument No. 47 of 2015 ("the Regulations"). These measures, known as macroprudential or mortgage market measures, have as their primary objectives:

- to increase the resilience of the banking and household sectors to shocks in the property market; and
- to reduce the risk of future bank credit and house price spirals.

Both of these aims are key priorities of the Central Bank in its dual mission to *'Safeguard Stability and Protect Consumers'*.

The Central Bank has committed to an annual review of the mortgage market measures. The first annual review examined the early performance of the Regulations against the stated objectives and potential side effects of the measures. As part of this the Central Bank launched, on 15 June 2016, a public call for submissions on the impact of the macroprudential mortgage market measures. The submissions received in turn informed the review of the impact and effectiveness of these measures.

The Central Bank welcomed data-based and other analytical submissions to inform its assessment.

1.1 Submissions Process

The deadline for receipt of responses to the call for submissions was 31 August 2016. In total, fifty-one submissions were received; twenty-four of these were from individual members of the public while twenty-seven were from institutions.[1] Of the submissions from institutions, nine were from the property and construction industry, twelve were from financial service firms and groups including mortgage brokers, financial advisors, banks and mortgage insurers, three were received from political parties, two from academics and one from a government department. Eleven agencies working in the property and construction industry commissioned and submitted the

[1] One submission was received shortly after the closing date for submissions and so was not included in the numbers released in the press release after the closing of the call for submissions but has been included for the purposes of this statement.

results of a survey conducted on potential home buyers, mainly in Dublin. Analysis from two additional surveys was also provided. One of these surveys covered the impact of the Central Bank mortgage lending rules in Leinster, with respondents compiled from the property valuation industry. The other, which surveyed the mortgage, financial and insurance brokers industry, attempted to ascertain the real impact of the lending requirements on those who are seeking to obtain a mortgage.

The Central Bank would like to thank everyone who provided a response to inform this process. All submissions received are available on the Central Bank website.

The aim of the call for submissions was to have a structured engagement with interested parties and feedback received as part of the process has been carefully considered. Details on the revised measures can be found in the *Review of residential mortgage lending requirements* and the accompanying research which has now been published. The full list of publications can be found on the Central Bank's webpage:

http://www.centralbank.ie/stability/MacroprudentialPol/Pages/LoantoValueLoantoIncome.aspx

1.2 Feedback Statement

The purpose of this Feedback Statement is to outline how significant comments received as part of this consultation process have been dealt with in the evaluation of the mortgage market measures. The Feedback Statement is structured around some of the common themes that emerged in the submissions. Section 2.1 presents an overview of responses; Section 2.2 discusses the main points of the submissions in relation to the LTV limit and Section 2.3 in relation to the LTI limit. Section 2.4 focuses on alternative proposals submitted.

2. Feedback received from submissions

2.1. Overview of responses

Feedback received during the call for submissions from *institutions* was predominantly supportive of the overarching aims of the LTV and LTI limits, with concerns more focused on the specific calibration of the measures. Of the *individual* submissions received, almost two thirds expressed criticisms of the rules, in particular referencing individual circumstances. However, there were also calls from several individual submissions not to change the measures at this point in time with four in particular considering that high property prices are their key concern, not the Regulations. This was also reflected in one of the surveys submitted. This survey of prospective borrowers predominantly in the Dublin region found that over a third of borrowers believed that high property prices were the most inhibiting factor to purchasing a home.

The supportive submissions received from both industry and individuals highlight potential positive impacts brought about by the mortgage measures. These include the moderating effect on house price expectations and the reduction in the probability of a re-emergence of a property bubble, the strengthening of economic resilience in future potential downturns, as well as protection against irresponsible lending and borrowing trends.

Across a number of submissions, a broad range of concerns regarding the current calibration of the mortgage measures was highlighted. These concerns can be roughly broken into those relating to the economy and those relating to cohorts of borrowers. More specifically, issues relating to the rental market, supply of housing, the geographic effect of the measures, the need for family assistance to accumulate a deposit, and timing of the measures were discussed and further detail is provided on these matters below.

The effect of the measures on the *rental market* was a common theme through a large proportion of the responses. Numerous submissions, including those from the property and construction industry, political parties and individuals, argued that the delaying effect of a higher deposit requirement is forcing prospective borrowers to remain in the rental market for longer, putting upward pressure on rents. It was highlighted that rising rents not only represent increasing costs for households but they can also make it more difficult to save for a mortgage deposit. A number of submissions suggested that this situation is aggravated by the measures which delay first time buyers

(FTBs) in buying their first home and as such increase demand for rented accommodation. For example, one of the findings from a survey submitted to the Central Bank showed that of prospective FTBs (mainly Dublin-based), 46 per cent cited deposit-related reasons as an inhibiting factor when purchasing a home. Furthermore, it was noted in some submissions that, given the high levels of rental payments currently, there is the possibility for a prospective borrower's rental payments to exceed potential mortgage repayments. Also highlighted was the potential pressure which rental market strain is exerting on social housing waiting lists.

Concerns regarding the *supply of residential property* for sale were also emphasised by a number of submissions across the banking and property and construction industries, as well as by political parties and individuals. From the property and construction industry perspective, relayed in four of the responses, it is considered that there are impediments (such as guaranteed sales) to their ability to deliver the required level of house builds to meet sustainable demand, as purchasers of starter homes may not have the capacity to raise the necessary mortgage due to the mortgage measures limiting their capacity to borrow. According to one response, the combination of these suspected credit constrained borrowers and high construction costs means that it is no longer profitable to build homes in Ireland. Three submissions from the property and construction industry warned that the high cost of building is limiting the supply of houses. A further submission proposed that depressed construction activity should be addressed by focussing on the supply side of the market through government policies which encourage house building, by decreasing construction costs or by increasing the provision of social housing. The €220,000 FTB LTV threshold was mentioned by two submissions as contributing to the inhibiting of housing supply.

A third proposed impact which commands attention across the submissions received is that of a *geographic effect* of the mortgage measures in that the effective LTV limit varies across the country. A range of submissions suggested that the measures are having the effect of diverting transaction activity to areas further away from work and family. It was argued that by pushing young families into these areas, social and lifestyle costs are imposed.

Another suggested effect cited by five responses is that the LTV requirement may necessitate recourse to *family assistance* in order to accumulate the requisite deposits. It was argued that the more onerous own-contribution requirement stipulated by the measures has unfairly disadvantaged prospective borrowers from less wealthy backgrounds. This was also highlighted in one of the surveys submitted, which found that 24 per cent of those surveyed believed that they would need to borrow from family in order to meet the deposit requirements.

A limited number of responses received expressed concerns over the *timing of the implementation*. A submission from the property industry suggested that it is too early into the cycle of recovery to limit the access to credit for potential homebuyers, stating that most other countries with similar regimes introduced their rules at a later stage in the cycle. The submission considered that the introduction of the measures will have a knock-on effect on the supply of housing in the future. The Central Bank’s own research was cited as showing that the measures are expected to have a negative impact on housing supply, which according to the submission is problematic given current supply levels.

A series of arguments postulated that the mortgage measures have had an *effect on growth in the economy* through a number of propagation channels. These include the weakening of banks by preventing profitable business writing, the deterrence of construction activity, and general reduction in property transactions.

In addition to the aforementioned commonly raised concerns, there were a number of additional issues raised in the institutional and individual submissions. These include opinions that:

- the tight valuation period of two-months is imposing unnecessary costs on prospective borrowers;
- the rules are difficult for those who (i) have escaped negative equity and wish to trade up and (ii) are coming to Ireland having owned property abroad;
- the increased deposit requirement is inhibiting commencement of pension contributions for FTBs;
- the layering of prudential measures is preventing credit unions from applying competitive interest rates and actively competing in the mortgage market (according to a submission from the credit union sector) and;
- the proportionate limits are forcing banks to adopt additional conservatism in granting allowances.

Furthermore, there were elements outside the scope of the mortgage measures which were identified by certain submissions as having an adverse effect on potential borrowers. In particular, a number of identified issues related to the wider property market featured across submissions from the property and construction industry, political parties and the mortgage industry as well as from individuals. These issues specifically related to increased pressure in the rental market, high construction costs and depressed housing supply. Whilst a number of submissions saw the measures as aggravating these problems by limiting the mortgage credit available to borrowers, it was noted by others that these identified problems require other policy responses outside the scope of macroprudential measures.

Finally, examination of the individual responses received indicated that roughly one third of these showed a potential misunderstanding of some aspect of the Regulations, such as the exemption for switcher mortgages or the flexibility provided to lenders by the proportionate caps.

Central Bank response:

The Central Bank has considered fully the feedback received through the call for submissions as part of the review of the measures. The review considered many of the issues highlighted by the submissions and a number of research papers are being published concurrently which contain the results of this analysis.

The review finds that the overall framework of the Regulations is appropriate and effective in meeting the objectives of the measures, which is in line with the high level support in many of the submissions for some form of mortgage lending measures in the market.

Analysis on the rental market shows that while rents nationally appear to exceed levels which would be justified by economic determinants, this has been the case since before the introduction of the measures.[2] A number of factors have been contributing to pressures in the rental market, such as the shortage of supply, changing expectations among landlords and tenants around future rental growth, low rates of housing sales and the improving

[2] Kennedy, G., O'Brien, E. and M. Woods (2016), "Assessing the sustainability of Irish house prices: 1980-2016Q2" and McCann, F. (2016), "Exploring developments in Ireland's regional rental markets", Central Bank of Ireland Economic Letter Series

economy. Rising rental prices affect households' ability to save and research shows that over the period 2014Q2 to 2016Q2 the average time-to-save for a hypothetical FTB who is currently renting has increased by between one and two years in Dublin and between six months and one year in the rest of the country.[3]

Analysis shows that housing market transactions have remained weak through 2016. While the level of transactions and the turnover rate in Ireland is currently low by historic standards, developments over recent years have been similar to other European countries. Preliminary empirical investigations on the drivers of housing transactions suggest that recent developments may follow from the long-run impact that is to be expected from financial crises. The introduction of the mortgage market measures may have had a tempering effect on the path of housing transactions through 2015, but more fundamental structural factors seem to dominate the overall level and dynamics of transactions in the market.

As a result of the review, some structural changes have been made to the measures. These changes were made to improve the sustainability and effectiveness of the current framework. As a result of these changes, FTBs buying properties valued over €220,000 will no longer face a higher deposit requirement and a 90 per cent LTV limit will apply to all FTBs, with higher LTV lending allowed in only a very small proportion of cases. The new LTV limit will result in broadly similar deposit requirements for FTBs compared to immediately prior to introduction of the measures, when many banks commonly required 90 per cent LTVs. The removal of the property value threshold will remove any geographic differences in LTV limits, and FTBs in cities and other regions with higher house prices will face the same LTV requirements as those in the rest of the country.

In order to adjust the proportionate caps framework to account for the removal of the threshold and taking into account that lending above 90 per cent LTV should be undertaken only in exceptional circumstances, the allowances will be differentiated for FTBs and second and subsequent buyers (SSBs). Under this framework, no more than 20 per cent of the value of new lending to SSBs will be allowed above the 80 per cent LTV limit

[3] Kelly, C. and McCann, F. (2016) "Rental markets, savings and the accumulation of mortgage deposits", Central Bank of Ireland Quarterly Bulletin, 4,2016.

and no more than 5 per cent of the value of new lending to FTBs will be allowed above the 90 per cent LTV limit. This differentiation of allowances between FTBs and SSBs leaves a more robust framework which allows for more targeted policy interventions in future in response to emerging risks in the property market.

Regarding the timing of the introduction of the measures, these measures have been introduced as prudent lending standards and are intended as a permanent feature of the market. The parameters of the measures can be varied according to economic, market, or other developments over time and the purpose of the regular review is to ensure that the measures are appropriately calibrated for the stage in the property cycle.

Regarding the issue raised on the valuation period, the Central Bank accepts that a two-month valuation period is too short. Feedback received indicates that a three-month valuation period is standard in the market. The Central Bank is increasing the valuation period to four months to allow for slight overruns above this level.

The Central Bank agrees that the macroprudential tools that are part of its remit are only part of the overall range of policies needed to ensure the smooth functioning of the housing market. The choice and timing of such other policy measures are not within the remit of the Central Bank. However, the Central Bank will contribute to public research and debate on issues relating to the housing market.

2.2. LTV limit

The majority of both individual and institutional submissions included a discussion of the LTV limit. As was the case for the original public consultation[4] on the measures, almost all institutional responses supported the overall goals of the LTV limit and agreed that some form of policy is beneficial to maintain the resilience of the household and financial sector to real estate shocks. However, most of these also argued that deposit requirements under the rules are excessive and suggested changes to the 80 per cent LTV limit for SSBs, changes to the €220,000 threshold on the 90 per cent LTV for FTBs or some form of allowance for households also facing rental payments. The majority of discussions focused on LTV limits for FTBs and SSBs with little reference to the buy-to-let (BTL) limit. Finally, two submissions flagged that there may not be sufficient public understanding of allowances related to the LTV limit.

Twenty-five of the submissions received proposed changes to either the FTB threshold or the LTV limit applied to borrowers. There were calls for increases in the threshold to values at or between €235,000 and €400,000,[5] some of which are dependent on the location of the property. There were also two suggestions to remove the threshold altogether. Greater transparency on the setting of the €220,000 limit was called for by four institutional submissions received. For proposed changes in the LTV limit, there were wide ranging suggestions covering the treatment of various cohorts of borrowers. A countercyclical application of the LTV limit was also proposed.

The rationale for agreement with the LTV limit was quite uniform across submissions. The need to avoid a repetition of the housing boom was acknowledged, in particular the impact that highly leveraged lending could have on housing spirals and household indebtedness. Six submissions also argued that loosening the Regulations may simply lead to house price inflation as opposed to increasing access to the mortgage market.

For those submissions which highlighted concerns with the LTV limit, the rationale was also quite uniform with the majority pointing to difficulties experienced by households in saving large deposits and to increased pressure in the rental market. A number of submissions from the property and

[4]http://www.centralbank.ie/stability/MacroprudentialPol/Documents/CP87%20Consultation%20Paper%20mortgage%20regs.pdf
[5] The majority were in the €330,000 to €350,000 range.

construction industry claimed that the rules are having a negative impact on the supply of homes. One mortgage insurance firm suggested that the LTV limit as it current stands (including the 15 per cent allowance for Principal Dwelling House (PDH) borrowers) is preventing willing banks and creditworthy customers from concluding contracts.

Eight of the submissions from the property and construction sector suggested a loosening of the €220,000 threshold on 90 per cent LTVs for FTBs. Four of these also suggested a loosening of the LTV limit by applying FTB rules to all borrowers or loosening the SSB requirements. One of the responses proposed that BTLs should require an LTV limit of 80 per cent (as opposed to the current 70 per cent limit) to facilitate the provision of additional supply for the the rental market.

Similarly, submissions from mortgage brokers and advisors suggested a loosening of the €220,000 threshold for 90 per cent LTV lending and a loosening of overall LTV limits. Submissions from the banking and credit union industry suggested relaxing the €220,000 threshold and one also suggested that the LTV rules be relaxed for marginal equity borrowers and renters. Furthermore, it was suggested that any future amendment of the €220,000 threshold should be based on the distribution of house prices around the country.

While numerous submissions from all sectors suggested that the €220,000 threshold for 90 per cent LTV lending is unsuitable for the greater Dublin area or urban areas more generally, only one institution and one individual suggested a differentiated threshold across urban and rural areas.

Three submissions received from the mortgage insurance industry and mortgage brokers and advisors advocated the use of mortgage insurance. Two of these suggested unlimited lending outside of the Regulations on the condition that mortgage insurance is used and the third suggested an increase in the current PDH LTV allowance to 30 per cent as long as the additional 15 per cent was insured.

All political party submissions highlighted the difficulties faced by prospective borrowers in saving for deposits while also paying rent. While one submission acknowledged this difficulty but felt that it would be better addressed by government policy, another suggested a loosening of the policies where there is a strong track record of rental payments and/or the use of mortgage insurance.

This difficulty was also a focus of the government department submission which suggested rental history should be taken into account in determining deposit size. It was also suggested that the allowances for lending above the LTV limit be increased to 20 per cent and that the increase in allowances should be directed towards FTBs, particularly those renting.

Suggestions from academics and financial advisors were quite varied with one submission suggesting that the limits were introduced at the wrong point in the housing cycle and that the LTV rule should be implemented countercyclically. Another suggested the removal of looser limits for FTBs, as borrowers seeking to take full advantage of these will be discouraged from buying modest starter homes, and the introduction of a tighter, gradual LTV limit on all borrowers.

Over half of individual responses mentioned the LTV restriction or issues surrounding deposit size and of these over half were negative. While most individual responses called for this aspect of the Regulations to be loosened, one called for the removal of looser rules for FTBs and another for tighter restrictions on BTL lending. Responses calling for looser restrictions generally did not propose specific measures although those that did included increasing the 90 per cent LTV threshold to €265,000 in Dublin and allowing bridging loans to partially cover deposit requirements where mortgage payments were substantially lower than rental payments.

Central Bank response:

The Central Bank notes the widespread support for the goals of the LTV limit and the review of the framework has concluded that the overall measures remain appropriate and effective. The majority of concerns regarding the LTV limit relayed via the submissions process relate to the size of the deposit requirement for FTBs. The decision to remove the threshold, based on a range of evidence and considerations, should address some of these concerns. FTBs are now facing broadly similar deposit requirements as they did immediately prior to the Regulations. The removal of the threshold should also address concerns around transparency on the setting of the level of the threshold and general concerns around how and when the threshold should be amended, particularly during periods of strong house price growth, which could give rise to some disruption to the market on an annual basis.

With regard to the proposals to tighten the LTV limit for FTBs, examination of new lending since the introduction of the measures highlights the role of the LTI limit in limiting excessive leverage among FTBs as LTV ratios increase. The LTI limits, together with the 90 per cent limit for FTBs which can only be exceeded by less than 5 per cent of the value of new FTB lending, should allow for an appropriate balance between prudent lending standards and allowing access to homeownership for credit-worthy FTBs. The evidence regarding the lower probability of default for FTBs[6] at all house price levels provides further support that this approach will not reduce the effectiveness of the Regulations in increasing the resilience of banks and borrowers.

The LTV requirements for SSBs remain broadly unchanged. The 80 per cent LTV limit for SSBs is still considered appropriate, particularly given the potential for these borrowers to build up equity in their current home. It is considered appropriate to allow for a certain amount of new lending above the SSB LTV limit. Under this framework, 20 per cent of the value of new lending to SSBs will be allowed above the 80 per cent LTV limit. This is broadly in line with the current new lending for SSBs above the LTV limits since the introduction of the measures.

Borrowers in negative equity who are selling their property and buying a new one will remain out-of-scope of the LTV limits.

The potential for combining mortgage insurance with the LTV and LTI limits was considered as part of the analysis undertaken prior to the original introduction of the Regulations.[7] It was found that such an approach would reduce the effectiveness of the Regulations in terms of dampening the pro-cyclicality of property lending.

[6] O'Malley, T. and C. O'Toole (forthcoming), "Mortgage Default and First Time Buyers: An Update", Economic Letters, Central Bank of Ireland.

[7] Hallissey, N. (2015), Mortgage insurance in an Irish context. Central Bank of Ireland Economic Letter, Vol 2015, No 5.

2.3. LTI limit

Over half of the responses to the call for submissions made reference to the LTI measures, with 65 per cent of institutions and 46 per cent of individuals mentioning them. Whilst there was almost an even mix of negative and positive reactions from individuals, the majority of institutions who discussed the LTI were generally positive in their feedback.

Overall the property and construction industry submissions received had strong views with respect to the LTI limit, with a large proportion generally agreeing with the concept of the limit however proposing different levels, all of which were higher than the current 3.5 times gross income. Three respondents suggested increasing the limit to between 4 and 4.5 times borrowers' gross income, with an additional three respondents proposing that the limit should be increased in Dublin and/or urban areas. Taking into account whether or not a borrower is paying rent was mentioned by two construction industry submissions, with an index proposed by one linking a borrowers' ability to pay rent and their employment status to the borrower receiving a higher LTI. One property industry response proposed the use of net income as being a more appropriate measure of income for the purposes of the LTI as it would provide for an enhanced measure of a borrower's purchasing power which is sensitive, for example, to annual variations in the tax burden arising from Budget measures. Concern was highlighted by one construction industry submission that the introduction of both the LTV and LTI limits at the same time has resulted in the exclusion of mortgage applicants from loan approval notwithstanding the applicants' ability to meet repayments.

The banking and credit union industry responses highlighted concerns with respect to the LTI limit, with two out of three proposing different approaches whereby banks would consider the ability of the customer to service the mortgage given other loan commitments and consistent out-goings/payments. Two submissions in particular suggested that the LTI measure is, at this early stage, proving to not be the most precise method of measuring affordability. It was suggested by one of these submissions that a more accurate assessment for prudent lending with respect to a borrowers' income would take into account the relevant mortgage payments in addition to all other debt commitments. The other submission proposed an affordability metric encompassing the term of borrowing, the borrower's existing debt levels and their other payment commitments. In contrast, one submission from this sector suggested that no recalibration of the LTI limit is required.

Only one political party mentioned the LTI element of the Regulations. This submission suggested that, where a borrower has a deposit greater than 20 per cent of the property value, there should be scope to relax the LTI limit and that consideration in such cases should be based on net disposable income. The submission also proposes that a limit on total repayments, including repayments of non-mortgage debt, as a share of net disposable income would be more suitable than an LTI limit.

A specific focus on the take up of the allowances permitted for the LTI was provided for in the government department submission. It was proposed that a 5 percentage point increase in allowances for high LTI lending should be directed towards FTBs, particularly those currently renting and who can provide requisite evidence of a strong payment discipline.

Within the academic and financial advisor cohort who addressed the LTI measure, the reaction was predominantly negative. One academic believed the LTI ratio is an inadequate measure of the affordability of housing more generally as it does not take into account costs arising from energy and travel. In addition to potential affordability problems arising from such costs being ignored, the submission suggested that this could act as a disincentive to invest in cost effective, energy efficient housing and, due to the difference between urban and rural incomes, could lead to urban sprawl. The submission also highlights that the measure does not take into account the interest rate environment and suggested that the Central Bank's focus should exclusively be on the LTV measures. Another submission flagged the absence of an LTI differential for FTBs and suggested raising the LTI limit for FTBs to 4 times. This submission also referenced European Central Bank research which supports the use of debt-service-to-income (DSTI) caps, suggesting that the Central Bank re-examine this approach.

A business representative organisation proposed a number of changes to the LTI limit, suggesting that future earnings prospects based on a potential borrower's current employment and educational background should be taken into consideration for LTI purposes. In addition, it was suggested that the LTI limit should be increased in city areas in circumstances where applicants have a proven ability to pay market rents.

Of the twenty-four individual submissions received, three suggested loosening the LTI. One suggested increasing the limit to 4.5 times gross income so as to be in line with the Bank of England approach whereas another suggestion was for a 4.5 times limit to be based on disposable income. A further submission considered that the LTI measure should take into account non-salary income such as child benefit.

Central Bank response:
With respect to submissions calling for a loosening of the LTI measure, the Central Bank maintains that the 3.5 times limit is an appropriate calibration. This calibration is based on international evidence and empirical research which finds that probability of borrower default increases substantially as originating LTI increases.[8] It is also significant to note the importance of the LTI limit to maintaining household resilience to financial shocks and the central role played by high LTI lending in the build up to the recent crisis.

With respect to the proposal for replacing the LTI measure with a DSTI ratio, as the centralised credit register is only becoming operational in Ireland, it is not feasible to implement this. However, the Credit Reporting Act 2013 provides for the establishment of a Central Credit Register by the Central Bank and on 22 September 2016 the Central Bank published regulations governing the operation of such a Register. The Register will begin collecting household data in 2017. Once fully operationalised the potential implementation of a DSTI in Ireland will be considered in future reviews of the mortgage market measures.

Furthermore, the Central Bank acknowledges that the LTI limit may be a somewhat blunt tool in assessing borrower affordability and that in many cases, due to a wide range of factors including a history of reliable rent payments or income growth expectation, an LTI higher than the 3.5 limit will be appropriate for a given borrower. This is the Central Bank's motivation for including proportionate caps in the Regulations which allow up to one fifth of the value of new lending taking place at an LTI higher than 3.5 times.

The Central Bank also acknowledges that the LTI measure is not a precise method of assessing affordability. However, the LTI measure is not

[8] Hallissey, N., Kelly, R., and T. O'Malley (2014), Macro-prudential Tools and Credit Risk of Property Lending at Irish banks. Central Bank of Ireland Economic Letter, Vol 2014, No 10.

intended as a substitute to banks' own assessments of affordability and credit risk. The macroprudential measures sit on top of banks' own lending standards and processes with the objective of limiting aggregate increases in indebtedness while not precluding prudent lending above these levels for individual cases.

2.4. Alternative proposals

An overall majority of submissions received acknowledged the need for some form of regulation on mortgage lending, however, they also contain recommendations on changes to the calibration of the current measures, alternative policy options and operational aspects for consideration by the Central Bank. These were more concentrated in institutional submissions than in the those of private individuals, with around 90 per cent of responses from institutions containing some form of alternative policy proposal, and just over 60 per cent of individual submissions doing likewise. This section discusses a number of common threads which can be stitched through the diverse range of policy suggestions received..

The LTV garnered much attention when submissions *proposed changes to the calibration of the measures*, with thirteen different suggestions provided, all of which are addressed throughout this Feedback Statement. At a high level, proposals to loosen the LTV included an increase to 85 per cent (for SSBs), as well as linking deposit requirements for FTBs with their rental payment track record and the amount of their perspective mortgage. In addition, the banking industry proposed a complete exemption from the LTV for equity release for home improvements. There was also a suggestion from a mortgage insurer to allow a high LTV limit for loans covered by mortgage insurance, similar to the 'Help to Buy' scheme in operation in the U.K. In addition, the importance of a flexible calibration and application of an LTV limit was emphasised.

Proposals, originating across submissions groups, for an upward revision of the FTB threshold (from the present €220,000) ranged from an increase to €235,000 to the entire value of the mortgage. Furthermore, some of these proposals recommended a regionally-differentiated loosening and others an overall loosening. On the differentiated recommendations, contributors variably suggested Dublin/non-Dublin, or urban/rural regulatory separation.

Two submissions from industry proposed an increase in the LTV for BTL borrowers to 75 per cent and 80 per cent.

Multiple submissions also proposed amendments to the LTI ratio from the present 3.5 times, with 40 per cent of institutions proposing an increase in the ratio. Alternatives ranged from 3.75 to 4.5 times in addition to outright removal of the LTI limit. The introduction of an LTI of 4 times specifically for FTBs was suggested. Recommendations for removal of the limit either included no replacement measure or movement to a metric which is more reflective of a borrower's true debt-servicing capacity. Further details on the submissions related to the LTI limit are relayed in the LTI section of this Feedback Statement.

For both the LTV and LTI proportionate limits, a recommendation was submitted proposing to change the calibration from 15 and 20 per cent to 20 and 25 per cent respectively. Another proposal was to only offer allowances on the LTV and LTI measures to FTBs, whereas an additional suggestion was to increase the allowance offered and for that additional portion to be directed towards FTBs only.

Numerous submissions, in particular from individuals, called for the recognition of rental-payment history in the assessment of borrowers' creditworthiness with only a minority of these providing details on how such recognition might be operationalised. One suggestion received proposed an affordability test whereby an index would link a potential borrower's ability to pay rent and employment status with the potential for receiving a higher LTI. A capacity to pay test was also proposed whereby a strong rental payment record over a significant period of time should be taken into account when setting the required deposit. A further suggestion was to allow a one-third reduction in the equity requirement for FTBs with a three-year record of rental payments equal to 90 per cent of the hypothetical mortgage debt service cost.

In addition to the cited areas outlined above, the following proposals were also received:

- adopt a flexible countercyclical approach to LTV limit with a 90 per cent limit during periods of weak credit growth;
- base exceptions to the LTI limit on the amount of the mortgage in excess of the limit and not the entire mortgage;

- take into consideration future earnings prospects based on a potential borrower's current employment and educational background for LTI purposes;
- with reference to the LTV requirements, a deposit assessment should be conducted to exclude monetary gifts from family members.

Five of the submissions received *proposed absolute alternatives to the measures*, focusing specifically on the LTI limit. The advantages of using a DSTI ratio for the purposes of assessing mortgage affordability were highlighted by two of these submissions. Furthermore, one response from the banking industry recommended transitioning away from the LTI to a more borrower specific metric encompassing the term of borrowing, existing debt levels and other commitments e.g. payment of rent while saving to purchase a property. Another submission considered that a more meaningful restriction than the LTI limit would be a requirement that monthly repayments on all outstanding loans do not exceed 35 per cent of disposable income. This could then be stress-tested to take into account the impact of an increase in mortgage rates.

In addition to the above listed alternative calibration and non-calibration proposals, a series of proposals were received concerning the *practical operation of the macroprudential mortgage measures*. These were principally submitted by property and construction industry groups and credit institutions, as well as private individuals.

The definition of FTBs was raised by five individuals and two institutions with suggestions including the extension of the FTB treatment to the entire borrower population in addition to the categorisation of the following borrowers as FTBs (in addition to the borrowers captured under the current definition);

- individuals who have not owned a property for an extensive period of time;
- individuals who have previously owned property but no longer have any stake in it (due, for example, to a relationship breakdown);
- individuals who have previously received a mortgage in another country (in particular, countries with substantially lower house prices), and;
- couples which include one FTB.

In relation to the application of the proportionate limits allowed under the Regulations for both the LTV and LTI measures, alternative options from the submissions focused largely on the difficulty in smoothing the operational use of these allowances across the year. A number of submissions also proposed that the Central Bank exercise greater control over their use by supervised institutions. The inclusion of a 'safety tolerance' within the current limits to allow for a smooth operation of the exceptions management process, as well as limiting the data obligations for lenders to the specific requirements of the Regulations was suggested by credit institutions. Furthermore, it was proposed that by basing the proportionate limits on lending over the calendar year the measures may create inefficiencies and seasonality in lending. To correct for this, it was suggested that lenders be allowed to carry over their unused allowances. It was also recommended that the allowances be calculated using the portion of the housing loan in excess of the limit (as opposed to the entire mortgage) so as to encourage lenders to use allowances for mortgages at LTVs just over the relevant limit. A further suggestion regarding the proportionate caps was that the use of moving averages should be considered to address any potential under-utilisation of the allowances by banks. Finally, submissions from the mortgage insurance industry recommended increasing the proportionate LTV limit from the current 15 per cent limit with a stipulation that mortgages falling in this increased portion be covered by mortgage insurance.

With respect to the original property valuation period (two-months), observations were raised by representatives from the banking, property and construction, mortgage brokers and advisors and individuals whereby it was argued that this period places undue strain and time constraints on closing sales and adds additional costs to buyers (as sales rarely close within that timeframe). It was noted in some submissions that, as the timeline in conveyancing transactions is beyond the control of borrowers, and given recently enhanced standards[9] for property valuation in Ireland and the perceived improvement in the stability of the property price register, an increase in the valuation period ought to be considered.

Central Bank response:

Many of the alternative suggestions have already been addressed in the Central Bank response in sections 2.2 and 2.3 in relation to the LTV and LTI limits. A number of additional proposals are discussed briefly below.

[9] Following the implementation of the European Union (Consumer Mortgage Credit Agreements) Regulations 2016 via S.I. No 142 of 2016.

The Central Bank considered the proposal to exempt equity release for home improvements from the scope of the measures. However, this would not be in keeping with the objectives of the measures in improving resilience of banks and households. In addition, this could allow for some circumvention of the measures and so is not considered a prudent amendment to the Regulations.

Following the review, the Central Bank will not be making changes to the LTV limit for BTL lending as the current limit of 70 per cent is still considered appropriate for the risks associated with this market. However, a technical amendment has been made to the scope of this limit whereby large commercial landlords and developers are not in-scope of the Regulations. As they stand, the Regulations cover loans made to any person for non-primary dwelling home residential property, including larger commercial entities purchasing blocks of apartments or property developers purchasing land on which to build houses. The inclusion of such loans in the BTL category inflates the amount of new lending allowed above the limits and reduces the effectiveness of the Regulations in addressing risks from the BTL market. This is being amended by applying the Regulations to consumers based on the definition in the Consumer Protection Code 2012[10] and that used by the Financial Services Ombudsman to define the scope of its jurisdiction. This definition includes persons acting outside the course of their business, trade or profession, in addition to persons (including sole traders, companies, partnerships and other unincorporated bodies of persons) with an annual turnover of €3 million or less in the preceding financial year taking into account the combined turnover of any group of persons of which they are a member. The advantage of this approach is that it relies on an existing definition and one with which lenders should be familiar.

With regard to proposals that more allowances be provided to FTBs via the proportionate caps, the removal of the threshold and the application of a 90 per cent LTV limit for FTBs reduces the need for allowances for FTBs. Lending above 90 per cent LTV should take place only in exceptional circumstances. In recognition that some limited flexibility for higher LTV lending may be warranted, 5 per cent of the value of new lending to FTBs will be allowed above the limit.

[10] Made by the Central Bank pursuant to section 117 of the Central Bank Act 1989.

A number of aspects of operationalising the proportionate caps were considered prior to the introduction of the Regulations and submissions in relation to these were further considered during the review. These include applying the proportionate limits only to the portion of the loan in excess of the relevant limit and allowing for carry-over of allowances. Some of these changes would be difficult to operationalise. In addition, as changes have been made to the operation of the proportionate cap system with the introduction of differentiated allowances for FTBs and SSBs, the Central Bank will assess the operation of this in the next review and consider if any further changes are required. The removal of the €220,000 threshold for 90 per cent LTV lending should alleviate some of the operational issues experienced by banks in implementing the Regulations.

The definition of FTB will also remain the same. While the Central Bank acknowledges the points raised by submissions with regards to some limitations to this definition, in the majority of cases this definition is appropriate and in cases where it is not lenders may make use of the proportionate caps included in the Regulations. The requirement for all borrowers of a particular loan to be FTBs is aligned with the definition of FTB from the The Office of the Revenue Commissioners

As discussed in Section 2.1, the Central Bank accepts that a two-month valuation period is too short and is increasing the valuation period to four months to allow for slight overruns above the standard three-month period currently experienced in the market.

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