Submission to Central Bank on LTV and LTI Regulations

Brendan Burgess 31 August 2016

First time buyers

The existing rules are appropriately calibrated and there is no evidence that they are preventing any first time buyer who should get a mortgage from getting a mortgage. The overall measure is correct, and only some minor administrative changes need be made.

Since January 2016, 42 First Time Buyers on askaboutmoney.com reported problems in getting mortgages. None was due to the Central Bank's limits. They were all due to the Banks' own credit policies. Even if the Central Bank's limits had not been in place during the period, these borrowers would still not have been able to get mortgages.

Bad credit record	10
Employment issues	10
Affordability	7
Life assurance refused	4
Age – Time to repay mortgage too short	3
Can't find a house we like in an area we like	2
Other, including combinations of the above	6
Prevented by the Central Bank rules	0
Total	42

(See Appendix 1 for more details.)

Given all the reports in the media, I would have expected the issue to come up frequently on askaboutmoney.com, but it just has not come up. Still, I was surprised by the lack of complaints, so I asked the specific question in this thread Has any First Time Buyer been prevented from buying a house due to the Central Bank's rules?

No one has replied.

This could be because

- Some potential buyers have simply given up any hope of getting the 10% together and so have not bothered applying for an exception to be made.
- It's not an issue because people have the deposit or can get family help with it
- First time buyers are settling for starter homes at around the €220k level. Previously they would have bought a more expensive home.
- Behaviour has changed and people have moved back in with their parents to enable them to save the higher deposit requirement
- Lenders are using the 15% exception quota to facilitate such borrowers

The main problems facing first time buyers is the lack of supply and the high prices of houses. Relaxing the lending rules would not ameliorate these problems.

Allowing reckless lending and reckless borrowing would not ease any of these problems and the Central Bank should not allow itself to be pressurised into making any fundamental changes to its rules. To do so would only distract attention from the real causes of the problems and further delay government action to solving them.

Second and subsequent buyers

It appears that the existing rules are appropriately calibrated and, in the main, are not causing problems for credit worthy borrowers who wish to trade up.

Since January 2016, 29 people wishing to trade up reported difficulties in getting mortgages or getting mortgages for the amount they want:

Must sell existing house first	6
Want to keep my existing house	2
Investment property	3
Property jointly owned with ex	3
NE on existing home	2
Bad credit record	2
NE & cheap tracker	2
Employment issues	1
Other	6
Affected by rules	2
Total	29

Only two people reported being affected by the rules. In practice, the lender would have probably made an exception for them.

No fundamental change is needed to the 80% maximum LTV rule, with 15% exceptions.

The Exceptions Regime is good, but needs some fine tuning

It may be discouraging people from applying for mortgages

The general impression has emerged that it's very difficult to get a mortgage. People are aware of the 10% and 20% minimum deposit rules. They don't seem to be aware of the 15% exceptions.

If there is a pattern in the exceptions, it would make sense to incorporate this pattern into the rules and then reduce the amount of exceptions allowed.

For example, if 50% of the exceptions are made for first time buyers in Dublin buying a house for €300k who have €30k but not €38k, then increase the 10% limit for first time buyers in Dublin to €300k.

At the same time, reduce the exceptions from 15% to 7.5%

Exceptions should not be based on a calendar year

The calendar year basis for exceptions causes some inefficiencies in the market. Many borrowers were told that they could not get approval towards the end of 2015, but that they would get approval in early 2016. And sure enough, they did get approval in early 2016.

This distorts the market.

Last year, permanent tsb used only 11% of its quota for exceptions. They should be allowed to carry over the unused portion.

If a lender wants to be more prudent than the Central Bank allows they should be able to do so without fearing the loss of their allowance exceptions.

There is a risk that a quota of 15% becomes a target to be used up.

The exceptions should be based on the amount of the loan in excess of the limit and not the entire loan

At present, a lender is allowed to give 15% of new loans in excess of the LTV limits. The quota applies to the entire loan and not the amount of the loan in excess of the limit. Thus a €100k loan on a €100k house uses up the same amount of the 15% quota as a €91k loan on a €100k house.

	Lender A	Lender B
Total new loans	€100m	€100m
Loans at 91% LTV	€15m	0
Loans at 100% LTV	0	€15m
Amount of loans in excess of 90%	€150k	€1.5m
Percentage of loan book	0.15%	1.5%

The quota should apply to the amount of the loan in excess of the LTV limit and not the entire loan.

This would encourage lenders to make more loans at 92% and fewer loans at 100%.

The 80% limit should be adapted for people trapped in starter homes

I agree with the 80% limit. However, it causes some problems.

Some solution has to be found for people with little equity who need to trade up.

A fairer rule would be to require second time purchasers to increase their equity by 20% of the increased value of the house. If a borrower wants to trade up from a house worth €200k to a house worth €300k, they would be required to have an additional deposit of €20k, irrespective of their current equity position.

	Borrower 1	Borrower 2
House value	€200k	€200k
Mortgage	€200k	€180k
Existing LTV	100%	90%
Deposit required to trade up to a €300k house – existing rules	€ 60k	€ 60k
Deposit required to trade up to a €300k house – proposed rules	€ 20k	€ 40k
New LTV	93%	87%

So Borrower 1 would require €20k and not €60k.

The lender's position would improve as their loan now has more equity in it.

This would also solve the First Time Buyer's dilemma

Before the introduction of the limits a first time buyer could buy a starter home and then trade up after a few years. Now they need to be very careful about "using up" their 90% LTV limit. They might be better off buying a much bigger house initially or deferring purchasing to get much more value from the 90% FTB limit.

Of course, they can apply for the 15% exceptions, but it would be better if the rules were amended to cater for them.

	First time buyer	Trader up
Existing home		€ 100k
Mortgage		€ 90k
Deposit required to buy a home worth €300k – current rules	€38k	€ 60k
Deposit required to buy a home worth €300k – proposed rules	€38k	€ 50k
Loan to Value	87%	83%

This would reduce the disincentive to buy a starter home.

Another solution would be to apply the limits to the value of the home, irrespective of the status of the buyer:

Maximum LTV on first €200k	90%
Next €100k	80%
Balance	70%

Examples

House price	€200k	€300k	€600k
90% of €200k	€180k	€180k	€180k
80% of next €100k		€ 80k	€ 80k
70% of balance			€210k
Total mortgage	€180k	€260k	€470k
Overall LTV	90%	87%	78%

A First Time Buyer could buy a starter home for €100k, knowing that he was not compromising his ability to trade up.

The Central Bank should produce evidence that the 90% LTV for first time buyers is justified.

The Central Bank has claimed that their research justified an exemption up to 90% for First Time Buyers as they default less often than second and subsequent buyers. But the default rate is not the correct measure of risk. The only way to justify such an increase is to show that the banks suffer lower losses on 90% mortgages to first time buyers. And there is no evidence that this is the case and, indeed, it's very unlikely that this is the case.

Other research by the Central Bank shows, as expected, that losses are higher on higher Loan to Value Mortgages. So while a 90% loan to a First Time Buyer might default less, the loss, given default, would be higher.

The Central Bank needs to produce evidence that the 90% limit is justified by loss rates, and not just by default rates.

If the FTB's increased LTV is justified, then, logically, it should be extended to other categories of borrowers

The Central Bank's default rate research showed the following:

- A self-employed person is 8.5 percentage points more likely to default than an employee
- A Second and Subsequent Buyer is 4.5 percentage points more likely to default than a FTB
- A borrower based outside Dublin is 3.7 percentage points more likely to default than a borrower based in Dublin

Based on this research, lending 90% to a Dublin employee who wishes to trade up, is far less risky than lending 90% to a first time buyer who is self-employed and living outside Dublin.