CAIRN PLC

Cairn Homes plc – Submission in respect of the CBI Review of Macroprudential Policy for Residential Mortgage Lending – 31 August 2016

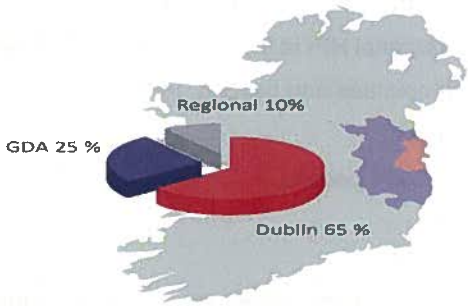
Executive Summary

Background

Cairn Homes Plc ("Cairn" or the "Company") is an Irish homebuilder founded in 2014 with a clear strategy to deliver high quality new homes with an emphasis on design, innovation and customer service.

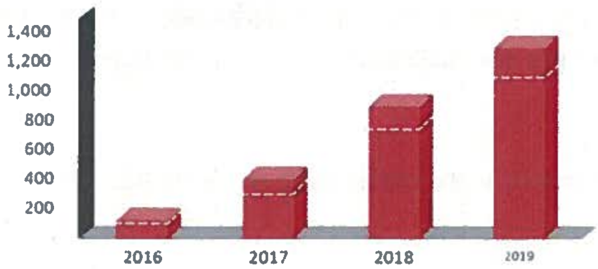
In June 2015, we completed an initial public offering ("IPO") to raise funds to finance the development of new homes in Ireland. This was based on our conviction that an element of the solution to the clear supply and demand imbalance was a well-capitalised and strongly governed indigenous homebuilder of scale. International investors responded very positively to our vision and since then we have raised €869m in capital to assist our residential land acquisition and building programme.

Cairn has a core land-bank of 27 sites to date, all of which the company will build on over the coming years, primarily within the Greater Dublin Area with the potential to deliver in excess of 11,500 new homes:



Source – Cairn Homes 2016 Interim Results Presentation

The Company is currently active on five sites (Parkside – Malahide Road, Albany - Killiney, Marianella - Rathgar, Ashbourne and Hanover Quay), which will deliver in excess of 1,150 units. We will be building on a further 5 sites within the next 12 months, delivering an additional 2,750 units. Based on our current plans, our estimated new home sales for the coming years are as below:



Source – Cairn Homes 2016 Interim Results Presentation

The views contained in this submission reflect the 75+ years of cumulative experience our management team has within this industry coupled with our ongoing experiences of building and selling houses throughout Ireland in the current economic environment.

Content of Submission

Our analysis, review and recommendations are outlined in the 6 key areas below:

1. Macroprudential Rules - An International Perspective

- On the date the Macroprudential Rules were introduced, the Irish economy was at a completely different stage in the housing cycle (post-recession initial recovery stage) than most other countries who have adopted similar measures (generally at the expansion / over-supply stage);
- Other countries had fully functioning homebuilding sectors pre and post implementation;
- No other country has adopted such stringent rules, particularly with regard to first time buyers;
- Ireland is one of a very small number of countries which adopted both LTV and LTI measures in parallel:
- Other countries offer higher LTVs for people living in built-up urban areas.

2. Impact of the Mortgage Rules

- New home completions are still c. 50% below national requirements;
- Homebuilders are not, in general, building large scale and affordable schemes as there is not sufficient and predictable end user mortgage backed demand apparent, thus pushing first time buyers out of the market;
- This in turn is driving homebuilders to build more expensive houses in more affluent areas where higher income buyers are not as impacted by the Macroprudential Rules. This is proven by the €431,359 average selling price of new homes sold in Dublin in H1 2016 by 3 sales agents who account for c. 60% of the Dublin new homes market (Source – [redacted]);
- Nationally, rental inflation is running at 11% and HPI at 6.6% in the 12 months to June 2016 (Source – Daft.ie, CSO) - split Dublin HPI at 4.5% and regional HPI at 8.6%. Regional HPI remains high as purchasers are forced to seek housing in commuter belt counties and beyond. HPI is higher in commuter belt counties than in Dublin since the introduction of the rules;
- Social housing lists are at record levels (140,000+ people).

3. Production Economies of Scale

- There are very few large scale (150 unit +) residential schemes being developed in Ireland presently. Economies of scale can only be delivered in schemes of such scale where hard construction costs can be reduced through efficient bulk purchasing and competitive tendering from contractors who can price keenly given the security of tenure provided by longer term contracts;
- It is significantly more expensive to build small scale residential schemes, thus increasing the average sales price to the end user;
- Cairn are one of the very few exceptions to this as shown in our Ashbourne scheme where we will deliver 3-bedroom houses in the €270,000 to €285,000 price range, some [redacted] cheaper than the price the Society of Chartered Surveyors in Ireland say other developers can deliver housing at.

4. Cycle of Supply and Demand

- Sufficient mortgage backed buyers, particularly at the starter home and affordable end of the market, do not exist;

- Mainstream funding is difficult to secure, so domestic homebuilders in 2016 have expensive capital and debt structures (funded by private equity and hedge fund money) which drive up sales prices;
- New home completions averaged 23,871 per annum in the pre-Celtic Tiger period 1975-1995 (Source – CSO), at a time when the fundamentals of the Irish economy were significantly weaker than they are today;
- The Macroprudential Rules, in their current format, will not encourage output to return to the ESRI forecasted number of 25,000 units required annually in Ireland;
- Homebuilders have little choice but to orientate production away from affordable housing to smaller schemes in more affluent areas where reasonable and predictable end-user demand is evident;
- The lack of normalised supply, particularly in Dublin City, will likely impact on Ireland's competitiveness in attracting future FDI and possibly deter post-Brexit prospects who are actively enquiring about relocating to Dublin;
- Other European cities like Paris, Frankfurt and Amsterdam will potentially gain from this at the expense of the Irish economy.

5. *Mortgage Costs versus Rental*

- It is now significantly cheaper to service a mortgage at 90% LTV on an affordable 3 or 4-bedroom unit in a scheme like Parkside or [redacted] than it is to rent the same unit;
- Rents have increased by over 15.5% nationally (Source – Daft.ie) since the introduction of the Macroprudential Rules driven by the continuing supply and demand imbalance;
- The Macroprudential Rules are keeping potential buyers in the rental trap when they could be paying cheaper mortgages.

6. *Proposed Solutions*

- Increase the LTI cap to 4.0x subject to a maximum 40% NDI rule for all purchasers;
- Increase the value of properties where first time buyers can obtain 90% Loan-to-Value to €300,000 in the Greater Dublin Area;
- Permitted exemptions to the LTV and LTI caps should only be offered to first time buyers;
- Quarterly publication of all exemption statistics in a timely manner.

Cairn believes that the above proposed moderate flexing of the Macroprudential Rules will result in a significant increase in the supply of new homes in Ireland, particularly in the affordable end of the market. We do not believe that these measures and suggested changes would dramatically change or increase the risk profile of either consumers or domestic banks. The CBI retains, through its regular review, full control and ability to flex and change the Macroprudential Rules in response to future market conditions.

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For further information on Cairn, please visit: www.cairnhomes.com

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1 Macroprudential Rules – An International Perspective

As a plc, Cairn works closely with a broad range of external advisors and with whom we engaged as part of our review of the Macroprudential Rules. We were keen to understand the impact which similar rules have had in other jurisdictions, and importantly the timing of their implementation in the context of the point in the cycle where the respective country's homebuilding industries found themselves.

We focussed on Canada, New Zealand, Norway and Sweden for the purposes of this exercise and the following table highlights the salient dates, rules currently in place and some general economic data on the relevant countries:

Country	Rules Initially Implemented (Base Date)	Rules Flexed / Moderated	Household Credit / Disposable Income - Base Date	Current LTV Cap	Current LTI Cap	3 year HPI pre Base Date	3 Year HPI post Base Date	Average Annual New Home Completions - 30 Years to Base Date [N4]	Average Annual New Home Completions - Post Base Date to 31-Dec-15
Sweden	Oct-10	Sep-14	170.70%	85%	-	4.80%	1.00%	30,380	27,280
New Zealand [N1]	Oct-13	Nov-15	148.70%	80%	-	3.90%	7.90%	21,760	23,150
Canada [N2]	Oct-08	Feb-16	150.00%	95%	40% (NDI)	10.30%	3.20%	175,680	182,910
Norway	Jul-10	Dec-11	211.90%	85%	5% stress	3.60%	7.00%	24,600	26,240
Ireland [N3]	Feb-15	-	167.00%	80% (90% FTB)	3.5x	0.30%	8.90%	35,958	12,966

N1 - New Zealand: LTVs in excess of 80% allowed on up to 15% of new housing loans: 7.9% HPI post base date is for the 2-year period to 31-Dec-15;

N2 - Canada: max LTV 95% up to CAD 500,000 reducing to 90% thereafter;

N3 - Ireland – 9.3% HPI post base date is for the 17-month period to 30-Jun-16;

N4 - International new home completions (Source – Euromonitor).

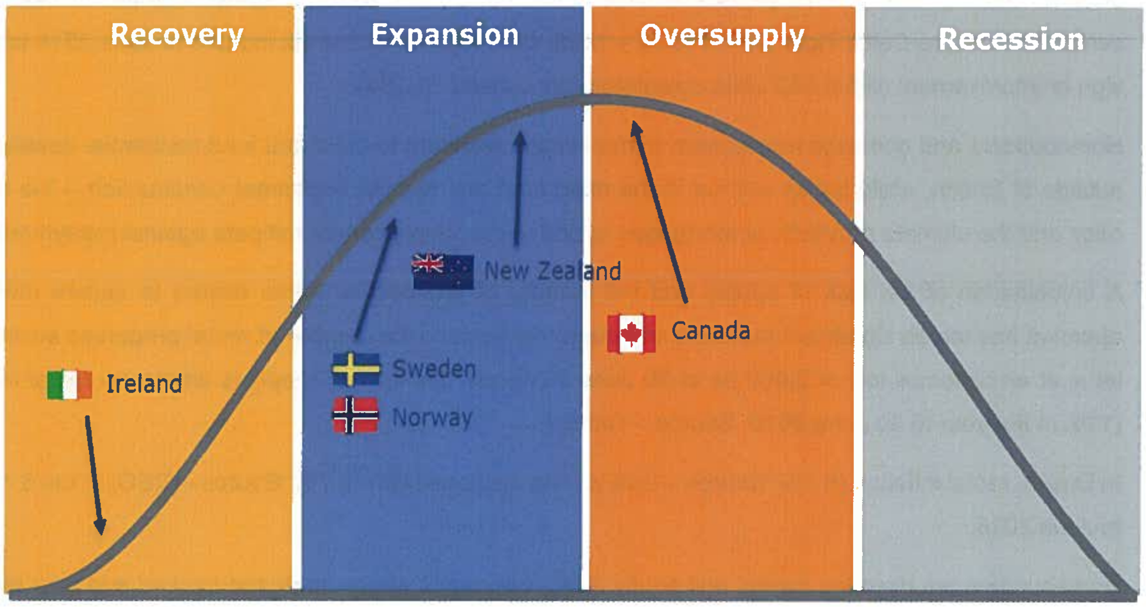
We observed that there are generally two main drivers behind the timing of macroprudential regulation:

1. *A surge of household debt to disposable income*: The surge in Irish household debt was predominantly fuelled by the boom years of 2002-2007 and increased from 110.8% in 2001 to 214.4% in 2009 (Source – CSO). The ratio was reducing steadily when the rules were introduced (171.1% as at YE 2014). Irish households were further impacted by an extended recessionary period from 2008 with negative wage inflation, increased income taxes and the implementation of austerity measures following the IMF bailout in 2011. While Irish household debt levels remain high at 149.4%, wage inflation returned in 2015 at 1.8% (Source – CSO) with the majority of economists forecasting 2% + wage inflation in each of 2016, 2017 and 2018 with debt / disposable income forecast to fall further to c. 140% by the end of the year. Interestingly, the level of household debt in the Irish under-35 demographic is amongst the lowest in Europe given the small number of affordable and starter homes built in recent years; and

2. *An increase in house price inflation (HPI):* It is obvious from an Irish perspective that the rules were not introduced following a period of sustained HPI. While the calendar years 2013 and 2014 recorded HPI of 2.1% and 13.0% respectively, this was after 5 consecutive years of negative HPI averaging (12.7%) per annum between 2008 and 2012 (Source – CSO Residential Property Price Index June 2016). It is also important to note the wider industry dynamics – the Irish homebuilding industry averaged 10,577 completions per annum in the 5 years prior to implementation, some 71% below the then 30-year average of 35,958 of new home completions per annum. Discounting the Celtic Tiger years from 1996 onwards, the 20-year average to 1995 was 23,871 units, nearly 13,000 units above the 5-year average to 2014.

We would note that homebuilders in the countries above (Sweden, New Zealand, Canada and Norway) were operating under "normalised" market conditions before and after the implementation of the rules as evidenced by average new home completions in the period pre and post implementation. The economic landscape in Ireland at the date of implementation was totally at odds with each of these countries – not one of them had encountered the level of severe recession endured by Ireland, their construction industries had not stalled with new home completions running at nearly a third of historic completions, nor were wage deflation and negative HPI apparent. Crucially, no other country was in the midst of a housing crisis.

The following chart plots the timing of the implementation of the macroprudential rules in each country in the context of the housing cycle:



The CBIs timing was at a completely different stage in the housing cycle than that witnessed elsewhere. Whilst Ireland does have a higher average debt / disposable income ratio we also note that this economic indicator has reduced significantly since peak. The Macroprudential Rules were implemented immediately after a spike in HPI which followed 5 successive years of house price deflation. Ireland has now had a dysfunctional housing market for a number of years, and this is becoming more pronounced with each passing month. Our continually improving national economic outlook needs the support of a functioning homebuilding industry which can deliver in excess of 25,000 units per annum. At the peak of the Celtic Tiger, the construction industry contributed c. 28% towards Irish GDP. This had reduced to 6% by 2015 with the government recently stating that the sector should contribute a sustainable c. 14/15% towards GDP annually. From a wider economic franchise perspective, this aspiration can only be met if it the construction industry is underpinned by a fully functioning and performing homebuilding sector delivering 25,000 new home units annually. This is not achievable in circumstances where the Macroprudential Rules implemented are harsher and stricter than those imposed elsewhere.

Conclusion:

The Macroprudential Rules have had a negative impact on both consumers and the homebuilding industry. Unlike other countries we have researched, the rules were enacted when Ireland was in the middle of a nascent housing supply issue which has deteriorated further over the past 18 months as output continues to materially lag national requirements. Moderately flexing the rules as proposed herein will allow more first time buyers to access the mortgage market which will enable homebuilders to deliver more housing and increase output safe in the knowledge mortgage backed demand exists.

2 Impact of the Mortgage Rules

While fully supporting the importance of a fair, robust and transparent regulatory environment, Cairn believes that the introduction of such stringent rules in the early recovery stage of the cycle was premature given the current disparity between supply and demand. In the 16 months post implementation, aside from curbing Dublin HPI in 2016, the following suboptimal side effects are evident:

- Supply side output of 12,666 units in 2015 is c. 50% below the ESRI advised national requirement of 25,000 units for each of the next 15 years and 47% below the 23,871 average annual number of new house completions in pre-Celtic Tiger period 1975 – 1995. CSO figures for the six months to June 2016 show no sign of improvement with 6,642 units completed (annualised 13,284);
- Homebuilders and domestic mainstream banks remain reluctant to build and fund residential development outside of Dublin, while banks will not in the main fund any form of apartment construction – the current rules and the ultimate provision of mortgages to end users simply cannot mitigate against repayment risk;
- A combination of the lack of supply and the inability of prospective home buyers to secure mortgage approval has forced significant numbers into the rental sector - the number of rental properties available to let is at an historical low of 3,600 as at 30 June 2016 and this lack of supply is driving up rental inflation (11% in the year to 30 June 2016: Source – Daft.ie);
- In Dublin, rental inflation (6.1%: Source – Daft.ie) has displaced HPI (0.7%: Source – CSO) in the 6 months to June 2016;
- Homebuilders are directing capital and equity at developments where mortgage backed end user demand from middle and high income consumers is apparent – not at the starter and affordable end of the market;
- Significant tracts of developable land remain in the hands of unnatural owners – financial institutions, private equity and distressed debt funds who have no development capabilities;
- Not enough of the permitted exemptions to the LTV and LTI caps are being offered to first time buyers. The CBI Macroprudential Measures and Irish Mortgage Lending: A Review of Recent Data Vol 2016 No. 3 suggests that c. 57% of all permitted exemptions in 2015 were granted to first time buyers. In other countries, for example New Zealand, the discretion contained within the macroprudential rules to banks is specifically and solely targeted towards first time buyers and is monitored accordingly. We believe a similar policy with regard to exemptions should be adopted in Ireland with first time buyers being the sole beneficiaries;
- As a result of both the shortage of new affordable homes and the rental crisis, local authority social housing lists continue to grow to record levels with over 140,000 people now seeking social housing nationally;
- The lack of new housing, and indeed rental accommodation, will impact Ireland's attractiveness in the context of FDI as competition to secure new FDI between the major European financial centres heats up in the aftermath of Brexit.

If the CBI chose to leave the Macroprudential Rules untouched and take the view that responsibility lies with the government and the Minister for Housing, Planning and Local Government to deal with supply side measures, the same supply side issues will exist without realisable demand absorption and it is reasonable to assume that this will continue into the foreseeable future. The Irish economy will be faced with a further period of under-supply and this will have a detrimental effect across a number of sectors. We have set out our position and where possible, provided real and relevant data to underpin our arguments.

In our opinion the basis for the Macroprudential Rules is conceptually sound and we respect the fact they will remain a permanent structural feature as it is not in any stakeholder's interest to create another property bubble. However, the rules were implemented at levels for a stage in the cycle in which they are too restrictive. Cairn believes that the current LTV and LTI exemptions should only be utilised by mortgage providers to assist first time buyers. The impact of the LTI cap is most keenly felt towards the affordable housing end of the market. Prior to the introduction of the Macroprudential Rules, the majority of financial institutions in Ireland underwrote repayment capacity on the basis that no more than 40% of an individual's monthly NDI was required to service their cumulative debt obligations. Prevailing mortgage interest rates were stressed by an additional 2% to ensure that this remained below 50%.

The following table shows the impact of the change in rules on what will be our median priced €285,000 affordable housing in Adamstown at various salary ranges for first time buyers:

			Existing CBI Rules					
Gross Salary	Maximum Mortgage	LTV	LTI	Monthly Repayments	Net Salary	NDI %	Monthly Repayments Stressed (+ 2%)	NDI %
€71,000	€248,500	**87%**	3.50x	€1,277	€3,833	33%	€1,563	41%
€61,000	€213,500	**75%**	3.50x	€1,097	€3,464	32%	€1,343	39%
€51,000	€178,500	**63%**	3.50x	€917	€3,044	30%	€1,123	37%

			Proposed Cairn Amendments							
Gross Salary	Maximum Mortgage	LTV	Mortgage Permitted	Maximum LTV	LTI	Monthly Repayments	Net Salary	NDI %	Monthly Repayments Stressed (+ 2%)	NDI %
€71,000	€284,000	100%	€256,500	**90%**	3.61x	€1,318	€3,833	34%	€1,613	42%
€61,000	€244,000	86%	€244,000	**86%**	4.00x	€1,254	€3,464	36%	€1,535	44%
€51,000	€204,000	72%	€204,000	72%	4.00x	€1,049	€3,044	34%	€1,283	42%

N1 - Existing Rules Maximum Mortgage = Gross Salary x 3.5x;

N2 - Mortgage repayment assumes 90% LTV mortgage from AIB, 25-year term, 3.75% standard variable rate at a cost of €5.14 per €'000, no impact for purchaser of 2% interest rate stress test;

N3 - Net Salary calculated using the Deloitte Budget 2016 Tax Calculator assumes no outgoings from gross salary outside of income and other taxes;

N4 - Proposed Cairn Increased Mortgage = Gross Salary multiplied by up to 4.0x subject to 90% LTV cap;

The table above is purely for illustrative purposes. However, our analysis shows the impact of increasing the LTI limit to 4.0 times in the context of a borrowers' overall debt servicing capacity. We believe that there is an inextricable link between LTI and NDI, and on this basis are recommending moderately flexing the LTI limit to 4.0 times subject to a maximum 40% NDI.

Ultimately, a properly functioning residential market operates where the property ladder looks like:

1. First time buyers can purchase affordable starter homes;

2. Families grow and trade up to larger homes from their starter homes;

3. Later in life, as children leave home, parents trade back down to smaller homes; and

4. Those wealthy enough to purchase large homes generally stay in these for life.

So unless there is a reasonable supply to the new homes market, the impact is felt right through the property ladder. If the average cost of new homes in Dublin is €431,359 (see table on page 16), the first two steps in the property ladder are not working and there is no market for the third step to move back to. The existing rules favour those who can get straight to the fourth step – higher income people living in affluent areas.

Conclusion:

An unforeseen consequence of the Macroprudential Rules will be the continued marginalisation of first time buyers and consumers seeking affordable housing. Homebuilders, and their funders, cannot economically underwrite large scale affordable housing schemes. As a result, production is now oriented towards more affluent locations where end-user demand is more predictable, resulting in limited output to the affordable end of the market where consumers will continue to be stuck in an inflationary rental trap.

3 Production Economies of Scale

As is common throughout the international listed homebuilding industry, Cairn uses contractors to carry out the construction of our developments and engages design team professionals, including architects, landscaping architects, mechanical and electrical engineers, structural engineers and planning consultants. We support, fund and collaborate with our contractor base in an effort to assist them in the growth of their respective businesses as we continue to scale up our operations. This enables our contractors to expand their own funding and resource platforms safe in the knowledge that they are essentially partnering with a sustainable homebuilder in Cairn. The industry needs activity and scale to ensure all service providers throughout the value chain can operate at a sustainable level, which is very difficult when the average homebuilder is only building small schemes and/or one off housing, while a well-capitalised company like our own is shifting its focus away from the first time buyer and starter home sector.

The lack of new affordable housing developments in Ireland is directly impacting the price of starter homes for most first time buyers. There are relatively few variables dictating the price of a newly built home that cannot be optimised as the scale of development increases, thereby reducing unit costs.

When homebuilders are certain of a reasonable measure of demand for housing, they can deliver a volume of houses that enables them to source materials and labour at significant cost reductions. From Cairn's perspective, this enables us to make our homes more affordable.

This is particularly prevalent in respect of labour costs where the sub-contracting sector has driven up the cost of construction considerably as their volume of reliable work has reduced or the length of contracts is diminished.

Economy of Scale: Sub-Contracted Labour

The current rate per brick charged by block laying contractors for smaller schemes where the volume of work will not sustain a fulltime permanent employee is [redacted] per brick. The average number of bricks in a typical 3-bedroom semi-detached home is 4,000. In Parkside, we have awarded our block laying contractor, [redacted], with an 18 month, 166 house contract. Our cost per brick is [redacted] leading to a [redacted] saving per house.

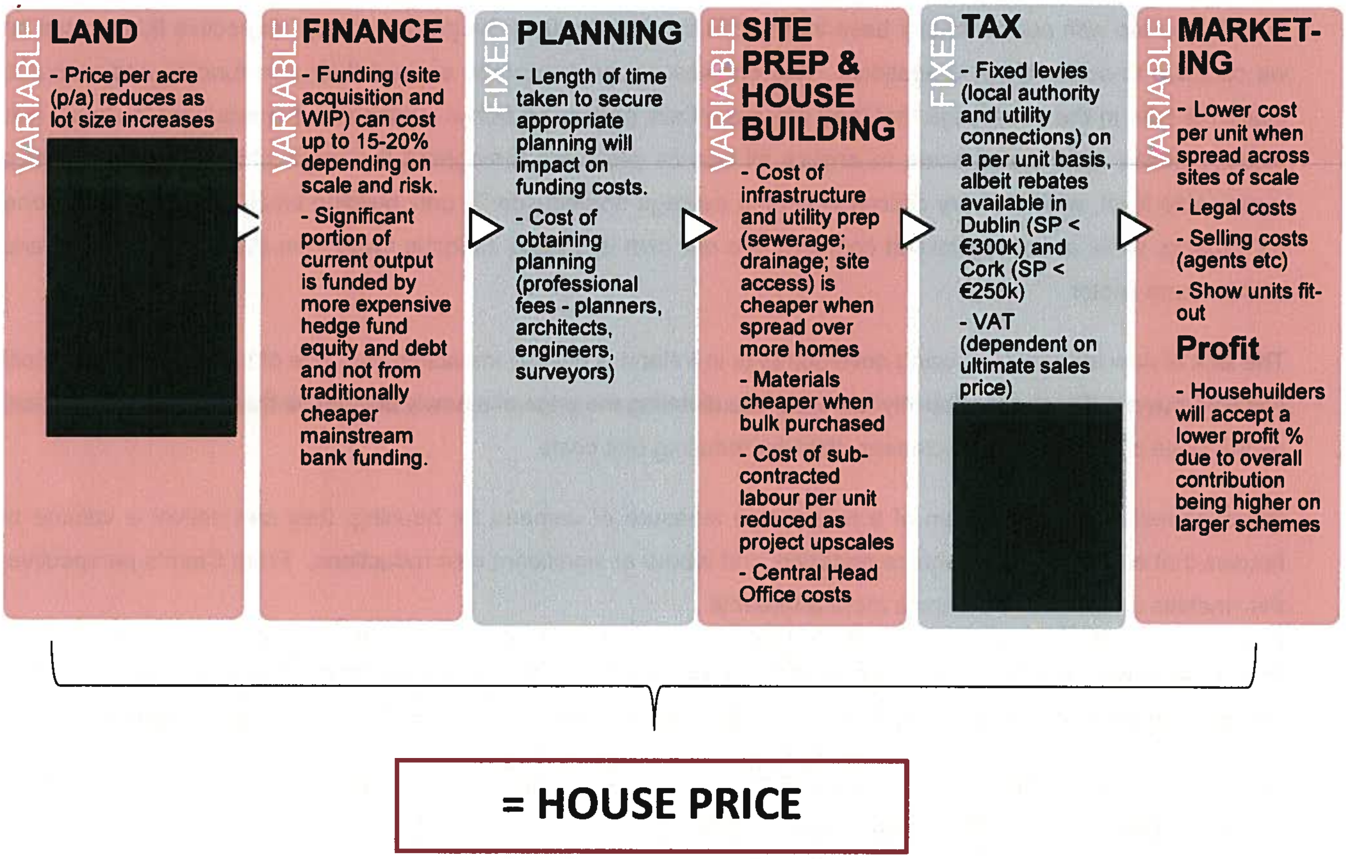
These efficiencies are possible due to the longer-term security a project of scale provides sub-contracting firms: firms for small projects are often top-heavy, comprising the senior most members of the firm. This longer-term security provided in larger projects enables contractors to take on additional, junior staff, with senior members taking on an oversight role over various teams.

In Parkside, 8 new apprentices have been hired by our contractors to date because we have been able to provide them with certainty in the construction of the first 166 units, thus contributing towards a new generation of homebuilding expertise which has been non-existent in our sector in recent years.

New builds in Ireland today are typically small in scale, directly resulting in this loss of efficiency and savings.

The prime determinant of the scale of development to a homebuilder (and their funders) is the level of risk they are undertaking. As reasonable predictable end-user demand is currently low, fuelled by an inability of customers to secure credit, insufficient reassurance is provided to developers that these affordable sites will provide an economic return on investment within a feasible timeframe, prompting a downsizing of plans to reduce risk to an acceptable level. This logical economic response is one which would be expected in any industry.

Factors in Determining House Prices and how Scale Impacts the Value Chain and Ultimate Sales Price:



Margin & Profitability – An Explanation

Homebuilders generally seek a 15-17% blended return over the lifetime of a development. However, the challenge for capital providers is in the way the industry works - in phase 1 and 2 of a large development, profits are generally lower due to the level of upfront investment in infrastructure and site development costs, with later phases generating higher profits, generally with the benefit of normal house price inflation during the lifetime of the development.

A homebuilder will acquire, hold and bring a site through the planning process ahead of development. There is a carrying cost of capital throughout this process and time period. A contractor will generally operate off a 5-9% net margin – they simply complete a low risk *design and build* contract. This c. 10% difference between homebuilders and contractors reflects the fact the latter is not carrying any capital risk with all Cairn sub-contractors paid monthly in arrears. Thus they only have to fund short-term working capital requirements. Homebuilders cannot operate off similar profit margins to fixed-price contractors given the capital and risk weighting at every stage of the process is firmly placed with them.

Land Costs – An Explanation

[redacted] Ignoring the boom years 2002-2007, the value of a house site as a percentage of the ultimate sales value was historically within the 15% - 30% range (and comparable with international markets).

There are a number of issues, outside of location, which impact the value of land including planning, infrastructure and development readiness. Land values are as cyclical as the housing market and we are currently in the recovery phase of the housing cycle with the majority of Irish economic indicators trending positively. Average development land values fell by c. 90% from peak 2005 – 2007 values and started to recover towards the end of 2012. Site value is an intrinsic component of the ultimate selling price and in a stabilised, recovering and expanding market, it is very unlikely this will decline.

Case Study: Ashbourne

Cairn acquired a 37-acre residential development site at Churchfields, Ashbourne, Co. Meath from a US private equity firm in early 2016. Ashbourne is a commuter town 23km northwest of Dublin and our site has full planning permission for 354 new homes. Cairn commenced construction of the first phase in June 2016.

A residential development of scale, Cairn expects to secure significant construction economies of scale to deliver affordable house prices for first-time buyers in Ashbourne, as described in the above '*Factors in House Price*' illustration. Accordingly, we expect prices for 3 bedroom semi-detached homes in Ashbourne to range from €270,000 to €285,000.

A report published by the Society of Chartered Surveyors Ireland (SCSI) in May 2016, using current and independently verified industry expertise and data, found that the average cost of construction for a 1,249 sq. ft. 3-bedroom semi-detached house in the Greater Dublin Area, inclusive of €57,500 land costs and VAT, is **€334,757** assuming hard build costs of €123.12 psf and soft costs, including VAT and finance costs:

	Cairn		Society of Chartered Surveyors in Ireland	
Element	PSF / Unit	Total	**PSF / Unit**	**Total**
House Build Cost	[redacted]		€100.70	€125,776
Site Works			€8.01	€10,000
Site Development (Prelims)			€14.41	€18,000
Total Construction Costs			**€123.12**	**€153,776**
Soft Costs:				
Professional Fees				€5,500
Development Levies				€8,500
Utility Levies				€3,250
Land & Acquisition Costs				€57,500
Sales & Marketing Costs				€8,200
Finance Costs				€20,042
Margin				€38,324
VAT (@13.5%)				€39,665
Total Soft Costs			**€144.90**	**€180,981**
Total Selling Price			**€268.02**	**€334,757**

Our hard build cost in Ashbourne is [redacted] lower than the SCSI and our finance costs, given our funding structure, are significantly cheaper also. These build cost efficiencies are created through Ashbourne's scale. Our price range for 3-bedroom houses will be €270,000 - €285,000, so ultimately our construction efficiencies and business model enable us to deliver housing which is up to [redacted] **cheaper than the SCSI average**, independently verified, cost of construction. This is a reflection of today's reality and is based on evidenced build costs. The SCSI has correctly reflected the cost of operating in a less efficient manufacturing business.

Conclusion:

A proper functioning homebuilding industry can only operate with the support of a mortgage market which is open to all consumers, not one which favours those on higher incomes. The Macroprudential Rules adversely impact a large number of first time buyers and those seeking affordable housing. This results in homebuilders not being able to benefit from production economies of scale on large scale affordable developments which deliver more competitively priced housing. Moderating flexing the Macroprudential Rules will positively influence demand side dynamics thus leading to the delivery of more affordably priced units to first time buyers and those seeking affordable housing.

5 Cycle of Supply & Demand

The supply of homes is not meeting the demand for housing.

Homebuilders will accept commercial risk on end-user demand up to a certain point. However, many consumers, and particularly first time buyers, cannot meet the current credit requirements (LTV and LTI) to afford starter homes. This curtails the amount of speculative development homebuilders can rationally undertake.

Development risk is acutely prevalent with homebuilders who are in the main wholly reliant on bank funding or from specialist lenders and hedge funds and do not have the benefit of a capital structure such as Cairn.

It is accepted that the 1975-1989 period was one where general living standards and economic growth remained below those in other advanced economies. Economic conditions began to improve in the early 1990's before the Celtic Tiger emerged in the second half of the decade. The average number of new home completions in the pre-Celtic Tiger period 1975 – 1995 was 23,871 units per annum:

House Completions	1975	1985	1995	1975 - 1995 Average
ROI	19,105	17,164	21,752	17,223
Dublin	7,787	6,784	8,823	6,649
Total	26,892	23,948	30,575	23,871

2016 Forecast
9,298
3,986
13,284

Economy	1975	1985	1995	2016
Employment ('000)	1,084	1,097	1,282	2,014
GNP (Real - €bn)	43.9	52.9	77.1	241.7
Interest Rates	11.3%	13.0%	7.0%	3.90%

N1 2016 forecast 13,284 is annualised H1 2016 completion of 6,642 (Source – CSO)

N2 €241.7bn is 2015 actual GDP (Source – CSO)

Throughout this 20-year period, the Irish homebuilding industry delivered an average output of 23,871 houses with the top 15 homebuilders, who were mainly privately run family companies, efficiently building and selling 100 – 150 units per scheme per year. This output was not achieved with 1,000 different homebuilders building and selling 25 units a year. The vast majority of Irish homebuilders are currently developing on small schemes, bringing completed units to the market and selling these units before commencing another phase, or simply focussing on higher value projects, where predictable demand exists and economies of scale are not as important due to higher average selling prices.

We asked the three largest new homes sales agents in Dublin to provide us with the average selling price across all new home schemes launched in H1 2016 – the average selling price is €431,359:

Selling Agent	# New Home Units sold in 2016	Average Selling Price
[redacted]	598	€402,312
	190	€452,630
	200	€498,000
Average Selling Price	**988**	**€431,359**

Between them, [redacted] account for c. 60% of the Dublin new homes market, so their combined average selling price is a very representative number. The imputed average price of a home in Dublin using ESRI and CSO data is currently €293,000 (nationally €222,000: outside Dublin €182,000), so the average selling price of a new home in the table above in Dublin is 47% higher in the year to date.

We estimate that the national annual requirement for 25,000 new homes is split between c. 11,000 new homes required for Dublin and c. 14,000 new homes elsewhere. The CSO reports that 2,891 units were completed in Dublin in 2015 and 1,993 units in the six months to June 2016. At this run rate, c. 4,000 new homes will be completed in Dublin in 2016 which is still significantly behind the number needed to satisfy demand.

[redacted]

For the purposes of assessing the suitability of the Macroprudential Rules against homes that will be developed with maximum production economies of scale, we have mapped the loan-to-value and loan-to-income requirements against our Adamstown site which when completed, would serve to make a substantial impact into addressing local housing demand in Lucan.

Implications of Lending Policy for Planned Affordable Starter Homes

Case Study: Adamstown:

Adamstown in Lucan, Dublin 15 is Ireland's first Strategic Development Zone (SDZ), with effective full planning permission for the construction of a new town incorporating up to 10,000 new residential units granted in 2003. With 1,200 new homes, 3 schools and a new train station delivered to date, Cairn acquired 1,195 of the remaining 5,400 residential sites as part of the Ulster Bank "Project Clear" development land loan portfolio, the largest single land transaction undertaken in the state, which Cairn acquired in conjunction with Lone Star in December 2015.

Only c. 65 new residential units have been developed in Adamstown in the last 5 years, however it's SDZ planning facilitates short-term development and we intend to commence construction in Adamstown in Q1 2017. The most

Under the current lending rules, a house costing €285,000 [redacted] would require a buyer to amass a deposit of between €35,000 (FTB: LTV 88%) and €57,000 (non-FTB: LTV 80%), as well as having a minimum gross salary of €71,400 (FTB) or €65,150 (non-FTB) which is **94% / 77%** above the Average Industrial Wage (€36,815).

If a single first time buyer could secure a 90% LTV mortgage (assuming they pass the 2% interest rate stress test), the deposit amount would reduce to €28,500. Monthly mortgage repayments would amount to €1,302 (25-year mortgage with AIB on a 3.75% standard variable rate). Using the "Deloitte Budget 2016 Mortgage Calculator", and assuming no other outgoings, this individuals' monthly take home pay for 2016 is €3,975 resulting in a NDI ratio of 32.77% and an LTI of 3.6x.

appropriate price point for the affordable, well located houses we plan to build would be [redacted] for 3 and 4 bedroom houses – these house sizes account for c. 80% of our total planned development.

FDI:

FDI supported companies employ 187,000 people in Ireland accounting for 1 in 5 private sector jobs and €130bn (or 67%) of 2015 Irish exports (Source – IDA). It has been a key driver in the Irish economic recovery in recent years. FDI is attracted to Ireland by an educated pool of talent, access to the EU and its markets, our track record in dealing with them and the ease of conducting business here.

The IDA launched its "Dublin and Regional" strategy in late February 2015 to create 80,000 new FDI jobs by 2019 in the services, manufacturing, technology, engineering, food, medical devices and fintech sectors. The homebuilding sector will play a critical role in the successful execution of this strategy as one of the key requirements of FDI is the provision of a suitably located, well built and affordable supply of residential units for FDI employees.

Within the last 3 weeks, Cairn met with the IDA and we were very encouraged to hear that there has been a notable increase in enquiries from UK based multinational and financial services companies in the aftermath of Brexit. It was clear from this meeting that the type of companies looking to locate in Ireland are focused on Dublin City Centre and the other major urban centres and are not the type of companies seeking manufacturing locations in rural Ireland. In our meeting, we were advised that the lack of housing is consistently raised by FDI companies as the major deterrent to locating in Ireland. We would reference quotes from Linda Phelan, CEO of PayPal Ireland, made at the Construction Industry Federation annual conference on 1st October 2015, to highlight the point:

> *"Our greatest challenge today is rental property."*
>
> *"Property prices are a consistent problem for my teammates trying to find somewhere to live. In terms of housing, I'm asking all teammates in Ballycoolin in Dublin and Dundalk to see will they rent rooms for teammates that I am bringing in from 26 countries because they can't get accommodation," she added.*
>
> *"Today I am paying €2,000 upfront to people coming into Ireland to put them into hotels so I can get a chance to get them residential accommodation. It costs about €1,500 to hire an individual, but today it's costing me about €3,500 upfront to find a hotel for at least two to three weeks. It's crisis time for us and for bringing in foreign direct investment overall.*
>
> *"The reality is that the IDA do an amazing job, but if you don't have the after-care service for people, FDI won't invest in you"*

Brexit FDI requires direct access to the EU meaning Ireland will face stiff competition from other European countries in our attempts to attract this welcome investment.

While we will benefit from being the only other English speaking country in the EU and the fact we have a similar common law legal system to the UK, the lack of available affordable and suitably located housing (to both rent and buy) is likely to act as a major deterrent. Cities like Frankfurt, Paris and Amsterdam will therefore have a significant competitive advantage as Brexit FDI seeks city centre office space and residential accommodation. Dublin can provide the office space, however the housing crisis and consequential rental crisis must be addressed if we are to position ourselves at the top of the queue to realistically attract Brexit FDI.

Conclusion:

Aside from dealing with the domestic housing crisis, the Macroprudential Rules do not promote FDI.

5 Mortgage Costs versus Rental

A clear consequence of the imbalance between the actual number of new homes being built (12,666 in 2015: Source - CSO) and the average annual national requirement (25,000: Source - ESRI), coupled with difficulties in securing credit, has resulted in spiralling demand for rental accommodation and associated rental inflation.

The cost of renting in Dublin is directly impacting many renters' disposable income as well as their ability to save, to the detriment of obtaining mortgages – rents have increased by over 51.3% since late 2010 (and in excess of c. 15.5% since the implementation of the Macroprudential Rules) and are now above their 2008 peak (source: Daft.ie Q2 2016 Rental Report). Furthermore, considering the propensity to buy amongst Irish consumers, it can be assumed that the significant inflated rents being paid to private landlords is a direct replacement for what would have been paid to Irish banks as mortgage repayments, limiting Irish lending institutions' ability to create long-term, profitable and performing loan books.

With just 75,553 new homes built in Ireland between 2010 and 2015 (average 12,592 per annum), the number of rental properties on the market has fallen from a peak of 24,000 in mid-2009 to 3,600 in June 2016. Nationally, average rents increased 11% in the 12 months to June 2016 on the back 16 consecutive quarters of national rental inflation (source: Daft.ie Q2 2016 Rental Report). The population of the country increased by 3.7% (170,000 people) in the 5 years to 2016, so simple supply and demand dynamics have driven rental inflation to a level where, from an affordable housing perspective, it is now significantly cheaper to service a mortgage financing the purchase of a property than it is to rent the same property.

Cairn believe that a flexing of the Macroprudential Rules moderately will help to address this imbalance and disparity. Cairn believes that support is required for both first time buyers and non-first time buyers of affordable housing as it is this demographic cohort which is being squeezed into rental accommodation. From a new homes output perspective, supply is at its lowest level in the affordable housing sector for the reasons outlined throughout this submission.

Our most relevant data relates to Parkside where we have closed 22 four bedroom homes (average selling price €362k incl. VAT) and 27 three bedroom homes (average selling price €314k incl. VAT) in the year to date (39 in H1, 10 in H2 to date). [redacted]. We have also included in the table below our [redacted]:

Location	Type	Cairn Average Sales Price	Mortgage Amount [N1]	Monthly Rent	Monthly Mortgage	Delta	Mortgage + 2%	Delta
Parkside	4 bed	€362,000	€325,800	€1,800	€1,675	**7%**	€2,027	**-13%**
	3 bed	€316,000	€284,400	€1,600	€1,462	**9%**	€1,772	**-11%**
[redacted]								

N1 - Mortgage repayment assumes 90% LTV mortgage from AIB, 25-year term, 3.75% standard variable rate at a cost of €5.14 per €'000. No impact for purchaser of 2% interest rate stress test from a mortgage underwriting perspective;

N2 - [redacted] Parkside are houses.

The rental levels for Parkside and [redacted] are all as currently advertised on Daft.ie and reflect current passing rents in both locations. The variance between rental and mortgage costs in [redacted], with keener sales prices on foot of lower site costs, is striking. **The cost of servicing a 90% LTV mortgage on a 3-bedroom house in [redacted] is €447 or 27% cheaper per month than the cost of renting a similar unit.**

When interest rate stress testing at 2% above current standard variable rates is applied, the cost of servicing a Parkside mortgage become more expensive than renting, however [redacted] mortgage costs remain below current rental levels. Interest rate stress testing should be viewed in the context of the current 10-year EUR swap rate at c. 30 bps, albeit we fully appreciate its importance from a credit underwriting and affordability analysis perspective.

Conclusion:

The relationship between the rental and mortgage market is constrained by the supply of new homes. The knock-on effect is that a materially higher number of consumers now have a greater dependence on the rental market. With double digit rental inflation continuing on the back of 16 consecutive quarters of rental inflation, this has resulted in a deterioration in the economic circumstance of consumers.

6 Proposed Solutions

In the Greater Dublin area, unless policy makers are content to leave most early-stage family formation units to seek rental accommodation in increasing numbers or live with parents, the inter-relationship between supply, credit and other support available to facilitate home purchasing needs to be reassessed. This includes but is not limited to the Macroprudential Rules, which can provide a short-term solution to recalibrate the balance between sustainable development and affordable house prices. It is clear that policy change is required to break the vicious cycle and establish a fully functional property market that is aligned to the economic resurgence witnessed in Ireland in recent years.

Cairn fully understands and respects the role which the Central Bank plays in regulating financial institutions and how they interact with consumers. Your mission statement "safeguarding stability, protecting consumers" is central to ensuring that the lessons learnt from the devastating economic crash which Ireland endured in recent years are put into practice.

Our strong belief is that the severity and timing of the Macroprudential Rules is preventing the creation of a sustainable affordable housing market in circumstances where the lack of access to mortgages for this demographic is creating wider economic issues.

Summary of our Key Observations

- **The level of efficiencies achievable though developing at scale are significant, even in today's market,** as can be seen at our Ashbourne and Parkside developments and our plans for the Adamstown site, directly resulting in significantly more competitive pricing for consumers.
    - Ultimately however, even taking these efficiencies into account, first time buyers will still struggle to raise the level of deposit required to purchase our 3-bedroom "commuter belt" offering in Ashbourne. With expected sales prices starting at €270,000, a first time buyer will require a €32,000 deposit equating to 1.1 times the net salary of an individual on the average industrial wage (source – Deloitte Budget 2016 Tax Calculator)
- **The 90% loan-to-value threshold for FTBs at €220,000 remains unsuitable in the Greater Dublin Area** where site costs are significantly higher than in the rest of the country, yet the lending criteria is uniform thus handicapping consumers in the Greater Dublin market in circumstances where:
    - The average price of a house in Dublin is €293,000 against €182,000 elsewhere (Source – CSO);
    - The Geoview Q2 2016 Residential Buildings Report advises that the average purchase price of the 13,118 houses which sold in Dublin in the 12 months to June 2016 was €380,237 (some 12.2% or 1,600 of these were new houses). The average sales prices of the 17,950 houses sold in the Greater Dublin Area was €348,784 against €149,663 in the remaining 22 counties nationwide;
    - The average selling price of new homes sold in Dublin in H1 2016 by 3 of the leading sales agents, who collectively account for c. 60% of the Dublin new homes market, was €431,359.

  The CBI Macroprudential Measures and Irish Mortgage Lending: A Review of Recent Data Vol 2016 No. 3 indicates that nearly 81% of first time buyer permitted LTV exemptions were granted to those living in Leinster, and specifically we assume in the Greater Dublin Area. This appears logical in the context of average house prices in the Greater Dublin Area compared to those elsewhere.

- The **3.5 times LTI multiplier is too restrictive** from the perspective of an individual borrowers' overall debt servicing capacity.
- **Nationally, annual rental inflation of 11% in the year to June 2016** (Source – Daft.ie) is running significantly ahead of current 0.3% CPI (Source – CSO) and 6.6% HPI (Source – CSO). This is resulting in significant numbers of potential purchasers not being in a position to save sufficiently to get on to the first step of the property ladder and acquire their first home. There are significant long term social implications to this imbalance.
- The lack of new housing supply, particularly in Dublin City Centre, has the **potential to adversely impact our ability to attract FDI.**

Internationally, first time buyers have greater access to mortgages through less stringent macroprudential rules and greater government support. Cairn believes the thrust of the current review of the Macroprudential Rules should be directed at first time buyers. The 25-35 year-old Irish demographic cohort is amongst the least indebted in Europe. This is the age bracket most first time buyers come from, so on this basis our recommendations are, in the main, targeted at this end of the market.

Key Recommendations

- **Increase the LTI cap to 4.0x subject to a maximum 40% NDI rule for all purchasers**;
- **Increase the value of properties where first time buyers can obtain 90% Loan-to-Value to €300,000 in the Greater Dublin Area**;
- **Permitted exemptions to the LTV and LTI caps should only be offered to first time buyers;**
- **Quarterly publication of all exemption statistics in a timely manner;**

The impact of our proposed changes recommended are best summarised in the following table:

First Time Buyer

Basis	Type	Salary	Cairn Average Sales Price	Mortgage Amount	Permitted LTV	LTI	Mortgage Allowed	Basis for Mortgage	Deposit Required	Monthly Mortgage	Net Monthly Pay	NDI
Existing	4 bed	€71,000	€310,000	€270,000	87%	3.80	€248,500	Salary * 3.5x	€61,500	€1,388	€3,833	36%
	3 bed	€61,000	€260,000	€230,000	88%	3.77	€213,500	Salary * 3.5x	€46,500	€1,182	€3,464	34%

Basis	Type	Salary	Cairn Average Sales Price	Mortgage Amount	Permitted LTV	LTI	Mortgage Allowed	Basis for Mortgage	Deposit Required	Monthly Mortgage	Net Monthly Pay	NDI
Proposed	4 bed	€71,000	€310,000	€279,000	90%	3.93	€279,000	90% LTV	€31,000	€1,434	€3,833	37%
	3 bed	€61,000	€260,000	€234,000	90%	3.84	€234,000	90% LTV	€26,000	€1,203	€3,464	35%

Non First Time Buyer

Basis	Type	Salary	Cairn Average Sales Price	Mortgage Amount	Permitted LTV	LTI	Mortgage Allowed	Basis for Mortgage	Deposit Required	Monthly Mortgage	Net Monthly Pay	NDI
Existing	4 bed	€71,000	€310,000	€248,000	80%	3.49	€248,000	Salary * 3.5x	€62,000	€1,275	€3,833	33%
	3 bed	€61,000	€260,000	€208,000	80%	3.41	€208,000	Salary * 3.5x	€52,000	€1,069	€3,464	31%

Basis	Type	Salary	Cairn Average Sales Price	Mortgage Amount	Permitted LTV	LTI	Mortgage Allowed	Basis for Mortgage	Deposit Required	Monthly Mortgage	Net Monthly Pay	NDI
Proposed	4 bed	€71,000	€310,000	€263,500	85%	3.71	€263,500	85% LTV	€46,500	€1,354	€3,833	35%
	3 bed	€61,000	€260,000	€221,000	85%	3.62	€221,000	85% LTV	€39,000	€1,136	€3,464	33%