CONSTRUCTION INDUSTRY FEDERATION

Submission to the Central Bank Of Ireland.

Loan-To-Value and Loan-To- Income Regulations

August 2016

CONSTRUCTION INDUSTRY FEDERATION

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Central Bank of Ireland
Dame Street
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By email: mortgagesubmissions@centralbank.ie

28th July 2016

Dear Sirs,

Response to Consultation on Housing Loan Requirement Regulations – Loan to Value and Loan to Income Regulations.

We welcome the opportunity to respond to the consultation process on the review of the Central Bank Macroprudential policy for residential mortgage lending with particular reference to Loan to Value and Loan to Income Regulations.

Whilst we agree with the requirement for a Macroprudential policy for residential mortgage lending, we believe that the review now underway is appropriate, and that a tweaking of the current regulations is appropriate at this juncture.

In preparing this submission have taken on board the views of our members who have direct experience of purchasers who wish to purchase a new home. The conclusions and recommendations contained in this Submission are based on the analysis of views expressed and research undertaken.

We would welcome the opportunity to present our findings and discuss these issues further.

Yours sincerely,

Hubert Fitzpatrick
Director

KEY RECOMMENDATIONS

Key recommendations for review of the CBI Macroprudential policy for residential mortgage lending include:

- LTV: The threshold figure of €220,000 included in the CBI Macroprudential policy could be increased to closer to €330,000 particularly in the city areas to reflect the starter price of a 3 bed home as determined by the SCSI. An application for a mortgage by a first time buyer who partners with a second time buyer should be considered as a first time buyer application and the deposit rules as a first time buyer should be applied accordingly;

- LTI: The multiplier figure of 3.5 could be increased to 4 or 4.5 so that persons working up to 5 years can have some chance of securing the required mortgage approval level to enable them purchase their starter home. A 4.5 LTI would seem reasonable particularly for the greater city areas especially when an LTV is already in place;

- Affordability Tests: In determining required deposit levels, some recognition should be given for track records established by mortgage applicants in paying rents for residential accommodation. An index should be available linking borrowers' ability to pay rent and the borrowers employment status to the borrowers' receiving a higher LTI under the updated CBI rules;

- Interaction with Government Departments/ Agencies: The Department of Housing Planning and Local Government (DHP&LG) has published the Governments Action Plan for Housing. Budget 2017 is to consider further initiatives to improve the affordability for some future first time purchasers. The CIF, in its Submission to Government on Budget 2017, has suggested a range of initiatives to help first time buyers including introduction of a Help to Buy Scheme. A scheme of this nature should be designed in conjunction with any revised Central Bank Mortgage lending criteria rules, thus relieving some potential social housing demand.

- The Government Housing Action Plan refers to the quantum of new housing units required to meet both private and social housing demand. Government targets require in excess of a doubling of new housing construction activity. The capacity of the banking sector should be reviewed so that the banking sector is adequately resourced to accommodate the demand for new residential mortgage lending, consistent with appropriate lending policies.

- It is important that co-ordination takes place between the CBI, the DHP&LG and the Department of Finance so that any proposed revisions to the CBI Macroprudential policy supports initiatives that may be taken by government to achieve the common goals, i.e. to achieve a sustainable Macroprudential policy that supports and protects home purchasers, supports and protects the banks, and at the same time assists in maintaining competitiveness in the economy.

CONTENTS

Submission on Loan to Value and Loan to Income Regulations

1. Introduction

The Central Bank of Ireland (CBI) has issued a call for submissions on the review of the Central Bank's Macroprudential policy for residential mortgage lending with particular reference to the Loan to Value and Loan to Income Regulations. The window for submissions is open from the 15th June to the 10th August 2016.

This Submission sets out issues surrounding affordability, how the current rules effectively exclude starter purchasers, the factual requirements for purchasers in terms of deposit requirement and income required to purchase homes at a certain price level. Specific reference is made to the first time buyer sector of the market which is a key sector that requires attention.

The Submission also refers to affordability thresholds which apply and to evidence where the cost of renting a property in some areas is more expensive than the repayments on a mortgage.

2. The Property Market in Ireland

Although recent indicators illustrate positive signs of recovery of the house building market, much of this recovery is dominated by projects where sales prices in many cases are lower than full replacement cost. While 12,666 new units were deemed completed in 2016, many of these units were half built during the crisis that hit the economy with the result that the stated new housing completion levels do not reflect construction reality on the ground. Housing completions levels are measured by the number of new housing units connected to electricity supply which does not reflect the real level of residential construction activity at any one time. The level of new residential construction activity is more appropriately measured against the lodgement of Commencement Notices under the building control process.

It is likely that the level of house completions for 2016 could be lower than that for 2015 at a time when the sustainable demand for new houses is publicly stated by many commentators to be circa 25,000 units. There are impediments to the house building industry being in a position to deliver this required level of output due to:

- Purchasers of starter homes not having the capacity to raise the required mortgage;
- House prices in many parts of the country still lagging behind all-in construction costs; and
- Other difficulties in relation to availability of ready to go serviced lands and infrastructural costs.

3. Issues Identification

Macroprudential policies are an appropriate long term goal and have an essential role to play in protection of the banking system and regulating the money supply for the residential mortgage market.

Appropriate Macroprudential policies are likely to be positive given the correct circumstances and economic environment. A lower LTV and requirement for large deposit reduces the risk to the banks who are less likely to lose money in the event of a default be it caused by a downturn or otherwise. A lower LTI ratio also means that borrowers have more disposable incomes after meeting monthly loan repayments.

However, overly stringent rules can effectively lock would-be purchasers out of the market compelling them to rent, which can be more expensive than purchasing their starter home.

It is appropriate that the operation of the rules which are now in place since February 2015 be reviewed and where deemed appropriate, tweaked to address unintended consequences that are now evident arising from implementation of the rules. The rules must continue to address affordability requirements and not result in future home purchasers over-extending themselves in terms of mortgage borrowing levels.

Capacity of Industry to Increase levels of New House Building:
There is no disagreement that the output levels of new house building must double to treble in order to meet the sustainable demand. The industry can only respond when there is clear evidence that the new units when built can be sold on the open market at prices that cover the all-in construction costs. This requires purchasers who can secure the required mortgage to purchase the home while still attaining affordability thresholds. A house builder cannot nor does he want to secure the required development capital to build speculative housing units at a time when purchasers cannot secure the required mortgage. However, if the capacity of first time purchasers to raise the required mortgage is improved, this reduces the risks for a house builder and the provider of development finance resulting in an increased level of house building taking place for this category of purchaser.

Affordability:
Affordability is still a key requirement in influencing the recovery of house building levels countrywide. House builder experiences over the past eighteen months reveal that the market for the basic starter home is sluggish. While new starter first time buyer show houses attract high levels of viewings, this does not translate into first time purchaser contracts. Depending on the geographic area, this is particularly relevant for new housing units priced up to €350,000.

In the greater Dublin area, there is in excess of 20 new housing developments where first time buyer (FTB) houses are on the market at prices less than €300,000. However, contracted sales in these areas are very slow resulting in a minimal level of new FTB house building taking place in these areas.

Many FTBs are currently renting private rented accommodation. This precludes them from establishing a track record for saving for the required deposit. In many cases, the monthly rent payable for private accommodation can be up to and higher than the monthly mortgage repayments on a new starter home. See appendix 1 attached illustrating loan repayments and comparable private sector rents for a 3 bed house in various locations countrywide. The current CBI Macroprudential policy does not recognise this situation. A track record of meeting monthly rent payments should be recognised by the CBI policy in satisfying affordability and deposit requirements. The CBI policy should be tweaked to reflect this relaxation.

A mortgage applicant's demonstrated record of ability to pay rent for a number of years together with their work status in settled employment should receive credit in the assessment of affordability to repay a mortgage. This should result in a higher maximum LTI being available to such applicants.

Interaction of LTI and LTV ratios with one another:
Internationally, where similar Macroprudential policies have been introduced in the past, they have never included both LTV and LTI limits together. The introduction of both policies at the same time has resulted in the exclusion of mortgage applicants from an adequate loan approval notwithstanding the applicants' ability to meet repayments as demonstrated by, for example, a track record of paying rents for private rented accommodation.

LTV Requirements:
In setting LTV requirements, the threshold of €220,000 for determination of deposit requirements countrywide is inequitable as house prices differ significantly countrywide. The basis for arriving at the €220,000 figure is not understood. However, a basis could be determined having regard to the all in construction cost for a 3 bed semi-detached house. In this regard, your attention is drawn to the independent report prepared by the Society of Chartered Surveyors (SCSI): *The Real Cost of New House Delivery – Analysis of Real Market Data to Evaluate Viability & Affordability of New Housing Development, May 2016* which illustrates the total house cost at €330,493. This price will vary countrywide due principally to the different land prices that may prevail.

The effect of introduction of the €220,000 limit for determination of the 10% deposit means that a FTB's deposit requirement for a new 3 bedroomed house costing €330,493 (as illustrated by the SCSI report) is €44,098, or 13.34% of the purchase price.

LTI Requirements:
The current LTI requirements exclude many young couples aged under 30/ 35 years from purchasing a home. Appendix 1 sets out the deposit and income requirements for a FTB purchasing a home. A new starter house costing €330,000 (SCSI May 2016) requires a deposit of €44,000 and a joint income of €81,714. To demonstrate typical salaries applicable for first time purchasers, appendix 2 sets out salary levels for public sector employees for a teacher, a garda, a nurse and an executive officer who are 5 years working. A teacher and a garda will have a combined salary of €73,635. They will not qualify for a mortgage to purchase a 3 bed starter home priced at €330,000 as a combined salary requirement of €81,714 applies. A civil service executive officer and a nurse will have a combined income of €65,868 after 5 years, a far cry from the salary requirement of €81,714 to secure the required mortgage approval.

An index should be available linking borrowers' ability to pay rent and the borrowers' status in settled employment to the borrowers' receiving a higher LTI under the updated CBI rules.

In a recovering housing market, a 4.5 LTI would seem reasonable particularly in the greater city area considering that an LTV is already in place.

The effect of the stringent LTI requirement is to exclude many first time buyers from the market unless they have significant financial support from others such as family members. This in turn deprives those social sectors where family financial support is not available from purchasing their home leaving them as involuntary renters of private accommodation. This results in a chain reaction of scarcity of rental accommodation pressurising levels of private rents.

4. First Time Buyers

The Central Bank's own research indicates that FTBs do default less and are a lower default risk in a Macroprudential context. A number of reasons are given to support this statement including:

- Due to lack of credit history, banks apply more thorough lending evaluations and stricter appraisal criteria to FTBs;
- If FTBs wish to move in the future and are concerned about the impact of default on their future credit access, they may be more active in trying to keep up with mortgage payments; and
- Becoming a second and subsequent buyer (SSB) may in fact reveal a higher tolerance for risk relative to borrowers who remain as FTBs.

For FTBs, the life time costs of default are higher as exclusion from credit markets in the future, following a current default, has higher repercussions.

A sustainable house building industry requires a sustainable FTB market with sustainable residential mortgage lending policies. Such policies must facilitate both the capacity of willing purchasers in conjunction with affordability criteria to purchase, and at the same time, enable the residential building industry progress with construction of new homes of the correct size, in the correct locations, and at the right price.

An application for a residential mortgage from a first time buyer who partners with a second time buyer is considered by the banks to be a second time buyer mortgage application. This means that one of the parties to the transaction loses their status of a first time purchaser. It is suggested that an application for mortgage in such circumstances should be considered as a first time purchaser application and that the deposit rules be adjusted accordingly.

5. Unintended Consequences

Kennedy and Stuart, in their review of Macroprudential measures and the housing market outlined that the primary objective of the measures was to increase the resilience of the banking and household sectors to financial shocks, while the secondary objective was to dampen the pro-cyclical dynamics between property lending and housing prices. They acknowledged that the CBI measures would alter the dynamics of the housing market and the incentives to both banks and borrowers. They outlined that a simple analysis of the housing market indicated that the proposed measures may not necessarily increase rents: in fact, the analysis suggested that rents could fall.

The CBI policy certainly affected the market. In relation to:

- *Residential Lettings:* Experience over the past 2 years illustrates that for every residential investor entering the market, two are leaving. Published reports from Ronan Lyons of Daft and from Marian Finnegan of Sherry Fitzgerald all confirm the reducing stock of residential properties that are available for rent;
- *New Residential Construction Activity:* A contributing factor in inhibiting commencement of larger numbers of new starter homes is the inability of willing first time buyers who do not have the capacity to meet the CBI Macroprudential rules for residential mortgage lending secure the required mortgage to purchase their new home. This curtails the financial viability of larger schemes of starter homes with the resultant effect that current levels of house building activity are well below the required activity level;
- *Residential Rents:* As minimal new residential building activity is taking place to increase the overall residential stock levels where required, future purchasers are unable to vacate their private rented accommodation resulting in excess demand for a fixed supply of private rented housing. This is putting upward pressure on rents and resulting in an increasing demand for social housing and homelessness;
- *Increased Demand for Social Housing:* Those willing purchasers who are excluded from the mortgage market due to difficulties in meeting the Central Bank's LTI or LTV requirements may now find themselves seeking alternative assistance in meeting their long term housing needs. This may entail applying for social housing supports which is a very expensive alternative to some tweaking of the CBI LTI or LTV rules or some small assistance that might enable them purchase their own home.

6. International Experience: Macroprudential Policy

The International Monetary Fund, in its Background Paper on Key Aspects of Macroprudential Policy (June 2013), reviewed the experience and effectiveness of Macroprudential rules. The paper acknowledged that not all credit growth booms end up in a crisis. Good booms are financed by stable sources of funding and are used to expand the productive capacity of the economy.

When deciding on when to act, policy makers need to take into consideration the imperfect nature of the signal and the possibility of over-regulation. Applying some judgement in the setting of the counter cyclical capital buffer (CCB) as required by Basel III is necessary.

Ireland's competitiveness could be considered challenged due to the shortage of affordable residential accommodation. This is at a time when industry housebuilding activity is at less than half the required sustainable level of building required.

Macroprudential policies – Limit on LTV ratios, Caps on DTI (Debt to Income) ratios, and sectoral capital requirements are all significant effective tools in protecting credit levels in economies, protecting the banks and borrowers. However, the IMF, in its paper on Key Aspects of Macroprudential Policy, confirmed that, out of 46 countries, only 15% of countries with Sectoral Macroprudential rules apply all three rules (7) while 39% applied any two of the rules (18). The Table below is extracted from the IMF Report and outlines the extent to which the range of tools is applied in respect of the 46 selected countries.

Table 1. Number of Countries with Sectoral Macroprudential Tools

	Limits on LTV Ratio	Caps on DTI Ratio	Limits on LTV and DTI ratios	Sectoral Capital Requirements	One tool	Any two tools	All three tools
Number of Countries (Total = 46)	24 (52 percent)	14 (30 percent)	14 (30 percent)	23 (50 percent)	36 (78 percent)	18 (39 percent)	7 (15 percent)

Source: IMF staff calculation.
Note: Numbers in ( ) shows the proportion of countries with a specific instrument among the sample.

It is suggested that the risk of over regulating via the Macroprudential Policy applied to the mortgage lending sector should be reviewed as the limiting factors now prevalent in the residential mortgage market are contributing to the curtailment of the required level of residential construction.

Once construction activity levels are restored to a sustainable and justifiable level, it will be open to the CBI to review the Macroprudential Policies again to ensure that potential overheating of the housing market does not prevail, and that mistakes of the past are not repeated.

7. Governments Action Plan for Housing and Homelessness

Pillar 3 of the Governments Action Plan for Housing and Homelessness has a key action to double the level of new housing output to deliver over 25,000 new units per annum on average over the period of the Plan [2017 – 2021], aided by a range of government initiatives.

While Land Supply Management, Supporting Infrastructure Investment, Planning Reforms, a New National Planning Framework, Addressing the Cost Base and Construction Sector Capacity and Skills are all key initiatives that must be addressed, these will only be productive in increasing the level of new housing build if willing purchasers have the capacity to purchase their new home, i.e. if they can raise the necessary finance to complete the purchase of their new home.

Central Bank research notes that in 2013/2014, cash purchasers accounted for close to 60% of the total transactions in residential sales, relative to c.30% in the first half of the 2000s. Goodbody estimate that cash purchases here remained consistently above 50% of total transactions since 2010.With regard to transactions overall, it notes that, in a "normal" market, transactions should amount to 4% of the housing stock. The rate in Ireland currently stands at c.2%. If cash purchases are above what one might expect (the contention of the Central Bank), it stands to reason that housing transactions overall are low because of inappropriately low mortgage lending. A normal functioning market therefore requires significantly higher mortgage lending. Goodbody Stockbrokers currently estimate that this level is c. €8bn per annum, compared to the €5.3bn expected this year.

Review of the CBI Macroprudential Rules is a key ingredient to facilitate the successful implementation of the Governments Action Plan for Housing and Homelessness. This is required for the industry to be in any way capable of delivering the increased housing output needed to meet the sustainable demand for new housing as predicated in the Action Plan over the years ahead.

8. Recommendations

An effectively operating residential market ensures that there is an available and affordable supply of residential property to meet the demands of the consumer. The gap between supply and demand for residential property that exists will continue to widen unless action is taken by a range of stakeholders to address this problem. One of these stakeholders is the CBI. The review currently underway in relation to its Macro-prudential policies for residential mortgage lending is appropriate at this time.

Key recommendations for review of the CBI Macroprudential policy for residential mortgage lending include:

a. LTV: The threshold figure of €220,000 included in the CBI Macro prudential policy could be increased to closer to €330,000 particularly in the city areas to reflect the starter price of a 3 bed home as determined by the SCSI. An application for a mortgage by a first time buyer who partners with a second time buyer should be considered as a first time buyer application and the deposit rules as a first time buyer should be applied accordingly;
b. LTI: The multiplier figure of 3.5 could be increased to 4 or 4.5 so that persons working up to 5 years can have some chance of securing the required mortgage approval level to enable them purchase their starter home. A 4.5 LTI would seem reasonable particularly for the greater city areas especially when an LTV is already in place;
c. Affordability Tests: In determining required deposit levels, some recognition should be given for track records established by mortgage applicants in paying rents for residential accommodation. An index should be available linking borrowers' ability to pay rent and the borrowers employment status to the borrowers' receiving a higher LTI under the updated CBI rules;
d. Interaction with Government Departments/ Agencies: The Department of Housing Planning and Local Government (DHP&LG) has published the

Governments Action Plan for Housing. Budget 2017 is to consider further initiatives to improve the affordability for some future first time purchasers.

The Construction Industry Federation has made its Submission to the Department of Finance for Budget 2017. The Submission suggests a range of initiatives to help first time buyers including introduction of a Help to Buy Scheme whereby Government could provide an equity loan scheme to assist qualifying first time home purchasers purchase a home. A scheme of this nature should be designed in conjunction with any revised Central Bank Mortgage lending criteria rules, thus relieving some potential social housing demand.

e. The Government Housing Action Plan refers to the quantum of new housing units required to meet both private and social housing demand. Government targets require in excess of a doubling of new housing construction activity. The capacity of the banking sector should be reviewed so that the banking sector is adequately resourced to accommodate the demand for new residential mortgage lending, consistent with appropriate lending policies.

f. It is important that co-ordination takes place between the CBI, the DHP&LG and government departments such as the Department of Finance so that any proposed revisions to the CBI Macroprudential policy supports initiatives that may be taken by government departments to achieve the common goals, i.e. to achieve a sustainable Macroprudential policy that supports and protects home purchasers, supports and protects the banks, and at the same time assists in maintaining competitiveness in the economy.

Hubert Fitzpatrick

Director
28 July 2016

APPENDICES

Appendix 1: FTB Deposit and Income Requirement for Home Purchase, Cost of Renting 3 Bed Homes in some locations.

Appendix 2: Salary levels for Public Sector Employees who are 5 years working

APPENDIX 1

HOUSE PRICE CALCULATIONS					
3 Bed Home Price	€250,000.00	€300,000.00	€330,000.00	€350,000.00	€400,000.00
Deposit Required	€28,000.00	€38,000.00	€44,000.00	€48,000.00	€58,000.00
Annual Income Required	€63,400.00	€74,857.00	€81,714.00	€86,285.00	€112,000.00
Loan Required	€222,000.00	€262,000.00	€286,000.00	€302,000.00	€342,000.00
Loan Repayment (BOI 30 years loan Standard Variable	€1,122.62	€1,324.90	€1,446.26	€1,527.17	€1,729.45
Source: BOI Mortgage Calculator	Mortgage over 30 years				

Residential Rents Q1 2016	
	3 BED HOUSE
	Current Rent Monthly
Dublin 4	€2,066.00
South Co. Dublin	€1,781.00
Dublin 3	€1,606.00
North Co. Dublin	€1,293.00
Cork City	€1,047.00
Galway City	€911.00
Limerick City	€799.00
Waterford City	€699.00
Co. Meath	€917.00
Co. Kildare	€996.00
Co. Wicklow	€1,049.00

APPENDIX 2

PUBLIC SECTOR WORKERS :5 YEARS WORKING	
	SALARY
TEACHER	**€ 37,795.00**
GARDA	**€ 35,840.00**
NURSE	**€ 33,189.00**
EXECUTIVE OFFICER	**€ 32,679.00**

Source: ASTI, An GARDA Website, INMO, IMPACT.