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Submission of the Free Legal Advice Centres (FLAC)

In response to the Central Bank of Ireland Consultation Paper (CP 146)

The mortgage measures framework review

March 2022

1. Introduction

It says a lot about the property market and housing policy in Ireland, that as of March 2022, the question of access to mortgage credit and the amount that a person may be allowed to borrow for house purchase is now a matter beyond the reach of most consumers to contemplate.

At this point, accessing any form of housing and trying to avoid rent arrears, once accommodation has been sourced, is the main priority for many, in addition to trying to avoid utility arrears and personal over-indebtedness resulting from non-mortgage credit agreements and simply trying to pay the bills.

Covid-19 and its aftermath; an initially underestimated global inflation problem exacerbated by energy supply chain ‘difficulties’; climate change concerns; threats of food shortages and the current existential threat to peace and security, all call into question the relevance of this review for many.

The recent historical perspective is also important. While we have no problem with the setting of responsible lending and borrowing guidelines – we called for these to be put in place in the first decade of the millennium when it was clear that reckless lending was becoming endemic and wrote to the Financial Regulator to that affect, to no avail – it is questionable whether such guidelines should be imposed by the CBI, or by anyone else, in apparent isolation from a wider consideration of the property market in its totality, including all forms of tenure.

Having presided, largely without interfering, over a glut of reckless lending (and some reckless borrowing too) pre-Global Financial Crisis (GFC), it was not surprising that the CBI decided in 2015 to avoid a repetition by setting borrowing limits. The CBI is independent in the performance of its functions and such action reflects both consumer protection and institution solvency concerns. However, we would ask what kind of consultation took place then, and what consultation is proposed now, with relevant government departments, particularly the Department of Housing in the context of the ‘Housing for All’ policy.

In our view, lending limits should at least be cognisant of the State’s plan for housing and should taking into account housing supply issues. In this regard, for example, it is apparent from the most recent data available from the Central Statistics Office that residential property prices increased by 13.5 per cent nationally in the year to October 2021.[1] The mean price in Dublin was the highest in any region or county at €494,917. The latest report from daft.ie on the private rental sector contains similarly worrying data. It shows that rents nationally rose at an annual rate of just over 10% in the last three months of 2021.

[1] As reported in the Irish Times. See: ‘House price inflation surges to pandemic high of 13.5% - Figures for October represent strongest level of growth seen in market since 2015, *Irish Times*, 15th December 2021.

Average rents are now at mortgage payment levels in many places and beyond in some. In essence it would appear that the state has relinquished a substantial degree of control over the private rented sector where real estate investment trusts (REIT) and pension funds have begun to increasingly control the market. A recent media report for example noted that large investors paid €2.27bn for almost 4,900 private rented sector (PRS) properties in 2021, an average of almost €430,000 per unit, €104,206 more than the average price of €325,502 paid by households who bought homes in the 11 months to the end of November 2021.[2]

This is the backdrop for consumers wishing to borrow for house purchase and strict borrowing limits increasingly militate against any that prospect until or unless that supply improves. This is of itself not a justification for relaxing those limits but neither is it a context that should be completely ignored in reviewing them.

In terms of the broader context for this review, the CBI must be cognisant that the Irish Human Rights and Equality Commission Act 2014 requires public bodies to take a proactive approach to addressing equality and human rights concerns. This is reflected in a 'Public Sector Duty' that specifically requires such bodies to carry out an assessment of the human rights and equality issues relevant to its functions and the policies, plans and actions that it proposes to put in place. Pursuant to section 42 of the Act, public bodies are required to consider how they will advance equality for groups protected under equality legislation and how they will protect the human rights of all citizens in regard to the human rights obligations in the Constitution and in domestic legislation. Have these obligations been factored into this review?

2. The current limits

A borrower must have a minimum deposit amount before obtaining a mortgage (loan to value (LTV) limits):

- First-time-buyers need to have a minimum deposit of 10%;
- Second and subsequent buyers need to have a minimum deposit of 20%;
- Buy-to-let buyers need to have a minimum deposit of 30%.

Lenders are allowed to lend a certain amount above these limits. In any one calendar year they can give an allowance of up to 5% of the value of mortgages to first time buyers; up to 20% of the value of mortgages to second and subsequent buyers and up to 10% of the value of mortgages to buy-to-let buyers.

[2] 'Families being massively outbid on new homes by funds, meanwhile rents soar', *Irish Independent*, February 9th 2022. Rents up over 10% in final quarter of last year, Daft report reveals', RTÉ News, February 9th 2022. This article reports that figures compiled by BNP Paribas Real Estate show institutional buyers paid as much as 32pc more for each residence that they bought last year compared with the average price paid by household buyers in Ireland.

A borrower can borrow to a maximum of 3.5 times his/her gross income (loan to income (LTI) limits). A couple therefore can borrow 3.5 times their combined gross income. Again lenders are allowed to lend a certain amount above these limits. In any one calendar year they can give an allowance of up to 20% of the value of mortgages to first-time buyers and up to 10% of the value of mortgages to second and subsequent buyers.

Seasonally adjusted average weekly gross earnings in Q.4 2021 were €862 per week gross equivalent to €44,824 per annum.[3] Earnings on this scale would allow a first time borrower who is a single person to borrow €156,884, which rules out purchase in most urban areas and many rural areas, depending on the location and condition of the dwelling.

A first time borrower couple on such earnings could borrow €313,768. Taking into account the first time buyers mandatory deposit of 10%, this would allow that couple to purchase a dwelling valued at around €350,000 (€35,000 deposit plus €313,768 borrowed = €348,768).

For second and subsequent borrowers, taking into account the second and subsequent borrowers buyers mandatory deposit of 20%, this would allow that couple to purchase a dwelling valued at around €400,000 (€80,000 deposit plus €313,768 borrowed = €393,768).

Neither of these maximum borrowing amounts (together with deposit) come near the average of almost €430,000 per unit paid by funds and large investors to buy almost 4,900 private rented sector (PRS) properties in 2021, suggesting that the LTI limits do not allow those on average earnings to compete with funds and buy-to-let borrowers.

In addition, neither of these examples take into account the cost of purchase – valuation fees, surveyor's fees, solicitor's fees for example, and the cost of any renovations that might be required.

We certainly do not want to return to the days of unsustainable lending/borrowing nor do we want to see aspirant owner occupiers chase investors to try to buy family homes at inflated prices and risk the effects of future negative equity should supply improve. However, some tweaks to the LTI limits should nonetheless be considered. It is clear, for example, that the limits operate to exclude single people in that the 3.5 times gross income limit for this cohort effectively means that house purchase is currently out of the question, except for those with very high incomes. Some small improvement on the amount a couple may borrow might also be appropriate.

An important caveat here is that, in our view, there is insufficient information and little granular data available to explain how lenders exercise the 'allowances' discretion afforded to them under these measures. In practice this can involve the drawdown of family home mortgages by borrowers at multiples of income in excess of the notional limits and possibly well in excess of them in some cases. The existence of this option potentially compromises

[3] Sourced from Central Statistics Office website, March 14th 2022.

those limits and undermines the process, especially if its application is not transparent. This is discussed in more detail immediately below.

3. The application of the lender's discretion through the use of allowances

Lenders have a discretion to lend more to individual borrowers than the notional lending limits allow. This runs to 5% of the value of mortgages to first time buyers and 20% of the value of mortgages to second and subsequent buyers in any calendar year, and, since 2021, unused portions of these allowances may be carried forward by the relevant lender to the next calendar year. This is a considerable amount of discretion. It is notable that these percentages are not percentage uplifts on the amount above LTI a borrower can borrow, but rather a general discretion for the lender to apparently exercise as it sees fit. It seems to us therefore that a given borrower/s can be allowed to draw down well above notional LTI without the lender having to consult with anyone about it.

Page 25 of the Consultation Paper review (CP 146) states that '*as part of the framework review, the Central Bank has examined the role of allowances in the overall mortgage measures framework'.* It is noted that *'the responses to the online survey highlighted some of the challenges relating to the allowance framework, with many respondents perceiving the availability of allowances to be limited predominantly to high-income borrowers. Frustration was expressed relating to the uncertainty and lack of transparency around the process of obtaining an allowance'* (our emphasis). Given what appears to be the very wide discretion given to lenders here, such frustration is understandable.

For example, within Box 4 (on page 27) it is generally observed that *'mortgages with an allowance tend to be more common in regions with high house prices relative to incomes, such as Dublin'* and that *'FTBs (*first time buyers*) with an allowance use the additional leverage to purchase significantly more expensive properties, even within the same region'*.

On page 26, it is suggested that *'focussing firstly on FTB's, borrowers with an allowance tend to be younger than those without an allowance'.*

Page 26 further notes that '*given the dominance of urban areas in the allowance pool, these borrowers tend to have high incomes'. Many of these patterns, particularly relating to the dominance of the Dublin market and higher value properties, hold when analysing SSB* (second and subsequent borrowers) *usage of the LTI allowances.*

Box 4 (on page 27) also notes that *'on average these loans have higher originating balances, higher average incomes and longer term loans, in part reflecting the younger age of the borrowers with an allowance'.*

This is to our mind a somewhat curious combination of observations. Allowances are more commonly used to help fund house purchase in areas where house prices are significantly more expensive. Borrowers who receive such allowances tend to be younger. In terms of first time purchase, allowances seem to be more readily provided to younger people to purchase more expensive properties and these trends hold for second and subsequent borrowers. While younger people may have longer to pay off their mortgage, does this not appear somewhat counter-intuitive in terms of risk, should the financial situation of these borrowers deteriorate?

A notable passage in the review (at page 25) further observes that *'Allowances are now a well-established part of European countries' mortgage measures frameworks, having grown in usage since the Central Bank introduced the measures in 2015. Looking across countries, the allowances in Ireland are high as a proportion of total lending. By contrast, the calibration of the "headline" limits (in particular the LTI limit of 3.5) is lower than in many other countries (ESRB, 2021). The net effect on the credit market of having a larger pool of allowances partially offset a lower headline LTI limit is difficult to accurately measure.*

and that:

'The allowances have played an important role in the Irish framework, providing flexibility for lenders and borrowers since their introduction. For example, the framework has been better able to deal with slow-moving structural factors in recent years, such as those relating to interest rates and housing supply constraints, than would have been the case with a smaller allowance pool. More broadly, it is an important principle of the regime that a macro prudential intervention will need to have flexibility to incorporate specific individual circumstances'.

These passages are to our mind revealing. LTI limits in Ireland are more restrictive than their European counterparts. By contrast, the allowances in Ireland are high as a proportion of total lending, i.e. it would appear that the discretion afforded to lenders to exceed those limits is greater in Ireland.

Despite the assertion that the CBI has examined the role of allowances in the overall mortgage measures framework, we see nothing in the consultation documentation that provides any profile of the status of those borrowers who have been favoured with allowances, in terms, for example, of social background and economic status.

A sentence such as *'More broadly, it is an important principle of the regime that a macro prudential intervention will need to have flexibility to incorporate specific individual circumstances'* may disguise an uncomfortable truth. The concern is that lenders may use this 'allowance' facility to discriminate in favour of borrowers from more privileged and/or wealthy backgrounds who have influential connections that may be leveraged in order to arrange the provision of larger mortgages.

It should also be an important principle of the mortgage measures framework regime that a macro prudential intervention should not operate to discriminate against potential borrowers on grounds of socio-economic status. The CBI should research this question and

the relevant data in much greater detail before retaining the allowances rules as they are currently are.

4. No lending restrictions for buy-to-let borrowers

As we understand it, the LTI limits do not apply to mortgages drawn down for investment purposes. Thus, the amounts that may be borrowed for buy-to-let property purchase are not subject to any regulatory assessment or control by the CBI and therefore no theoretical limitation, except that imposed by the lender. In our view, this is wrong for the basic reason that is it inconsistent with the other measures and for a number of other specific reasons as follows:

- It gives BTL borrowers an unfair advantage in terms of their capacity to outbid owner occupiers who are looking to purchase family homes to live in and this is deeply unfair, though this is probably more likely to occur with institutional investors with large amounts of capital to spare. We have seen above at page 3 of this submission the effect of this in practice in 2021.

- BTL properties have tenants for whom the property is their home. Yet their landlords, particularly one property investors, may in the future and have in the past run into payment problems and arrears on these mortgages, sometimes due to over exposure and related financial problems. This can and has affected the security of tenure of tenants who have become exposed to eviction and homelessness, as BTL lenders bring proceedings against landlords that adversely affect their tenants.

- During the pre-2008 boom, it is apparent that a number of BTL mortgage borrowers cross-securitised their family home as additional security for the BTL 'investment' mortgage. In many instances, there was substantial equity in those family homes and some were even owned outright. Anecdotally, a number lost the family home as a result or had judgments obtained in the courts and judgment mortgages registered on the family home. These homes contained families whose lives were seriously disrupted by the temptation to make 'your equity work for you' and other such blandishments.

5. How the deposit was obtained

The LTI limits are something of a blunt instrument and do not allow any deviation that might help to distinguish the potential borrower in terms of credit risk. The exception to this, as we have seen are the allowances provided by lenders to certain borrowers in the privacy of their own bank, a process that seems to be outside the direct remit of the CBI.

A number of potential borrowers who are currently living in rented accommodation responded to the review in critical terms, pointing out that rent levels are in some cases more expensive than the equivalent mortgages, but that the fact that they are consistently paying those rents and not accruing rent arrears is not taken into account in deciding the amount that they can borrow, under the lending rules at least.

It is also the case that a number of these potential borrowers are also building their deposit from their earnings as they continue to rent and are simultaneously meeting their day to day expenses; evidence perhaps of capacity to service a mortgage at greater levels than the lending limits allow for.

One of the two core objectives behind the introduction of the mortgage measures in 2015 was to '*increase the resilience of banks and borrowers to negative economic and financial shocks'.* Resilience is the key word here. There is a substantial difference in terms of potential borrower resilience to financial shocks between a person who has worked consistently to earn a deposit while living independently and a person who has, for example, availed of financial assistance from family to present that deposit. In our view, track record in terms of ability to plan, budget and save should count for something extra in terms of the LTI limits, subject to the applicant being in a position to present the appropriate documentary evidence. In reviewing the LTI criteria, the CBI should consider building some flexibility into the limits on this criterion.