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Irish Congress of Trade Unions

Submission from the Irish Congress of Trade Unions to the Central Bank Consultation on Mortgage Measures Framework Review

March 2022

"Overall, as we highlighted earlier, the current housing policy has benefited both institutions and developers <u>at the expense of individual buyers</u>. The potential risk for institutions.....comes from a potential change in Government policy."

- Note to investors, Gillen Markets, Investment & Wealth Management (May 2021)

1. Supply & Affordability

Increasing supply is the key priority of official housing policy as expressed in the government's *Housing for All* plan, which was unveiled in September 2021.

Underpinning that strategy is the clear view of government that increasing supply will ensure a fall in house prices and help to close the 'affordability gap' that has widened so dramatically over recent years.[1]

In April 2020, the Nevin Economic Research Institute (NERI) was already warning that the level of house price (and rental) inflation then being experienced meant that securing a mortgage on an average-priced home in the capital city was beyond the means of some 85% of the population.[2]

The concerns expressed by NERI related not to the mortgage measures in place, rather on the evident failure of official policy to deliver on affordability.

In the intervening period, that affordability gap has widened considerably, in terms of both house prices and rents.

According to the CSO, annual home price growth reached 14.4% in 2021, its highest level in six years.[3]

The overall target of *Housing for All* is to deliver some 33,000 units per annum over the coming years, up to 2030.

However, this comes with one crucial caveat: the majority of these homes (156,000) are to be delivered by the private sector, which means that government has no real levers to ensure either their delivery, or their pricing when they come to market.[4]

Yet there is significant ongoing debate and no little dispute over whether increased housing supply automatically and inevitably translates into more affordable homes for all who need them, or whether there is even a direct causal link between the two.

Indeed, a recent KPMG report for Dublin City Council forecast house (and rent) increases of some 25% by 2028, *despite* the increased supply promised by the official strategy.[5]

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[1] https://www.breakingnews.ie/ireland/housing-minister-says-2022-can-bring-slowdown-in-irish-property-price-rises-1190596.html

[2] https://nerinstitute.net/blog/time-tackle-private-rental-sector

[3] https://www.rte.ie/news/business/2022/0216/1281161-cso-residential-property-prices/

[4] https://www.gov.ie/en/publication/ef5ec-housing-for-all-a-new-housing-plan-for-ireland/

[5] https://www.businesspost.ie/houses/dublin-house-prices-to-soar-by-25-per-cent-council-study-finds-99d58790

In addition, a Canadian study of extensive house building in that country between 2006 and 2016 found that price increases had been highest where the greatest number of new homes had been built.[6]

The study concluded that *quality* of demand rather than *quantity* was a key factor in driving price inflation, in other words the finance available to buyers, rather than the number of buyers.

This is confirmed by a UCD study which reveals that, internationally, price reductions arising from increased supply are generally ‘modest’.

It identified sustained low interest rates and heightened speculative activity as the drivers of house price growth over recent years.[7]

Housing experts and academics such as Dr Lorcan Sirr and Orla Hegarty have also questioned whether increased supply of itself is capable of delivering affordable homes, suggesting that high prices are now “baked-in” to our model of housing provision.[8]

In that context, a fall in house prices would almost certainly see developers experience difficulties in accessing finance and possibly halting or slowing output on existing schemes, which is the opposite of the scenario envisaged under *Housing for All*.

In a recent opinion piece, Dr Sirr observed: “Indeed, housing policy is arguably designed to *not* allow new house prices to fall. For every 10pc fall in the price of a new house, site values drop by about 30pc......as prices fall, the value of the developer’s other land falls even further.

“To help **maintain** new house sale prices, we have taxpayer-funded shared equity and help-to-buy schemes. This is also why ‘affordable’ housing is now defined as €450,000 in Dublin and €400,000 in Cork. Neither of these schemes will bring down house prices — quite the opposite — but they will **protect land values**.”[9]

Arguably, it would that seem the very policy premise of *Housing for All* is questionable, if not entirely misconceived.

It addition, it is also clear that much expert opinion - here and abroad - believes the focus of policy should be on *affordability* and clearly defined *affordable supply* as opposed to simply increasing the number of new units available.

However, official strategy seeks to deliver on affordability only as a *by-product* of supply, as opposed to establishing it as the essential metric of official policy.

In that respect, current policy retains the same essential flaw that has bedevilled housing policy over the last decade, namely a dependency on private, speculative interests to provide what is an essential public good.

This arises primarily from policy choices made in the immediate aftermath of the 2008 Crash.

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[6] *Business Post Dec 9, 2021*

[7] https://publicpolicy.ie/perspectives/understanding-irelands-housing-challenge-in-the-light-of-housing-for-all/

[8] https://twitter.com/orla_hegarty/status/1403621937851535360

[9] https://www.independent.ie/opinion/analysis/housing-policy-failure-is-a-political-own-goal-of-enormous-proportions-41164274.html

Between 2008 and 2014, State funding for public housing effectively collapsed, falling by some 88.4%. This led directly to a fall of over 91% in public housing output.[10]

Public housing provision never recovered and government subsequently moved to effectively outsource such provision, by way of expensive leasing schemes and massive subsidies to private landlords, via the Housing Assistance Payment (HAP).

Up to **one third of the 2021 housing budget** - €1 billion - was allocated to fund these and other subsidies to private landlords, expenditure which represents very poor value for the State and equally poor outcomes for households in this sector.

This ongoing dependency on private interests has been reinforced by *Housing for All* which, as we have seen, will rely on the private sector to deliver the majority of its overall 300,000 target.

Given this dysfunctional 'developer-led' policy it is perhaps no great surprise that supply should emerge as the key metric of the current government's strategy.

Indeed, it is argued that successive governments have effectively retreated from the provision of housing, for fear of 'interfering' in the market.

As Dr Lorcan Sirr told RTE's *Morning Ireland* in 2020:

"In theory….the State could build houses for X and sell them for X and the State doesn't really need to be making profit and we have hundreds of thousands of acres of State land out there, available and ready to go….

"There is an ideology, I think, on policy-making level against competing with the private market……where the Government are afraid to start building houses at any scale because then you're starting to compete with private sector and that would be an ideological barrier from the Government's perspective.[11]

2. Land Values & Profit Margins

For its part, the European Commission is of the view that **inflated land values** and **increased developer profits** are key contributors to the growing 'affordability gap' in our housing system.

A December 2020 Commission briefing - *Housing Affordability in Ireland* - looked specifically at the factors that influence construction and housings costs.[12]

While it found that Dublin was the third most expensive city in Europe in which to build, this was not attributable to labour costs which were similar or lower than costs in at least 11 other EU 'regional markets', including London and Zurich.

Residential construction costs here were found to be similar to those in other EU countries (comparable to Germany, France, the UK; higher than the Netherlands).

[10] https://www.ucd.ie/geary/static/publications/workingpapers/gearywp201615.pdf

[11] https://www.broadsheet.ie/2020/01/21/its-not-possible-to-make-housing-more-affordable-by-just-increasing-supply/

[12] https://ec.europa.eu/info/publications/housing-affordability-ireland_en

The report speculated that skills and labour shortages could cause costs to rise, as we emerged from the pandemic. It said relatively low productivity in Irish construction - below the EU average - left the sector more vulnerable than others to a spike in labour costs.

Overall, construction costs represented just 45% of the costs associated with delivering a 3-bedroom semi-detached home (2016 figures). Other costs were:

- Taxes, levies, fees 18%;
- Finance/ marketing 8%;
- Land 17% (rising to 25-30% in some parts of Dublin);
- Profit 11%;

The Commission concluded that: "The surge in house prices in recent years seems to have been mainly driven by increases in land prices and construction margins."
The report warned that the growing dominance of investment groups/ funds in the housing market could lead to a 'concentration' of land ownership and fuel further price inflation.

It said **increased investment in social/ public housing was "paramount"** for improving overall housing affordability, while **utilising public land for residential construction** was also recommended, along with provision of an adequate supply of serviced land.

An additional and emerging problem with the current model is the **growing 'displacement' of households** as a result of increased activity by investment funds and State activity in the housing market (turnkey purchases/ leasing etc).

Thus, while overall output increased to 20,000 units in 2020, just one third of that number (7500 approximately) was available to purchase by households, due State and investment fund purchases. This displacement is likely to persist - if not worsen - over the coming years and likely place additional upward pressure on price and rental levels.

It is therefore the clear view of Congress that the core difficulties in the housing sector arise from misconceived and flawed policy over many years and clearly predate the implementation of the existing mortgage measures framework.

Essentially, official policy has attuned to the wishes of the development and speculative sector, as opposed to the housing needs of the wider population.

Rather than **making homes more affordable**, it seeks to ensure potential buyers can **afford what is on offer**, thereby underpinning existing high price levels and price inflation in the sector.

In that context, the net effect of a change or revision upwards of the existing mortgage framework would be to burden new and young buyers with **far greater levels of debt** and likely **spur a further inflationary spiral.**

It would so nothing to assist the significant number of young workers and families who are now effectively locked out of the market and **nothing to ensure delivery of affordable homes** for all, quite the reverse.

3. Mortgage Measures Framework Consultation Questions

The response to this section was compiled in consultation with the Nevin Economic Research Institute (NERI).

i. Please provide any feedback on the channels of macroeconomic benefits and costs of the mortgage measures that the Central Bank proposes to consider within its updated framework.

The mortgage measures help dampen the boom bust cycle by acting as a break on the ability of households to overleverage themselves (i.e. to borrow beyond their limit to repay). By not allowing households to overleverage or banks to divert too much credit into the economy, the rules are effectively placing an upper limit on the potential severity of a housing bubble and by extension the potential severity of the subsequent bust. Indeed, the probability of a boom developing is itself much reduced.

In addition, reducing the amount of credit going towards housing assets should free up credit for businesses and households borrowing for productivity enhancing uses. This will benefit the economy in the long-run. Getting rid of the mortgage measures will push up demand and therefore house prices. This will benefit property owners at the expense of borrowers and will increase overindebtedness.

ii. Please provide any feedback that you have on the proposed principles underpinning the refreshed objective statement of the mortgage measures.

We agree with the principles underpinning the mortgage measures.

iii. The Central Bank proposes to maintain a dual-instrument approach with both a collateral-based and income-based instrument in place. In your opinion, is this dual-instrument approach appropriate? Please provide additional information to support your view.

The dual approach is appropriate. The income ratios link the mortgage value to the borrower's capacity to repay. The deposit requirements provide evidence of the borrower's capacity to save. Both measures are themselves imperfect indicators of affordability. Combining the measures increases the probability that mortgages will only be given to people that are highly likely to afford the repayments.

iv. Taking both the proposed objective statement for the mortgage measures and the pros and cons of different income-based instruments into account, what are your views on the Central Bank's proposal that LTI remains the most appropriate income based instrument? Please provide additional information to support your response.

We agree that the LTI remains the most appropriate income-based instrument.

v. What is your opinion on the role of allowances as part of the mortgage measures? Do you agree that allowances are important to maintain flexibility within the framework?

We do not agree that allowances should form part of the mortgage measures. It is not clear what macroeconomic advantage arises from incorporating allowance within the system and they expose borrowers to undue risk. Consistent affordability rules should apply in the same way to all potential borrowers.

vi. What is your view on the proposal that the Central Bank reconsider the balance between the calibration of the limits and the level of the allowances?

It is reasonable to reconsider the precise calibration of the limits, though we would not agree that the level of the allowances should be increased.

vii. The differential treatment for FTBs reflects their different risk profile and the challenges for FTBs in accessing mortgage finance, including paying rents while saving for a deposit. Would you agree that differential treatment across borrower groups remains suitable, given their different characteristics and the different roles they play in the housing cycle?

We see no compelling reason to justify differential treatment across borrower groups.

viii. If so, what would you consider to be the most appropriate option for the choice and design of implementing differential treatment across borrower groups?

NA

ix. The Central Bank proposes that any future calibration changes of the mortgage measures would primarily reflect slower-moving, structural factors rather than responding too frequently to cyclical developments. Do you agree or disagree with this view? Please provide additional information to support your response.

We agree with this view. Policymakers should avoid responding too frequently to cyclical developments.

x.Taking into account the balance between the need to regularly review the measures while not inadvertently disrupting the market with overly-frequent expectations of changes to the measures, should the annual reviews of the measures be replaced by regular assessment of the functioning of the measures in the context of the mortgage market, combined with periodic overarching framework reviews, for example, every 3-5 years? Please provide further information to support your view

We would support this approach.

Irish Congress of Trade Unions,

March 2022