Property Industry Ireland
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Property Industry Ireland (PII) submission to Mortgage Measures Framework Review Consultation Paper 146

March 16, 2022

1. **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.**

In its consultation paper the Central Bank acknowledges that the mortgage measures “can have both benefits and costs across the wider economy and society”. However, it is the view of PII that the Bank then narrows its focus to concentrate only on the macroeconomic costs and benefits.

Peydro et al. (2020), examine the effects of the Bank of England’s LTI limits and find that mortgage borrowing by low-income households and first-time buyers declined following the introduction of these policies. Acharya et al. (2020) report a similar finding for Irish macroprudential mortgage measures: mortgage credit was reallocated from low- to high-income borrowers. They also document a reallocation of credit from urban areas where borrowers tend to be close to the lending limits, and towards rural areas, where these limits are less binding.

This is an important finding in the context of the Irish Government’s green agenda, the increased regulation of new home development and home retrofitting and the direct and indirect taxation on these homes. The rules mean that some potential home buyers are purchasing homes that are further away from work and education – thus incurring commuting costs and having an environmental impact. There are benefits to society if commuting is reduced, with lower emissions.

Census data and the Central Bank’s own research shows that the average age of a FTB is now 35 (CBI). Census data shows the age at which home ownership became the majority tenure category was 35 years in 2016. Prior to that age, more householders were renting rather than owning their home. In comparison to previous censuses dating back to 1991, the ages which marked the changeover between renting and home ownership were 32 years (2011), 28 years (2006), 27 years (2002) and 26 years (1991).

The Consultation Paper recognises that a consequence of the mortgage measures is that “borrowers’ entry to the first-time buyer (FTB) mortgage market would be delayed by time taken to accumulate a deposit”.

Separately the Paper states “certain would-be homeowners may remain in the rental market for longer than might otherwise have been the case, which may also increase the rent-to-price ratio in the housing market, with implications for the composition of supply.” Thus, the mortgage measures are contributing to a lack of mobility in the rental market and contributing to rents being higher than they otherwise would be.

It is PII’s view that as well as the composition of supply that the Bank should also consider the consequences for affordability. Data from daft.ie shows that in most urban areas’ rents are significantly higher than mortgage repayments. Research by the ESRI shows that for some cohorts in the rental market rents are up to 50% of income. For some of these the mortgage measures are preventing access to a mortgage, home ownership and an improvement in affordability.

The Bank states that, at present, regarding rental costs and retirement income “there is insufficient data globally to make an empirical assessment of these long-term effects.” PII would argue that this is one of the most important long-term issues facing Irish society. While there may be insufficient data PII believes that the Bank should start work now to consider the implications of long-term rental post-retirement, including the role of the mortgage measures.

The Bank argues the benefits of the mortgage measures accrue across the entire population and not just those accessing mortgage finance. However, this does not recognise that the costs are borne by

a much narrow cohort of the population – primarily the younger age groups at the start of their housing journey. For many the mortgage measures are impacting on life choices much broader than housing market decisions.

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

While the principles underpinning the refreshed objectives include the commitment to "weigh up the costs and benefits of the measures as they are experienced across the population" it is disappointing that the proposed update to the objectives of the mortgage measures only refers to "taking into account both the macroeconomic benefits and costs that the measures pose." It is the view of PII that this focus is far too narrow and should be broadened to include the impacts on the society and the population – consistent with the Bank's acknowledgement that the mortgage measures "can have both benefits and costs across the wider economy and society."

3. **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.**

PII support the continuation of a dual instrument approach. We believe that the LTV is the appropriate collateral-based instrument. However, we argue that the LTI instrument needs to be replaced with a debt-service to income ratio instrument. The LTI is an income-based measure that is not a good means to capture affordability.

While it is common for LTVs to be combined with an income-based measure, data from the European Systemic Risk Board show that the LTI is only used in 3 EEA countries in Q4 2020 – Ireland and 2 non-eurozone economies (Denmark and the UK). In contrast a debt service to income ratio is used in 14 economies.

4. **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.**

It is very disappointing the Central Bank propose to retain the LTI instrument. A loan-to-income ratio restricts the size of a mortgage loan to a fixed multiple of household income, acting as a restraint on excessive repayment burdens and unsustainable increases in household debt. However, this is a very blunt instrument with which to assess affordability and is inflexible.

The Consultation paper acknowledges that DSTI limits are commonly used in other jurisdictions. The LTI instrument is not a good measure of affordability. It is income based and takes no account of an individual or a household's debt. It is the view of PII that the arguments used against DSTI (challenges in implementation and monitoring, non-transparency) do not outweigh the benefit of a more accurate affordability measure.

The 3.5x LTI does not consider true repayment capacity. PII argue that the introduction of the Central Credit Register (CCR) gives lenders more reliable data to adopt the DSTI approach and will significantly

improve the data to understand each household's credit history and debt levels. This additional data set supports a move to a more nuanced DSR approach to lending as opposed to an LTI measure. This is in line with the Central Bank's own view:

"The new Credit Register will be another important step in enhancing the functioning of a well-regulated and stable mortgage lending market in Ireland and will allow for further consideration of macro-prudential tools such as DTI and DSTI in future."

Central Bank of Ireland, Macro-prudential policy for residential mortgage lending, Consultation paper CP87, 2014

Many of the reasons put forward by the Bank to support the LTI ignore the role that the Central Credit Register can play. In addition, many of the retail banks are using the central credit register as part of their mortgage lending decision making and so the argument of additional complexity would not appear to be an issue and so should not prevent the introduction of a debt service to income instrument. Given the extensive use of the Central Credit register in mortgage lending PII strongly disagree with the Central Bank statement that "The adoption of a DSTI metric as a macroprudential tool would risk blurring the lines between the macroprudential measures and the responsibility of lenders to continue to use these assessments as a core part of credit risk management".

The Central Bank's own analysis shows that 83% of borrowers with an LTI greater than 3.5 have a DSTI that is less than 33%.

Lenders are innovating, with longer term, fixed rate mortgages now available in the market which reduces interest rate risk considerably. Perhaps for products of this nature, higher DSR levels would be considered more appropriate, particularly for FTBs with uplift projected growth in the household income. This could allow more flexibility to the financial institutions, within the framework, to determine levels of DSR that fit a household's circumstances.

5. **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?**

No comment

6. **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?**

No comment

7. **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?**

PII agree with the Central Bank's view that a differential limit by type of borrower group continues to have merit.

However, the impact of the mortgage measures needs to be recognised. For example, PII agree that "house price growth makes saving for a down-payment more difficult." (Box 5) In addition, saving for

a down-payment is also made difficult by high rents. Research shows that the introduction of mortgage measures results in rents being higher than they otherwise would be.

Furthermore, while the analysis of rental payments and prospective home buyers Respondents to the Central Bank online survey highlighted

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

No comment

9. **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.**

It is the view of PII that responding too frequently to cyclical developments would not be appropriate as this could lead to uncertainty in the market. The mortgage measures should operate on a rules basis. Duffy, McInerney, McQuinn (2016 in an Irish Context and Borio and Shim (2007), Goodhart (2004), Galati and Moessner (2012) and Aikman, Haldane and Nelson (2014) amongst others, have highlighted the importance of rules in calibrating macroprudential policy. However, while any calibration changes should reflect structural factors, the measures themselves should be flexible enough to account for changes in household incomes, the cost of living, and changes in interest rates. This can best be provided for by replacing the LTI measure with a DSTI measure.

10. **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.**

PII consider a 3-year period as appropriate for framework reviews. However, as we have seen in recent times there is a need for flexibility to respond to changing circumstances. PII would argue that use of a DSTI would allow a more rapid response and greater flexibility from the mortgage measures. In addition as per our answer to Question 9 the move to a fully transparent rule basis could contribute to greater flexibility while avoiding market disruption.