Submission from the Green Party
on
The Central Bank of Ireland's Consultation Paper 87

<u>CBI's Proposal</u>

The Central Bank ("CBI") has published a Consultation Paper ("the Paper"); it includes proposals for Regulations that will restrict:

a) mortgage lending at a high loan-to-value (LTV) ratio
b) and mortgage lending at a high loan-to-income (LTI) ratio

by "*regulated financial services providers*". For the purposes of this submission we shall call such institutions "*Lenders*".

CBI describes its proposed Regulations as "*a set of simple rules*" (referred to in the Paper as "*macro-prudential tools*") that will supplement other tools and good practice to manage risk and help avoid the mistakes of the past and in particular the damage caused to Ireland's financial stability by the property bubble. The simple rules can be summarised as follows:

i. the amount of a housing loan may not exceed 80% of the purchase price, (80 per cent LTV)

ii. the amount of a housing loan may not exceed 3.5 times the LTI, ("the LTI ratio")

iii. the amount of a loan for an investment property, for a for buy-to-let (BTL) property, may not exceed 70% of the purchase price, (70 per cent LTV)

The limitations are not absolute; each lender will be allowed to make a certain limited fraction of its mortgage loans at LTV and LTI ratios in excess of specified thresholds.

A. The threshold for lending for primary dwelling purchases above 80 per cent LTV is 15 per cent of the aggregate value of the flow of all housing loans for principal dwelling home purposes.

B. The threshold for lending for primary dwelling purchase above 3.5 times LTI is 20 per cent of that aggregate value.

C. The threshold for buy-to-let (BTL) properties above 70 per cent LTV is 10 per cent of all BTL loans.

CBI explains and provides evidence that;

✓ several countries have LTV caps at 80% for primary residence,

- ✓ a 3.5 times LTI ratio generates a gross debt service ratio of about 30 per cent but a net (after tax) debt service ratio of about 40 per cent and this compares with loan term and rates used in the UK
- ✓ In some countries the limit on non-owner occupied mortgages is as low as 50 per cent.
- ✓ The restrictions do not apply to all lenders' new residential mortgage lending because high LTV and high LTI lending can be appropriate in certain circumstances and CBI provides examples.

CBI has invited comments on the draft Regulations attached to the Paper and on the questions raised in the Paper. This is the Green Party's response.

Green Party's Response

The Green Party ("GP") welcomes the Paper and the proposed Regulations; the Paper explains the reasoning behind the proposed Regulations with great clarity and GP commends CBI for its transparency.

CBI is introducing the proposed Regulations for essentially three separate reasons:

1. To improve the ability of both lenders and borrowers to deal with sudden changes in house prices.
2. To dampen the pro-cyclical dynamics between property-lending and housing prices (its financial stability objective).
3. To perform and discharge its statutory duties as the designated authority under both National and EU law with a mandate for regulation and supervision in relation to the overall stability of the financial system

CBI reminds us that the proportion of new loans issued at over 90 per cent LTV grew from 14 per cent of loans in 2000 to 29 per cent in 2006 and when the property bubble ended in 2007 (and property prices fell in some places by as much as 46 per cent from 2007 peaks), great damage was caused to borrowers and their families and also to the financial stability of the Irish economy as a whole. GP accepts that much of that damage was caused by lending behaviour that was not prudent. In these circumstances, GP accepts that restrictions on mortgage lending at high loan-to-value (LTV) ratios and mortgage lending at high loan-to-income (LTI) ratios are appropriate tools to address the objectives set out at 1 to 3 above.

Background and context

GP accepts that:

- now is the right time to introduce the proposed Regulations since demand for both mortgage lending and consumer credit is increasing, consumer confidence is increasing and prices are rising in the housing market:

- lax mortgage credit standards can fuel housing demand;

- lax mortgage credit standards fuel increases in house prices;

- High house prices create social exclusion and inequality; a Government's housing policy should aim to reduce inequality and provide for social inclusion rather than subsidise the market. Rent allowances and rent supplements and subsidised homeownership all support the market more than the poor

- When house prices rise and become not sustainable a heavy burden of debt is imposed on families;

- When house prices are not sustainable an unsustainable percentage of a family's income is required to service borrowings

- When house prices are not sustainable family life is impacted; life for our children is impacted; when two salaries are needed to service the mortgage there is an economic necessity (rather than individual choice) for both parents to work outside the home and leave their children with carers;

- We ask CBI to read the letter from Donna Hartnett that was published recently in a national newspaper and listen to her interview on national radio; GP believes Ms Hartnett articulated the strain that families feel as a result of "*being boxed into a life that no longer*" serves them; instead, families are required to serve an economic model that relies on credit driven demand; on accumulations of debt; families do not want long mortgages even if that is the only way to make mortgage repayments affordable; families do not want the certainty of a fixed rate mortgage if two salaries are needed to fund the fixed rate; families do not want to be enslaved by "*mortgage/financial products*". A mortgage should be affordable and it should not be for longer than 25 years. The market is not providing affordable loans or affordable homes.

- Rising house prices can fuel demands for wage increases, currently the minimum wage is €8.65. There is widespread demand for an increase to over €11. This demand is driven by high living costs.

- Ever rising house prices creates a housing crisis because families cannot afford to buy; this situation is exacerbated by lack of security, lack of supply and no control on increases in rent in the housing rental market. High house prices, not prudent credit standards, price low income families out of home ownership even though they may work hard in the labour market;

- A housing crisis cannot be resolved by CBI or by imprudent lending or by burdening individual households and families with unsustainable debt.

- Increases in house prices caused by increased lending fuels expectations of further price increases and yet further lending; the bonus culture incentivises lending; each lender is influenced by the lending behaviour of its competitors; hence the need for

independent regulation to foster and supervise prudent lending, to manage the dynamics between property lending and housing prices and to afford some protection against, or, to reduce the probability of damage caused by boom-and-bust cycles in the housing market

- We need spaces throughout our society, for example, in the economics and other classes in our universities; in our public service media, in Dail Eireann; where we can have quiet, deliberative and respectful discussion on why the market is not providing affordable loans or affordable homes; what is the role of private capital in the provision of homes rather than houses; why do private investors in the Housing Market not want competition from the State in the Housing Market; why do private investors in the Housing Market require so much State support and State intervention in the form of tax and other incentives; why is "rent control" acceptable in other EU States but not in Ireland; does the market challenge definitions of "the common good"; is Classical Economics delivering the kind of society that our people want; what are the possible alternatives?

GP's Response to CBI's specific questions

We now respond to your specific questions as follows:

Question 1:
Which of the tools or combination of tools available to the Central Bank would, in your opinion, best meet the objective of increasing resilience of the banking and household sectors to shocks in the Irish property market and why

The "macro-prudential" tools referred to in the Paper make sense to GP and should help to prevent increases in house prices that are driven by easy credit.

The "macro-prudential" tools should be combined with strict requirements on capital adequacy and other EU wide regulatory tools.

The "macro-prudential" tools or rules are easy for the public and potential borrowers to understand. They should dampen demand for credit and help to guard against a return to the culture of cavalier borrowing and reliance on debt without due regard for affordability; that should make for a more sustainable economy. We agree that a credit-driven price dynamic creates risks for everybody by placing financial stability at risk.

However, we accept that the purpose of tighter lending standards is not to halt increases in house prices or to regulate or directly control housing prices but to reduce the losses from a fall in prices. CBI's primary concern is threat to financial stability.

We agree that a Central Credit Register should be created so as to assist Lenders to ascertain total borrower indebtedness

In particular we think LTV and LTI caps are appropriate tools and we note your comment that LTI addresses affordability for the borrower, while LTV addresses the scale of potential loss to the lender in the event of the default of a borrower unable to service the debt. We accept the need for both these tools but we feel it would reassure potential borrowers if it could be expressly documented that if a potential borrower can demonstrate a track record of ability to pay rent over a sustained period that that would be relevant when assessing affordability.

It is the view of many that Dublin House prices today are 10-25% above affordable levels. We refer CBI to a piece in the Irish Times Saturday 18th October 2014 on a presentation made by Dr Kenneth Jordan of the Department of Transport at Dublin Chamber of Commerce 37th annual economic policy conference. Dr Jordan explained that his study found that increases at the upper end of the property market are pushing up average house prices. Dr Jordan explained that his study looked at affordability by measuring property price or cost of mortgage repayments relative to income. Operating on the premise that mortgage repayments account for 30% of disposable income, Dr Jordan found a Dublin house-buyer would need an income of €66,572 to buy an average house there, compared to €32,042 for a house-buyer outside Dublin. Carrying out a similar analysis based on the premise mortgage repayments account for 25% of disposable income Dr Jordan found a house-buyer in Dublin would need an income of €79,887 while a non-Dublin house-buyer would need an income of €38,450. Depending on which premise was applied, 30% or 25%, Dr Jordan found that Dublin house prices appear to be between 10 – 25% above affordable prices.

***Question 2**:*
Do you agree that the measures should apply to all lending secured by residential property (which will include lending on property outside the State)?

Yes the measures should apply to all lending secured by residential property. We have seen how foreign banks were destabilised by lending that relied on Irish property as security when the value of the security crashed and we have seen the damage caused to Irish families that bought in property bubbles abroad.

***Question 3**:*
Do you agree with the exemptions set out?

Yes, we agree with the proposed exemptions.

***Question 4**:*

Are there any additional exemptions which you consider appropriate, taking into account the objectives of the proposal and the balance between the benefit of any exemptions and the resulting increase in potential for unintended consequences?

No, we do not consider it appropriate to have further exemptions; the more exemptions there are the greater the scope for potential borrowers and their advisers to circumvent the rules; to manipulate matters so as to argue they come within an exemption. Keep it simple. We agree that exemptions weaken the effectiveness of the macro-prudential measure as a tool to dampen the pro-cyclical credit-price dynamics.

***Question 5**:*
Should some adequately insured mortgages with higher LTVs be exempted from the measures and if so what should be the criteria for exemption?

We are totally opposed to any form of a Government backed/government funded mortgage guarantee or insurance scheme whether it be limited to a fraction of the mortgage, (the excess of the loan over the cap) or not so limited. The Government should not be a player in the dynamics between property lending and housing prices. The Government should not be entrapping households in debt. The Government should not be doing anything that enables potential borrowers to circumvent rules designed to reduce threat to the financial stability of the State.

We are concerned about the fiscal costs of a Government mortgage guarantee or insurance scheme and believe it would exacerbate housing price dynamics. The Government should instead concentrate on sourcing funds to build homes for the people; see below.

We wonder what the costs for the borrower would be in procuring privately or in the market a high-quality guarantee payable on first demand by a highly-rated financial intermediary. We feel such a guarantee will be expensive because it will charge the borrower for the risk that he or she represents and could result in the borrower increasing the amount of his or her borrowings in order to cover the cost of the guarantee.

We feel a mortgage insurance exemption would weaken the effectiveness of the LTV cap as a tool to dampen the pro-cyclical credit-price dynamics and encourage risk taking. We have seen how seductive risk taking is in the banking sector especially when it is taxpayers that rescue the banks when it all goes wrong. The Lenders need an excuse to say *“No, we are not allowed to lend you that much”*. Lenders like lending; that’s the way they make their money and their bonuses. Lenders also like to ‘game the system’. CBI needs to help the Lenders to say “No”.

***Question 6**:*
If there are any significant operational difficulties envisaged by regulated financial services providers in complying with the measures as outlined above and in the draft Regulations (Annex 1) and the proposed exemptions, please submit brief details of same.

This is a matter for the Lenders

***Question 7**:*
Do you consider restrictions on loan-to-income ratios as suitable for buy-to-let mortgages?

Yes, we consider restrictions on loan-to-income ratios suitable for buy-to-let mortgages?

CBI's own research shows that BTL mortgages are more likely than other mortgages to be in arrears and exposed to negative equity. In our property bubble, people in very ordinary (sometimes insecure) jobs on very average wages borrowed heavily in order to buy-to-let on the assumption that the rent would cover the mortgage payments and the value of the property would only go up. The desire to make sure the rent was sufficient to at least service the mortgage drove up rents; high rents, plus high utility bills, property tax and increases in VAT and other taxes has made the cost of living very difficult for our people; that in turn puts pressure on wages and affects the jobs market. It is entirely inappropriate for the Government to rely on the individual investor in the buy-to-let market to discharge the Government's duty to provide housing. The State itself has been paying high rents/rent supplement to investors in the buy-to-let market. Those same investors and representatives for private landlords are now lobbying for a diverse range of tax and other reliefs; for example they want the buy-to-let market to be treated as a business liable for our extremely low corporation tax.

High rents affect all sectors of our society, for example, the young professionals and graduates setting out on a career are spending too big a percentage of their disposable income on rent. We won't fix this spiral and the price dynamics by advancing further BTL mortgages without *loan-to-income ratio restrictions* and LTV caps

Question 8
What impact would a restriction on such loan-to-income ratios have on buy-to-let lending in the State?

A restriction on loan-to-income ratios for buy-to-let mortgages would probably diminish the number of buy-to-let investors entering the market and that in turn might impact on the number of properties available to let. However, this is not CBI's problem and it is not a reason why CBI should hesitate about doing whatever is the right thing to do to achieve the objectives set out at 1, 2 and 3 on page 2 of this submission.

Question 9*:*
What unintended consequences do you see from the proposed measures and how could these be avoided?

An unintended consequence is that people may have to stay in rented accommodation longer as they try to save for a deposit; this may in turn put further upward pressure on rents and may affect first time buyers more than others.

It is up to the Government, not CBI to fix the housing crisis; the Government must not rely on tools that will cause a new bubble or drive up prices or burden families with unaffordable debt. House price inflation threatens long-term stability. CBI's Paper makes it clear that a cap on lending is an effective way to stop another bubble.

More expensive housing is not a "good thing"; it is not good for those who may not be struggling financially but are unable to spend their income on something other than the mortgage; it is not good for those that are homeless or for those that are unable to afford to buy.

The Government should build more houses, lots more houses and maybe then people will not take out loans they cannot afford and house prices will not rise so relentlessly.

There are CSO figures that show that average new house prices rose from less than five times the average annual industrial wage in 1997 to over nine times the annual industrial wage in 2007. Government policy fuelled the rapid rises in house prices because Government policy flooded the market with subsidies and property-based tax incentive schemes that were popular with high earners seeking to shelter income and to reduce their tax bill.

The banks then bundled house loans in a package (securitisation) and sold those packages to investors to raise funds for further lending with the result that the same asset i.e. a family's home was in effect re-mortgaged by the banks; this explains why banks but not families can get a bailout when mortgage accounts fall into arrears

GP is not in favour of easy credit or tax incentives or subsidies; instead GP favours direct public expenditure to build affordable homes; if there is something in EU State Aid rules that prohibit the Government from providing affordable homes than we should be lobbying the EU for changes to the State Aid rules.

To describe the proposed tighter lending standards as a "*fundamental bias against first time buyers*" is emotive, misleading and simply wrong.

Question 10*:*
Is the threshold of €50 million over 2 quarters an appropriate threshold and time period for reporting requirements?
If not, please indicate a threshold you believe to be appropriate and provide reasons why you believe this is the case.

This is a matter for the Lenders

Question 11*:*
Are there any significant obstacles to compliance by regulated financial services providers with the limits?

This is a matter for the Lenders