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Perspectives on the Irish Housing Market – the past five years - Deputy Governor Sharon Donnery

13 November 2019 **Speech**

Speech delivered to second annual ESRI/Department of Housing conference on the Irish housing and mortgage market

Introduction

Good morning, it is a pleasure to address the second annual conference on the Irish Housing and Mortgage Market.[1] I welcome this forum, jointly organised by the ESRI and the Department of Housing, bringing together experts on housing from academia, government, and industry. The papers presented so far this morning have provided insightful discussion and healthy debate.

Considering the housing market today, it is important to place it in context of the wider Irish economy. The economy has performed remarkably well over the past five years and has been one of the fastest growing economies in the European Union. We have seen consistent, strong growth in employment, and average weekly earnings have increased by 14 per cent.[2]

The strong recovery and performance of the economy has come with rising housing costs. Compared with five years ago, today, house prices and rents are both over 40 per cent higher.[3] While house price growth is slowing, average rents increased 4.3 per cent in the first half of 2019.[4]

This house price growth affects households differently. Higher house prices are an affordability challenge particularly for younger households, and households that are renting. These people face larger hurdles to finding a home.

However as part of the legacy of the credit fuelled house price boom and bust, the rise in house prices has also benefitted some households. Five years ago over one third of mortgaged households were in negative equity.[5] When that happens, households can become trapped: they cannot refinance to a lower interest rate and it is difficult to move, be it to find a new job or to upsize or downsize to accommodate changing family size. Today, only three to four per cent of mortgaged households are in negative equity.[6] Thousands of households, therefore, have more options now than they did five years ago.

These substantial highs and lows in house prices create differential effects across generations. Younger households face affordability issues. Households at or close to retirement benefit from higher house prices as the family home represents the majority of savings for most Irish households, strong price growth leads to an increase in the value of those savings.

The effects of the house price boom and bust reverberate through the housing market long after the event. The consistent stable supply of credit to households can help reduce the risk of a future credit fuelled cycle occurring and build the resilience of households to these risks.

Today, in looking at the housing market, I will first discuss how demand for housing has evolved over the past five years, I will then give a flavour of how our current housing market compares with markets in Europe and the rest of the world. I will then look at the supply side of the housing market. Finally, I will give some thoughts on where some impediments to the supply response might lie, and on how the Central Bank's policies fit within the housing market.

Demand for housing in Ireland

The bottom line is there is not as much housing per person as there was five years ago.

The number of people in Ireland over the past five years has increased around seven times more than the number of dwellings.[7] So more households are competing for fewer available homes.

We are seeing more young people living at home, and more adults in group housing.[8] The average household size, of 2.7 people per home, is the second largest in the EU.[9] And while demographics and family size also play a role in this, if household size moved in line with the European average of 2.3 people per home – then there is unmet demand for over 260,000 homes in Ireland.[10]

260,000 homes is over four times the number that have been built in the past five years.[11]

In Dublin, especially, supply has not kept up with demand. For every 12 new jobs created in Dublin over the past five years, just one new dwelling has been built.[12]

It would be short-sighted to see this as simply a 'Dublin problem'. Over the next five years, employment growth is expected to be concentrated in services, which are largely take place in urban areas, and in construction concentrated in Dublin and the mid-east.[13] Currently an estimated one in seven Irish employees works for a large multinational enterprise.[14] Jobs at these multinationals have been concentrated in Dublin, Cork and Galway. It is therefore not surprising that it is in Dublin and Cork that we are seeing the most concern expressed about affordability.

The next generation of young people will want to move to our cities to take advantage of those opportunities.

And our cities are already struggling to accommodate them. Commute times increased by 10 per cent between 2011 and 2016, as households have had fewer opportunities to live near the places where they work.

This urbanisation is a strong global force. As technology changes, and developed economies focus more and more on service delivery, businesses tend to cluster closer together in order to operate efficiently. As a result, jobs everywhere are becoming more and more concentrated in cities. And there is no sign of these trends shifting. Currently almost two thirds of Irish people live in cities. Across the OECD as a whole, that number jumps to four out of every five people.[15] To accommodate that level of urbanisation - even without increasing our population or reducing the number of people per dwelling - we would need at least one quarter of a million new homes in our cities.[16]

Not surprisingly, we are seeing the increase in demand for housing translate into higher demand for mortgages. Mortgage drawdowns in the third quarter of 2019 totalled over €2.7 billion, 2.3 times their value five years ago. Mortgages to first time buyers in particular have grown by over 20 per cent per year over that time. Total drawdowns in 2019 so far have been almost double total drawdowns over the whole of 2014.[17]

We no longer have the large number of outstanding mortgages with loan-to-income ratios of 5 or more that we had five years ago.[18] But the loan-to-income ratios on new loans have steadily increased since the bottom of the cycle. We are seeing more and more new mortgages being initiated with a loan-to-income ratio of near, or exactly 3.5 times income – the limit set by the mortgage measures.

But before we jump to conclusions about the role of the mortgage measures, it is worth taking a step back, and looking at how the Irish housing market compares with other housing markets globally.

The Irish housing market in a global context

Concerns over housing affordability have existed in major cities across Europe and the world for a long time.[19]

Housing affordability concerns are not unique to Ireland. Housing supply constraints have been raised as an issue by the IMF referring to European cities such as London, Paris, Stockholm, Copenhagen and Oslo. Globally, cities such as Sydney and Vancouver are also affected.[20]

In broader terms, over half of all OECD countries have experienced at least 20 per cent real growth in residential house prices over the past five years.[21] Most of these countries did not experience price declines to the same degree as Ireland did after the financial crisis, but have nevertheless seen substantial decreases in affordability. Even countries such as Canada and Sweden, who were relatively unaffected by the financial crisis, have seen real house price growth of 28 and 24 per cent respectively since 2014.[22]

These countries have grappled for a long time with many of the same of the issues we are facing now.

For example, according to Eurostat, around two thirds of all young people in Europe aged 16 to 29 are living with their parents. Even in a country like the UK, where these rates have been historically much lower, over half of people in this age group are estimated to still be living in their childhood home.[23]

Many countries have partly tackled the issue of increased demand for urban housing by increasing their supply of apartments. Across the EU, 42 per cent of people live in apartments, compared with less than 10 per cent of people in Ireland.[24] While it is important to recognise that housing demand varies across countries and through people's lives, even within Ireland the number of people living in apartments rose 21 per cent between the last two censuses, seven times faster than any other type of dwelling and 50 per cent faster than the supply of apartments.[25]

Ireland, as a small open economy, is heavily integrated into European and broader international labour markets. Over the past 5 years, we have seen net inward migration of 110,000 people, amounting to 4.5 per cent of the labour force.[26] In 2018 and 2019, only one-third of the growth in the working age population was from natural population growth. The rest came from net inward migration.

Due to our openness, conditions in other countries and cities have an impact on demand for housing in Ireland. Anything that makes Ireland more attractive as a place to live and work – or for that matter anything that makes other areas *less* attractive as places to live and work – will increase demand for housing here. This includes any improvement in housing affordability.

In fact, there is evidence from some countries – including Ireland – that high house prices in some regions can limit the number of people who relocate to those areas for work.[27]

Consequently, we cannot measure the demand for Irish housing simply by looking at the number of people living in Ireland right now. Recent Central Bank analysis has highlighted that strong net inward migration will be the most important source of employment growth if the economy continues to grow at the rates seen over the last number of years.[28] Further, if homes in Ireland were to become more affordable, we would expect to see an increase in willingness of people to either migrate or return to Ireland. Even should housing supply increase to the levels we need, we might therefore see demand increase even faster. The fact remains that demand for housing is high but supply of housing does not appear to be increasing sufficiently fast enough to satisfy it.

Supply of housing in Ireland

So what can be done? At the end of the day more dwellings are needed. But the construction of a new dwelling is complicated, and involves a huge number of policies that extend well beyond the mandate of the Central Bank. Our objective in setting the mortgage measures is to ensure that banks and other lenders lend money sensibly. They are designed to stop house buyers from borrowing more than they can afford. In addition they prevent excess credit from building up within the Irish financial system which can fuel house-price spirals. There are a myriad of other policies that can help determine whether, at any given price, affordable homes can be built. For example, Project Ireland 2040 outlines a number of policies that will affect future housing supply.

Due to the complex nature of the housing market, the number of different actors and their interactions, policies can affect the market in complex ways. Take for example, infrastructure investment. In the long term, this infrastructure will provide support for more housing. However in the short term, it may lead to competition for inputs such as labour and equipment between homebuilders and those providing this infrastructure. Large private sector projects, while important for ongoing investment in Ireland, add further to demand for these inputs.

At the same time, we are building better quality homes, which have also increased the amount and costs of inputs required to produce a given dwelling relative to a few years ago. Improved energy efficiency, wheelchair accessibility, and construction quality have all lead to higher quality homes. Apartments built in Dublin today are generally dual aspect, come with parking spaces and internal storage, and adhere to the fire safety standards.[29] These requirements have generally improved the quality of our new housing stock. However, they do come with a cost: they take longer to build, and require more materials.

But it's also not just about what we build. It's also about where we build it. The push towards higher density – both from changes in housing demand and from government policy – should prompt an increase in the supply of apartments. But apartments in the inner city are more expensive to build, for a number of reasons, than houses in the outer suburbs.

In addition to these 'hard' costs of housing – labour, equipment and supplies – there are other things that factor into the cost of housing. 'Soft' costs, including taxation, development fees, return on capital and land values, appear to make up nearly half the cost of each new dwelling.[30]

These 'soft' costs are more complicated to unravel. They are affected by everything from international capital markets to land values, to government policy. In addition, VAT, local government policy, approvals processes, mezzanine finance rates, property price expectations, vacancy taxes and development levies all play a role. Some of these appear to be unintended consequences, others represent carefully considered trade-offs between policy goals.

In order to understand the impact of these policies better, the Central Bank of Ireland is engaging with a range of stakeholders from industry to civic society among others on an ongoing basis. All who play a role in any area that affects the housing market: the construction industry, the building and materials sector, planners and regulators, banks and other financial intermediaries, estate agents and yes, the Central Bank – need to be asking themselves how their actions are interacting with the housing market.

Role of the Central Bank

Which brings us back to the role that the mortgage measures play in housing markets. As I mentioned earlier, many countries are facing similar housing market pressures. Policy responses, such as the mortgage measures, are used to build resilience of borrowers and lenders and such policy measures are in place in all EU countries. Every country in the EU has a loan-to-value limit, and 17, including Ireland, have a loan-to-income or debt-service-to-income limit.[31]

In Ireland, the objectives of the mortgage measures are to increase the resilience of banks and borrowers to negative economic and financial shocks, and to dampen the pro-cyclicality of credit and house prices so a damaging credit house price cycle does not emerge.

In addition, the measures are designed to be flexible enough to take into account specific circumstances. A system of allowances, for example, is in place that allows banks to lend above the mortgage measure limits. To illustrate, in 2018, one in eight loans to first time buyers were above the loan-to-income limit of 3.5 times income.[32] Further, almost 50 per cent of these allowances were for loans issued with a loan-to-income ratio above 4. Looking at both first and subsequent borrowers last year, one fifth of the value of total mortgage lending was issued with an allowance to the loan-to-income or loan-to-value limits. The flexibility of the framework enable banks to take individual borrower circumstances into account.

There is an ongoing public debate as to the impact the mortgage measures might have on the demand for owner-occupied housing. But prices have risen substantially, and are now back to 2005 levels in nominal terms, or 2003 in real terms. So the demand is there. What is needed is a sustainable level of supply. Supply has started to respond, but it's still below estimates of what is needed.[33]

The fact is, a higher level of credit by itself will not build more homes. However it risks the re-emergence of a credit price spiral. If supply is not responding to prices, then any move to increase the level of credit is likely to lead to higher housing costs and higher indebtedness. Even if supply were to respond more strongly than we expect, new homes take time to build. We could see a rapid spike in prices, followed by an equally rapid decline. Higher indebtedness also brings with it more risk. As I've discussed today, a lot of demand for housing in Ireland comes from people who have moved to find work. Ireland's position as a small, open economy means that we are more vulnerable to structural shocks emanating from abroad.[34] It is important that households and borrowers are resilient to shocks that can have quite large, sudden effects on Irish employment and wages.

We need to ensure that if such a shock does occur, it does not trigger a repeat of 2008. The five years up to 2008 saw the same kind of growth rates we are seeing now. Over that time, house prices grew by over 40 per cent for example.[35] The difference is that with that growth came an unsustainable increase in credit. The subsequent crisis dramatically reduced the demand for housing, and over-indebted Irish households were left 'holding the bag', as it were.

Many of these households had taken on very large debts in order to be competitive in the home purchase market. This was the credit price spiral that mortgage measures today are trying to prevent a re-emergence of. Many of these households were financially devastated, indeed continue to struggle, even today. Households in mortgage arrears was one effect of the credit price spiral.

Recall, that in September 2013, one in eight private home dwelling loans were more than three months in arrears on their repayments. This proportion has came down substantially, so that at the end of June 2019 six per cent of private home dwelling loans were more than three months in arrears.[36] This reduction reflects the considerable progress that has taken place in resolving mortgage arrears and non-performing loans more broadly.[37] Much has taken place through the engagement of the borrower and lender, via restructuring for example.[38]

We must therefore be extremely careful to ensure that this stress, hardship and indebtedness does not happen to another generation of Irish households. Higher levels of indebtedness for families are not going to solve the complex issues at play.

Conclusion

The mortgage measures do not operate in a vacuum. We at the Central Bank review the measures on an annual basis, and supply and demand in housing market is an important factor in that review. This market undoubtedly faces a number of challenges – challenges which we have seen are not unique to Ireland. However, the challenges facing the wider housing market, around sustainability and affordability are not addressed by excessive indebtedness of households and imprudent lending standards by banks.

In conclusion, the past five years have been years of exceptional growth for the Irish economy. With that growth has come jobs and greater real income for Irish households. However, with more jobs comes more demand for housing, especially in cities. The supply of new homes was slow to respond with low rates of home building.

The result has been higher rents, higher house prices and a growth in demand for mortgages. With that demand has come increased public scrutiny over the mortgage measures. However we need to tread carefully. Higher debt burdens increase the vulnerability of families and households in the event of a future shock.

The mortgage measures ensure that households do not take on excessive pro-cyclical debt while competing to purchase a relatively fixed supply of homes. We are in the process of undertaking our annual review of the mortgage measures. Our aim remains to ensure the sustainability of both borrowing and lending. We will only make changes if the evidence is clear that change will not encourage lending and borrowing that leads to excessive and ultimately pro-cyclical debt. We will continue to focus on protecting financial stability today, and ensuring risks do not build up which we will regret in the future.

[1] I would like to thank Samantha Myers and Caroline Mehigan for their contribution to my remarks and to staff in the Macro-Financial Division for providing supporting material.

[2] Central Statistics Office. "EHQ15: Average Weekly, Hourly Earnings and Weekly Paid Hour of All Employees by Economic Sector 2 Digit NACE Rev 2, Quarter and Statistic".

[3] Calculated from the RTB rent index and Central Statistics Office "HPM06: Residential Property Price Index by Type of Residential Property, Month and Statistic".

[4] ibid

[5] Central Bank of Ireland (2019). "Financial Stability Review 2019:I" (June 2019).

[6] Central Bank of Ireland (2019). “Financial Stability Review 2019:II”, forthcoming.

[7] Central Statistics Office. NDQ05: New Dwelling Completion by Local Authority and Quarter and PEA15: Annual Population Change by Component and Year.

[8] Central Statistics Office. E4097: Population Aged 15 Years and Over Still Living With Their Parents 2011 to 2016 by Single Year of Age, Principal Economic Status, Sex and CensusYear

[9] Eurostat. “Employment and unemployment (LFS) Database”

[10] Authors calculations based on data from Central Statistics Office (PEA15: Annual Population Change by Component and Year , E1068: Permanent Housing Units by Occupancy Status and Vacancy Rate 2011 to 2016 by Aggregate Town or Rural Area, County and City, CensusYear and Statistic, NDQ05: New Dwelling Completion by Local Authority and Quarter).

[11] 61795 dwellings completed between 2014Q3 and 2019Q2 inclusive. Calculated from Central Statistics Office data on New Dwelling Completions (Data series NDQ05).

[12] Central Statistics Office. “Population and migration estimates and labour force survey” (PEA15: Annual Population Change by Component and Year and QLF08: Persons aged 15 years and over by Region, Quarter and Statistic)

[13] Estimates based on internal Central Bank calculations of sectoral forecasts.

[14] Central Statistics Office. Foreign Direct Investment in Ireland 2017.

[15] United Nations (2018). World Urbanization Prospects: The 2018 Revision.

[16] Current population estimate of 4.9215 million *.78 - 4.9215 million * .63, divided by average headship rate of 2.73.

[17] Banking & Payments Federation Ireland. “BPFI mortgage drawdowns"

[18] Central Bank of Ireland (2019). Household Credit Market report (23 October 2019)

[19] The ability of households to afford housing given fixed incomes, be it in the form of down-payments or monthly servicing costs.

[20] IMF (2016). “Global House Prices: time to worry again?” (8 December 2016)

[21] Percentage difference between Q2 2019 and Q2 2014 real house price indices from OECD stat

[22] ibid

[23] Calculations based on Eurostat and ONS data.

[24] Eurostat. Distribution of population by degree of urbanisation, dwelling type and income group - EU-SILC survey.

[25] Calculated from Central Statistics Office data on Private Households by Type of private accommodation (E1001: Private Households 2011 to 2016 by Regional Authority, Aggregate Town or Rural Area, Persons per Household, Type of Private Accommodation and CensusYear).

[26] Central Statistics Office. “Population and migration estimates and labour force survey” (PEA15: Annual Population Change by Component and Year and QLF08: Persons aged 15 years and over by Region, Quarter and Statistic)

[27] Duffy, David, Fitzgerald, John and Kearney, Ide. "Rising house prices in an open labour market" Economic and Social Review 36.3 (2005): 251.

Rabe, Birgitta, and Taylor, Mark P. "Differences in opportunities? Wage, employment and house-price effects on migration." Oxford Bulletin of Economics and Statistics 74.6 (2012): 831-855.

[28] Byrne, Stephen, & McIndoe-Calder, Tara (2019). “Employment Growth: Where Do We Go From Here” Central Bank of Ireland, Signed Article, Quarterly Bulletin 2019:3.

[29] Dublin City Council (2015). “Dublin City Development Plan 2016-2022”

[30] Based on EY (2019) “Viability and Affordability of Apartment building in Cork” (18 July 2019) and “Delivery of Apartments- Cost changes post 2018” Society of Chartered Surveyors, RICS

[31] ESRB (2019). “Overview of national macroprudential measures” (4 November 2019)

[32] Central Bank of Ireland (2019). Financial Stability Review, 2019:1

[33] Internal Central Banks calculations based on CPI-adjusted combined nominal house price index. Housing construction taken from CSO data.

[34] Donnery, Sharon (2019). “Small open Economies- Vulnerabilities in a Changing World” Speech delivered at the Dublin Economics Workshop, 13th September 2019.

[35] House prices come from ESRI/PTSB house price index.

[36] Central Bank of Ireland (2019). Household Credit Market Report. (23 October 2019)

[37] Donnery, Sharon, Fitzpatrick, Trevor, Greaney, Darren, McCann, Fergal & O’Keeffe, Mícheál (2018). “Resolving Non-Performing Loans in Ireland: 2010-2018”, Central Bank of Ireland, Signed Article, Quarterly Bulletin 2018:02

[38] Sibley, Ed (2019). "Building Financial Resilience" Speech delivered at the MABS National Conference 5th November 2019.