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ISSUES IN THE IRISH HOUSING AND MORTGAGE MARKETS

Ireland has traditionally had a strong culture of home ownership. In 2000 the percentage of owner occupiers in Ireland was one of the highest in the EU (83%) up from 74% at the beginning of the 1980's (Fig. 1). Typically, young people once they enter the employment market, aspire to purchase their first home as soon as possible. Aside from lower socio-economic groups who may live in public housing, a longer-term rental market has not developed.

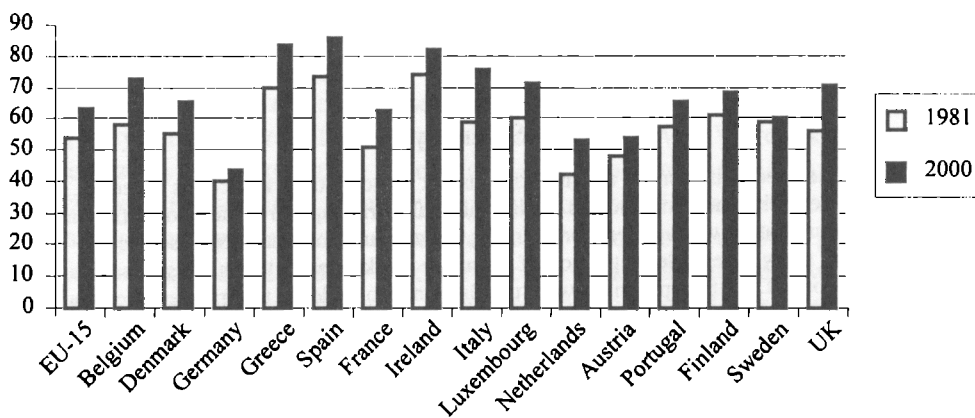


Fig. 1. Percent owner occupiers in Ireland vs other EU countries

Home ownership in Ireland is financed significantly by long-term mortgage finance. In addition to specialist "Building Societies", typical Irish retail banks regard long-term mortgage lending as a core offering. Variable/Flotation rate loans, which change with

market interest rates are the norm, although in the past decade fixed rate financial has become a feature. Even with the latter, the fixed period tends to be short (2-3 years) reverting to variable thereafter.

Table 1. Home ownership in Ireland is financed significantly by long-term mortgage finance
Features of Irish Mortgage Finance

Providers:	13 Banks/Building Societies
Maturity Terms	15-40 years
Distribution Channels	Bank Branches
	Brokers/Intermediaries
	Telephone/Internet
Interest Rates	1-2% above ECB
	Variable /Floating
	Fixed
Investors	25-30% of Buyers
Equity Release	

In the past decade, house prices in Ireland have grown strongly (Fig. 2). Effectively prices have tripled since 1996.

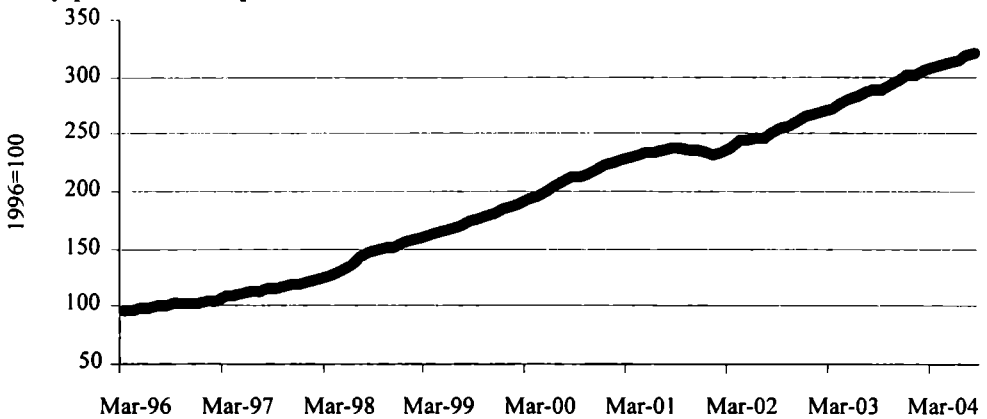


Fig. 2. National Hedonic House Price Index

Source: permanent tsb.

In an overall European context, when measured in real terms, house prices in Ireland have shown the highest annual growth rates between 1977 and 2000 (tab. 2).

Table 2. Annual Average Percentage Change in Real House Prices

Period	UK (%)	Spain (%)	Germany (%)	Ireland (%)
1976-1980	2.0	0.4	2.2	6.7
1981-1985	0.5	- 3.0	- 2.1	- 5.7
1986-1990	8.9	17.1	1.2	3.8
1991-1995	- 4.0	- 1.7	1.5	1.0
1996-2000	7.1	3.4	- 4.4	14.0

Sources: Ring Deutscher Makler; National Data, supplied by Bank of International Settlements.

The Irish housing market is driven by a number of factors which are summarised in tab. 3. The exceptional strength of the Irish economy is the last decade (“The Celtic Tiger”) is of course crucial (Fig. 2).

Table 3. Factors Driving Housing Market

Overall Economic Growth, rising income and employment
Demographic Factors
Cultural Changes, family patterns and behaviour
Affordability
Cost of Borrowing

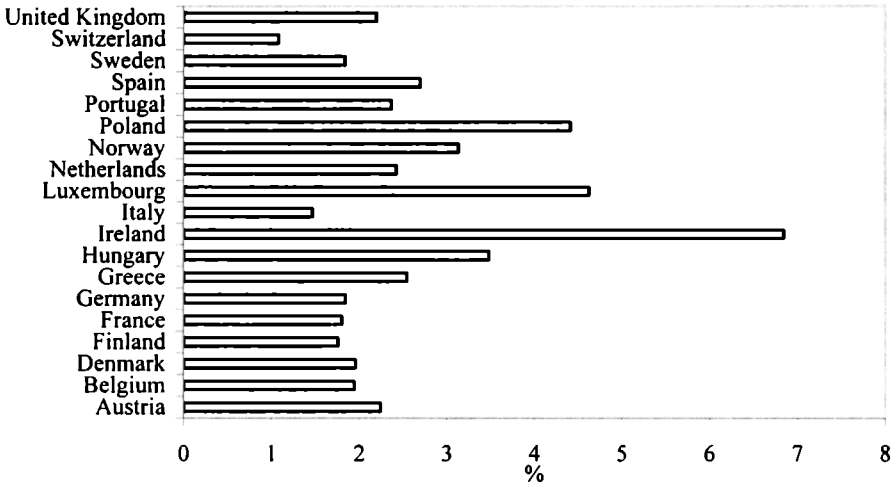


Fig. 3. Real GDP growth average 1990-2003

There is effectively full employment. Population growth has also been fuelled by returning Irish emigrants and growing inward migration, partially for the new accession countries (Fig. 3). Analysis of the migration figures offers some explanation as to the potential impact on the housing market. The bulk of out-migration is

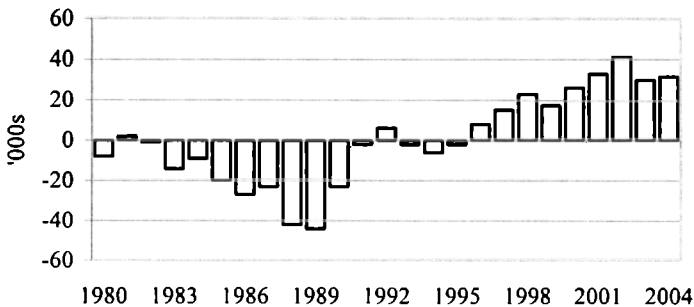


Fig. 4. Net migration

from the 15-24 year age group, 53,5% in 2004. This age group is younger than the main household formation age groups, so emigrants are either leaving the parental home or rented accommodation. The bulk of in-migration, 49,5%, is in the 25-44 year age group, the key age group for independent household formation. This has created for the first time in modern history, the phenomenon of net immigration into Ireland.

The demographic features of Ireland with a high proportion of the population in the key 20-40 age groups have been significant in promoting demand for housing (Fig. 5).

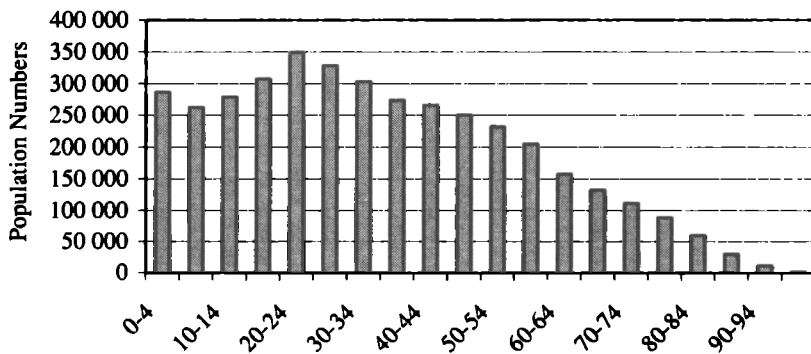


Fig. 5. The distribution of the Irish population across age groups

Another important factor is the headship rates i.e. the proportion of each age group who are heads of households. As shown by Fig. 6, the headship rates increase significantly in the 25-39 year age group. Figure 6 also shows that rates in Ireland are still below those in the UK. If Irish rates were to rise towards those in the UK, this would represent a further increase in demand for dwellings.

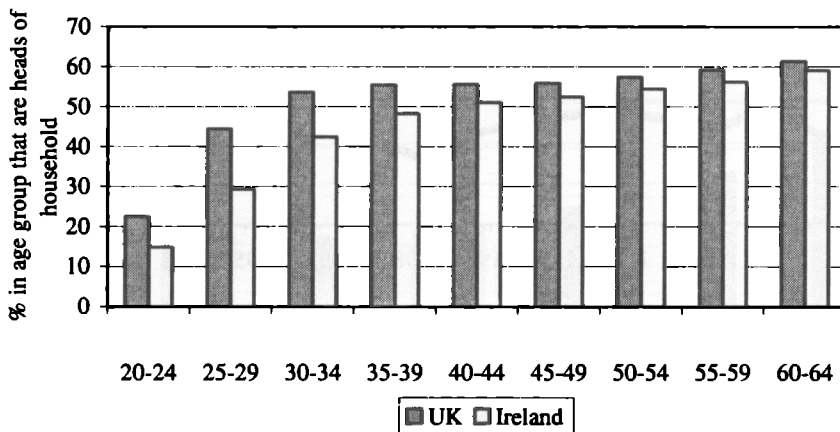


Fig. 6. Irish and UK Headship Rates, 1996

Irish interest rates declined as the Irish economy moved towards membership of EMU. This resulted in a convergence of interest rates to Euro rates as set out in Fig. 7. Aside from the obvious reduction in mortgage servicing costs, the combined reduction in interest rate and inflation rates has significantly reduced interest rate expectations.

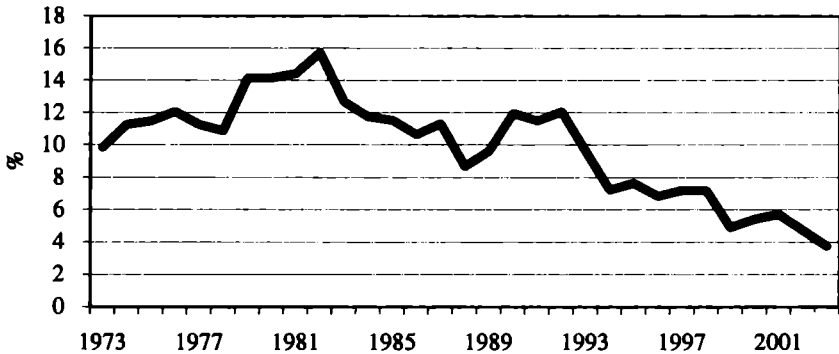


Fig. 7. Representative mortgage rate

The housing market like all markets is a balance between demand and supply. Strong growth in the economy, growth and employment and net immigration has fuelled demand for housing. To meet that demand, a significant increase in housing supply has occurred also in the past decade. Figure 8 shows how house completions has increased dramatically since the early 1990's.

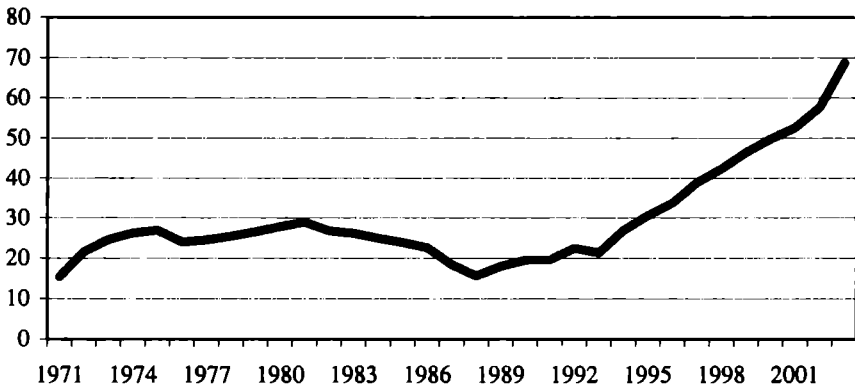


Fig. 8. House completions

As stated earlier, the Irish house price growth has been strong. Figure 9 shows trends in house prices from 1976 to date. Over that period the trend in nominal

house prices has been steadily upward apart from a brief period between 1985 and 1987 when prices appeared to remain stable.

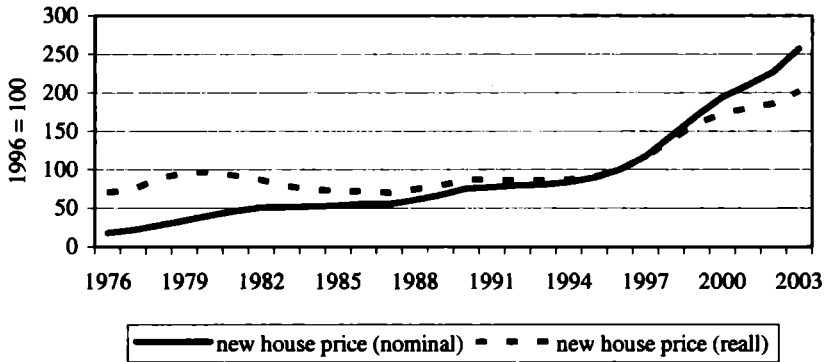


Fig. 9. Trends in nominal and real house prices

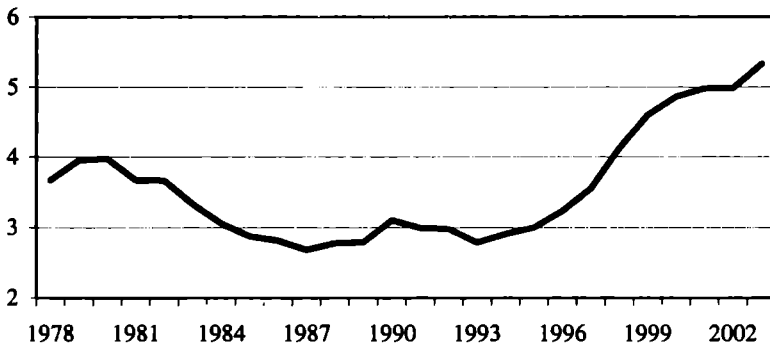


Fig. 10. New house price to income ratio

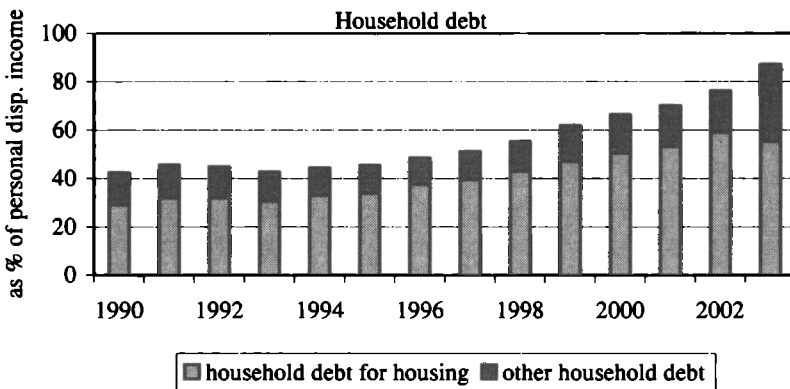


Fig. 11. Personal sector debt, as a % of personal disposable income

Adjusting for inflation house prices have risen by 177% between 1976 and 2000. As is evident from Fig. 9 there have been periods where prices have fallen in real terms. Since 1994, however, prices have risen by 97%, virtually doubling in real terms.

The growth in Irish house prices has been much faster than income growth as shown in Fig. 10. The house price to income ratio peaked in 1979 before declining steadily until 1987. Since 1990, however, this ratio has been increasing significantly.

The availability of flexible long-term mortgage credit (as described in tab. 1) has significantly helped fund Irish investment in residential property. As set out in Fig. 11, the ratio of personal debt to personal disposable income has increased in the period from 1990 to 2001. The vast majority of this increase has been in borrowing for housing purposes.

The unprecedented growth in house prices has also resulted in a substantial increase in real household wealth as shown in Fig. 12. Other studies have shown that there is a much stronger relationship between consumption and housing than between consumption and equity wealth. This growth in house prices as in other countries substantially sheltered the Irish economy from world recession in 2002 to 2004.

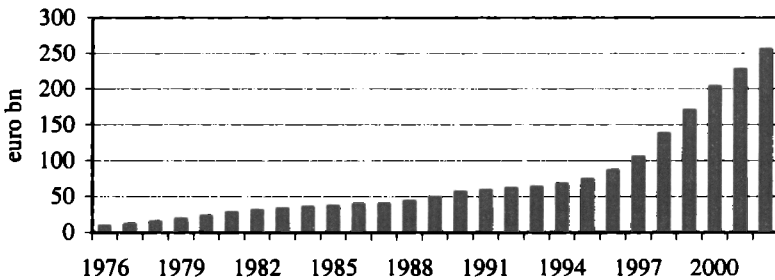


Fig. 12. Housing wealth

What is now the outlook for Irish housing? The Irish economy currently remains robust, employment creation remains good, the outlook for interest rates appears to be positive with rate increases unlikely for some time and likely in the foreseeable future to be modest. These factors should underpin housing growth. There is however growing evidence that affordability is likely to be a significant factor going forward.

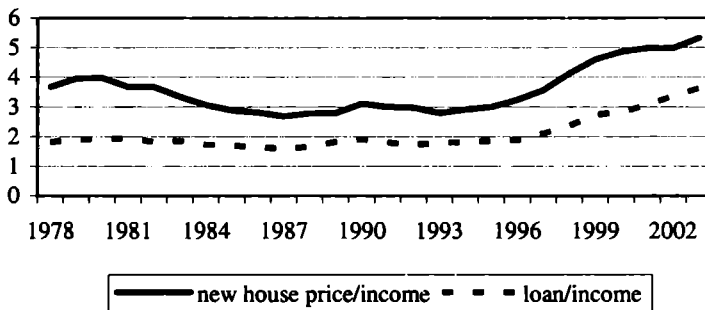


Fig. 13. Ratio of new house price and mortgage loan to income

Figure 13 relates house prices and mortgage loans to personal disposable income. The rising figures in both cases indicates that affordability is becoming an issue.

Another important factor is the ability to make the deposit down payment which is critical in the Irish market. A minimum deposit of 10% is usually expected by credit institutions.

Figure 14 relates the deposit to personal disposable income. Again this access measure shows that access to the market is becoming increasingly restricted by house price growth.

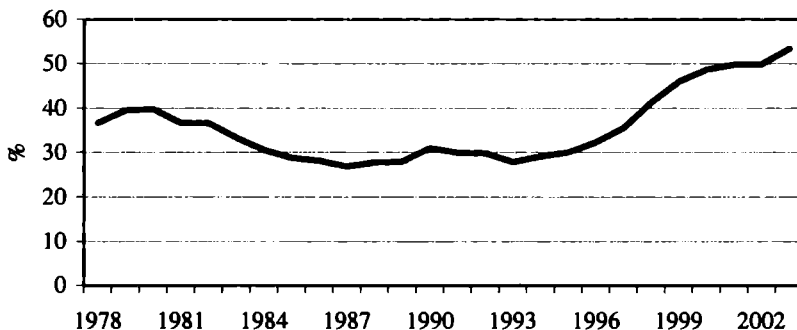


Fig. 14. Deposit as % of personal disposable income (assumed at 10% of house purchase price)

Another measure in terms of affordability is to look at mortgage service cost relative to disposable income. Figure 15 relates the mortgage service cost to that of new houses. Again this shows that there has been some deterioration since the mid 1990's although some evidence of an improvement in recent years.

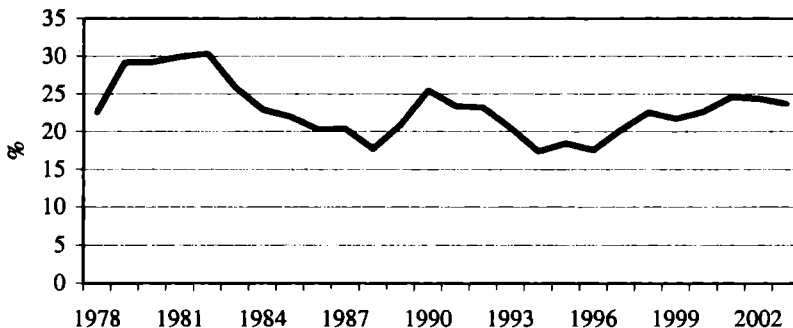


Fig. 15. Mortgage service cost as % of personal disposable income

For the house buyer, there are two elements to the 'real' cost of houses, i.e. the mortgage rate less the capital gain on the house. This is shown in Fig. 16. Clearly these numbers show that housing costs have been negative, i.e. put another way Capital Gains have more than compensated for the interest cost.

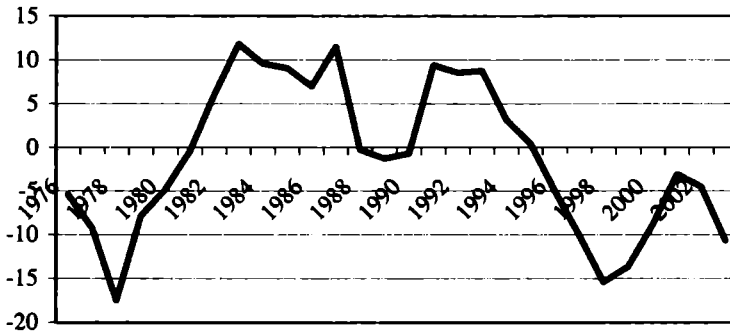


Fig. 16. User cost of housing (user cost = mortgage rate – new house price inflation)

Taking an overview then, the Irish residential housing market is a significant part of the Irish economy (tab. 4). 30% of new investment in Ireland goes into the housing stock, and housing has been in recent years responsible for 20% of the growth of the Irish economy. Increased consumer confidence, through the wealth effect from rising house prices has in Ireland as in other countries maintained economic growth at a time of world slowdown.

Table 4. Impact of housing in Irish economy

Housing 30% of New Investment
20% of Economic Growth
Supports consumer demand
Popular Investment vs Shares
BUT
Entry costs for young people rising
House prices may restrict immigration

There are of course also significant negatives. An increasingly large gap is being created between those people with and without houses. Getting on the housing ladder will eat up an increasing part of the income of young people. Also worryingly for the Irish economy which now depends on immigrant labour, the high cost of housing is now a significant discouragement to those who might plan to move to Ireland.

Table 5 summarises some key statistics in the Polish market and compares them to Ireland. In looking at these statistics one must bear in mind the relatively small size of Ireland (a population of 4 million) to that of Poland with a population of 40 million. In terms of GDP, the Irish economy is smaller than that of Poland. These statistics show that there is significantly higher levels of mortgage debt in Ireland relative to those in Poland. While the growth rates have been high in Poland, they have also been high in other countries including Ireland.

Table 5. Poland vs Ireland

KEY MORTGAGE STATISTICS

	Poland	Ireland
GDP (€m)	185,000	132,000
Value of mortgage debt (€m)	9,000	59,000
Per capita mortgage debt (€)	200	14,900
Growth in mortgage debt (2003)	23%	26%
Res. debt to gdp	4.7%	45%
Owner occupation	55%	77%
Mortgage rate	7.6%	3.5%

We are clearly in Poland at the beginning of a significant expansion of the housing market supported by mortgage finance. This will occur at a time when the mortgage rate can be expected to fall over time to significantly lower Euro levels. In that context Poland might well learn from the Irish experience. It may therefore be instructive to identify things that Poland might do in terms of policy and on the academic side to impact on that development.

Table 6. Lessons for Poland

Housing critical in economy
Significant fall in mortgage rates likely
PLAN
Spatial strategy
Link infrastructure / housing
Encourage supply
BUT
Intervention is dangerous

Table 7 highlights some key issues which policy makers in Poland should consider. These include planning for the significant expansion in housing creation that I have discussed. Identifying locations for houses and very importantly, something that Ireland didn't really learn until it was too late, to create the infrastructure in terms of roads and public transport that will facilitate a spatial strategy. The most important lesson that Ireland learned was that policy makers should do everything to facilitate house supply. The Irish experience has also shown that measures to influence demand such as taxation, interest or taxation relief for house purchase, measures to discourage investors buying property were counterproductive.

Table 7. Areas for research

Data necessary re housing starts / completions house prices site prices
Demand/demographic projections
Model impact on economy
Affordability (income/interest rates/house prices)

Finally some areas may be worth focussing from a research point of view. Poland is significantly lacking in terms of data in relation to the housing market. Even in the latest European Mortgage Federation publication there were significant gaps in terms of Poland. This situation is worse than even in the other accession countries in terms of data availability so it is important that data should be published in relation to housing starts, housing completions, estimating demand for housing and using all these to build up a model of the Polish housing market. In an environment where housing is financed by long-term mortgage credit, studies might also follow on things like affordability and the effect of falling interest rates on fuelling housing demand.

In conclusion the biggest challenge will be to manage the environment at a time of a strategic long-term interest rates. Successfully exploiting this environment could from an economic point of view have significant benefits for Poland. Failure could produce very negative results.

Literature

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PROBLEMY RYNKU NIERUCHOMOŚCI I KREDYTÓW HIPOTECZNYCH W IRLANDII

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