Property Industry Ireland
Ibec

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Debt Service Ratio

An alternative to Loan to Income

PII Sectors

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PII Vision
A sustainable Irish Property Industry which is creative, responsive, competitive and well integrated in meeting the socio-economic needs of all the stakeholders in the built environment.

PII Mission
To be the trusted partner and provider of "evidence based" information, policies and strategies for the property industry at National level, to the Oireachtas, Government, Local Authorities and Agencies, and for the benefit of the people of Ireland.

Debt Service Ratio: An alternative to Loan to Income

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INTRODUCTION

Property Industry Ireland welcomes the Central Bank of Ireland's (CBI) review of the mortgage measures. We believe it is vitally important that the review objectively analyse the data, market trends, innovations in the market and other factors to determine if a new policy instrument is required which is better and more appropriate. We acknowledge that the focus of the mortgage measures is to primarily manage systemic and cyclical risk within the financial services sector, and that one of the objectives for the Central Bank is to build resilience when times are good to absorb economic shocks when they occur.

Debt Service Ratio: An alternative to Loan to Income

Property Industry Ireland (PII) understands the need for the introduction of the mortgage measures. The fallout from the 2008 financial crisis had an impact not only on households and lending institutions, but also on many businesses and employees working in the construction and property sectors. For this reason, we continue to advocate a sustainable approach to housing delivery and financing.

However, it is important to be aware of the serious impacts the mortgage restrictions are having on the operation of the housing system, contributing to lower supply by restricting effective demand, making homes less accessible for purchase by prospective homeowners. First time buyers (FTBs) looking to purchase a home are constrained by the existing mortgage measures. This primarily affects FTBs in in urban centres.

The Loan-to-Income (LTI) limit of 3.5 times income locks out a generation of young families and lower income households from home ownership. At a time when Ireland needs to urgently address climate change the current structure of the mortgage measures are pushing FTBs further from cities, driving unhealthy and unsustainable commuting patterns and further increasing rents.

More difficult accessibility to home ownership is leading to greater demand and inflation in the rental market. One consequence is that, in many areas, rents are at levels higher than a private market mortgage repayment could be. Declining homeownership amongst our younger age cohorts and increased rental costs significantly impair their ability to own a home and save for a pension at the same time. This has long-run implications for Irish society and Irish pension and fiscal policy.

The current mortgage measures use the mortgage as the total cost of home ownership. This is limiting some households in their wish to purchase a more-energy efficient home with lower running costs. In addition, 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.

We must examine the cost-benefit of the measures against the correct counter-factual scenario: i.e. we must compare the status quo with more flexible approaches to mortgage measures.

The importance of the measures and their benefit is not being called into question: it is the design and calibration of these measures that needs to be assessed in more detail. PII call for mortgage measures to be implemented using an alternative policy lever – the Debt Service Ratio (DSR), replacing the Loan-to-Income Ratio.

Property Industry Ireland (PII) suggests that the well-known benefits of mortgage measures would still accrue using a fairer DSR system. There are disciplined savers in secure employment who cannot access mortgages in Ireland despite their sacrifices in consumption as the gap between mortgage levels and house prices is too wide.

Rents are at levels higher than a mortgage repayment

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Property Industry Ireland (PII) suggests that the well-known benefits of mortgage measures would still accrue using a fairer Debt Service Ratio system.

It is important to be aware of the serious impacts the mortgage restrictions are having on the operation of the housing system

SUMMARY

While the Mortgage Measures have been successful in meeting the Central Bank's main objectives, PII believes they have stopped many families with good finances from being able to buy a home, particularly because of the LTI restriction.

THE CENTRAL BANK'S CURRENT LENDING RULES

The Central Bank of Ireland introduced the Macroprudential Mortgage Measures in 2015.
The measures were introduced to ensure that:

Banks are lending sustainably

SUSTAINABLE

Borrowers are not borrowing at levels they can not afford

AFFORDABLE

Any house price increases are not because of too much credit being offered

CREDIT LEVELS

There are different limits depending on if the borrower is a first-time buyer, second-time buyer, or investor, and banks are allowed a certain number of exemptions each year

THE CURRENT MORTGAGE MEASURES ARE:

A limit on how much homebuyers can borrow relative to their income **(Loan-to-Income, LTI)**

A limit on how much homebuyers can borrow relative to the price of the home **(Loan-to-Value, LTV)**

These measures are separate from and in addition to the assessment banks do on a borrower's ability to repay a loan

Debt Service Ratio: An alternative to Loan to Income

WHY PII THINKS LENDING RULES NEED TO CHANGE

The existing rules have several unintended consequences, including:

- Keeping families in the rental market - unable to buy a new home
- Having more people in rental properties which has contributed to increased rents
- Rents in many places being higher than the monthly mortgage cost for a new home
- Homebuilders build homes based on funded demand (the number of people able to get a mortgage)
- The current rules are too restrictive. This means there have been fewer homes built since 2015 than there could have been

WHAT PII RECOMMENDS AS AN ALTERNATIVE LENDING RULE

Property Industry Ireland (PII) believes a new measure called Debt Service Ratio, or DSR, should replace the current Loan-to-Income (LTI) limit.

A Debt Service Ratio (DSR) calculates how much a household has available to spend after taxes and other loan repayments are taken into account.

This sets a limit on how much a household can pay in mortgage repayments based on affordability.

PII believes DSR is a better measure as it takes into account any possible changes in interest rates. It is fairer on households because it is focussed on how much a household can repay instead of what their income is.

A DSR, rather than an LTI, measure is more common in most Europe Union countries.

We show the example of a two-earner household with an income of €75,000.

€75,000 household income: 3.5 LTI limit vs DSR%

	LTI 3.5	DSR @ 25%	DSR @ 30%
Gross Income	€75,000	€75,000	€75,000
Maximum mortgage	€262,500	€312,650	€375,034
Maximum house price	**€291,667**	**€347,389**	**€416,704**
Net annual income	€61,570	€61,570	€61,570
Net monthly income	€5,131	€5,131	€5,131
Average mortgage interest rate	2.79%	2.79%	2.79%
Maximum Monthly mortgage repayment	€1,077	€1,283	€1,539
Debt Service Ratio (DSR)	**21%**	**25%**	**30%**

We also look at what the current maximum house price is for two earner households earning €50,000 and €90,000.

Property Industry Ireland (PII) believes a new measure called Debt Service Ratio, or DSR, should replace the current Loan-to-Income (LTI) limit.

MEETING THE AMBITION OF HOUSING FOR ALL

Government has set out a hugely ambitious Housing for All plan which is taking a multifaceted approach including delivery targets for new housing by tenure, cost rental and affordable housing, and planning reform. The plan sets out some of the issues facing Ireland's housing system.

"Right now, Ireland's housing system is not meeting the needs of enough of our people.

- There are not enough houses to buy or rent in the private sector.
- There are not enough houses being built by the State for those who need social housing.
- Housing has become increasingly unaffordable for the 'squeezed middle' who would once have expected to be able to purchase their own home.
- Too many people are experiencing homelessness or are unable to access appropriate housing.
- The cost of building housing is too high.
- Too much vacant housing stock remains unused.
- Our housing stock needs to be more environmentally friendly."

Housing for all commits to the delivery of over 300,000 new homes by 2030, of which approximately 170,000 are private homes. This requires an increased supply of new housing, up to an average of at least 33,000 per year to 2030.

The success of Housing for All will require all stakeholders to work collaboratively in the best interests of Irish people including the Central Bank as the financial services regulator, the property sector, and the banking sector.

Changes to demographics and the dynamics of the housing system and mortgage market mean the flexibility of the mortgage measures need to be reconsidered:

- Ireland's population is now 5 million and housing demand of 35,000-40,000 new homes is forecast until 2040
- The vast majority of the 'stuck middle' in Ireland can only access the housing market through the rental sector
- Declining rates of homeownership for younger age groups as well as lack of capacity for investing in a pension due to rental costs is a challenge
- A Central Credit Register has been established
- New non-bank mortgage lending has entered the market but is much smaller than those leaving the market
- New house price inflation remains subdued – since the second quarter of 2019 annual inflation in new house prices has averaged 2.6%
- Mortgage interest rates have fallen
- Some lenders are leaving the Irish market
- Longer term fixed rate mortgages have been introduced

27%

FTB aged less than 30 years old dropped from 60% in 2004 to 27% in 2020

Success of Housing for All will require all stakeholders to work collaboratively in the best interests of Irish people

A key driver of the supply of new homes is funded effective demand

Mortgage market of approximately €15 billion is required in 2022, growing to close to €25 billion in 2030

While the median borrower age has been relatively stable in recent years, the profile of borrowers continues to age. Some 60% of FTBs were no more than 30 years old in 2004, according to the Department of Housing, Local Government and Heritage. Eight years later, that proportion had dropped to 42%, and falling further to 27% by 2020. Similarly, about one third of mover purchasers were no more than 35 years of age in 2012. By 2020, that proportion had more than halved to 17%[1].

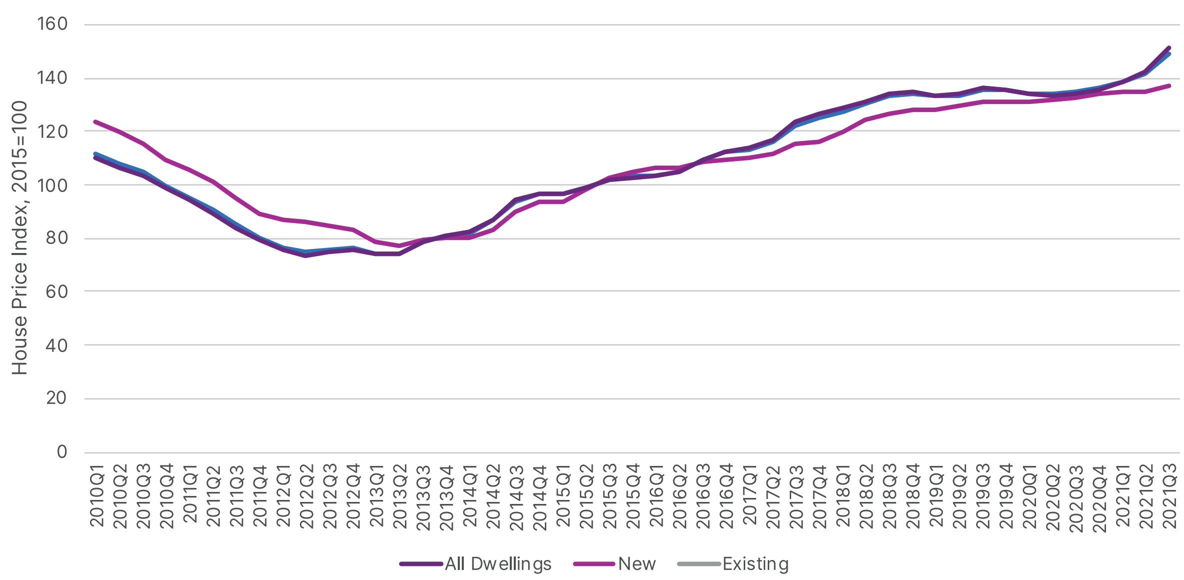
Central Bank data show that annual credit growth for home purchase has averaged just 2% since the mortgage measures were introduced. However, house price growth has been stronger, averaging 7% annually. This suggests that credit is not the main driver of house price growth in the Irish market at present. In a variety of submissions to Government PII have highlighted a number of issues that are contributing to the gap between housing supply and housing demand. For example, our submission to Housing for All argues that one of the keys to solving much of Ireland's housing crisis lies in solving the mismatch between viability and affordability.

If Housing for All is to deliver and Ireland's society are to enjoy the minimum required output of homes, significant capital flows and liquidity will be required over the coming years. This liquidity will be required from development finance to deliver these homes and from mortgage finance to allow potential purchasers fund their home purchase.

As acknowledged by the Central Bank Governor, "The mortgage measures are not the solution to Ireland's housing market ...it's ultimately a question of supply"[2]

[1] BPFI Mortgage Market Profile Report H1 2021
[2] ESRI Macroprudential Policy Seminar, November 8th, 2021

CSO Residential Property Price Index



As set out in the plan, a considerable step up in delivery in private housing, rental and public homes is projected, requiring significant investment, including institutional and State. Funding to deliver the required number of homes across all tenures out to 2030 could amount to close to €130 billion. This liquidity will come from a variety of sources. Institutional investors, private investors and cash purchasers will deliver a proportion of this liquidity.

> A key driver of the supply of new homes is funded effective demand – increases in the supply of new homes will occur when more people can access mortgages to support an increase in construction levels. BPFI data on mortgage drawdowns show a mortgage market of approx. €9.5 billion in 2019 (pre-Covid). Based on the targets set in Housing for All we estimate that a mortgage market of approximately €15 billion is required in 2022, growing to close to €25 billion in 2030.

The implementation of mortgage measures is not without its challenges. Duffy, McQuinn and McInerney (2016) found that, while the macroprudential measures proposed will more than likely result in house prices being lower than what they otherwise would be, they may also result in fewer houses being supplied to the market and fewer mortgage loans being issued than a "baseline" or no policy change scenario. As a result, the measures may well end up curbing house price inflation but at the cost of generating a sub-optimal equilibrium in the housing market, where the measures result in restricted demand for new houses, while the supply-side response in the housing market is impaired by credit and other regulatory restrictions.

CHALLENGES WITH CURRENT MEASURES

The mortgage measures were introduced in 2015 to provide stability and ensure prudent lending to support Irish consumers. These measures have had their desired effect over the last 6 years.

However, the measures have remained largely unchanged since their introduction[1] . In the consultation paper (CP87) accompanying the introduction of the measures, it was acknowledged by the Central Bank that the absence of a Central Credit Register restricted the options open to the bank in respect of mortgage measures and that the expected introduction of a register *"will allow for further consideration of macro-prudential tools such as DTI (Debt-to-Income) and DSTI (Debt Service to Income) in future.* In a recent blog[2], the Governor acknowledged the importance of a credit register in reviewing the mortgage measures.

We believe the overly strict and unchanged mortgage measures have been one of the main contributors to the significant shortfall in the number of starter homes built for owner occupiers since 2015. The level of debt finance available for homebuilding has not been fully accessed because of a lack of funded effective demand.

PII recognise the need for a careful approach to lending. However, as currently constructed we see the LTI policy lever as blunt and inflexible. A change to a Debt Service Ratio (DSR) approach that could enable liquidity to be flexible is more appropriate to a changing housing system.

Unchanged mortgage measures have been one of the main contributors to the significant shortfall in the number of starter homes

[1] There were changes to FTB LTV ratio from 2017 and changes to exemptions for FTB and non-FTB from 2018.

[2] Mortgage Measures, 17 June 2021: www.centralbank.ie/news/article/blog-mortgage-measures

3.5x

income rule means FTBs on single or combined salaries of €80,000-90,000 cannot access typical starters home in Dublin

43%

of these tenants would be looking to reduce their monthly housing costs by becoming an owner occupier

First time buyers (FTBs) looking to purchase a home are constrained by the existing mortgage measures. This primarily affects FTBs in in urban centres. The 3.5x income rule means FTBs on single or combined salaries of €80,000-90,000 cannot access typical starters home in Dublin. In addition, most renters in Dublin are paying over 30% of their net income on rent, reducing their ability to save.

The recent survey by the RTB (Tenant Research Report July 2021) found that if they were to buy, 43% of these tenants would be looking to reduce their monthly housing costs by becoming an owner occupier. Tenants who saw themselves being an owner occupier were asked what actions they were taking to help achieve their goal to buy a property. The majority (69%; 349 respondents) said they were currently saving for a deposit. Regarding future housing aspirations, most felt that their opportunity to buy was impacted by the mortgage measures in place. They simply did not have the capacity to save for the required deposit.

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The Housing Agency undertook a survey of those living in apartments (2019). Some families who were renting saw the current rental market as a barrier to finding more suitable accommodation. There were frustrations too, as many thought their rental costs are higher than what a mortgage would be. Even though they believed this demonstrated 'ability to pay,' the upfront cost/saving for a deposit and Central Bank mortgage measures meant homeownership was out of reach for many. In a tenant focus group, rental costs were seen to be a significant barrier to those who were aspiring to own a home, making it difficult to save the required deposit. Possibly reflecting their personal situation, this group were more likely to believe mortgage lending rules should be relaxed and supported 100% mortgages.

The average price of a new home sold to household buyers in Ireland in 2020 was €350,000, requiring the purchaser to have a single or combined income of €90,000 to qualify for a 90% LTV mortgage. Only c. 4% of households in Ireland have incomes at or above this level.

Ireland now has the highest mortgage interest rates for home buyers in the EU 27. One important aspect of the Irish market is how any policy rate changes are passed through to borrowers. For the standard variable rate, a breakdown in the pass-through relationship has been observed in the Irish market since 2013. Both Goggin et al. (2012) and McQuinn and Morley (2015) examine the breakdown in the pass-through relationship in the Irish mortgage market. Amongst other reasons, both studies cite the decline in competition in the Irish mortgage market post-2008 as a reason for this. The recent announcement by two lenders to leave the Irish market will not help this issue.

22%

Irish homebuyers effectively paying in excess of 22% more per month in mortgage repayments compared to their EU 27 counterparts

The EU 27 average interest rate on new mortgage agreements in July 2021 was 1.28% and there are examples of innovations in certain European jurisdictions where mortgage interest rates are lower than this for responsible purchasers. The impact of these higher interest rates is resulting in Irish homebuyers effectively paying in excess of 22% more per month in mortgage repayments compared to their EU 27 counterparts.

Despite Irish banks having some of the highest prevailing effective mortgage interest rates in Europe, the monthly cost of these mortgage repayments to households is significantly less than equivalent rental payments, even when the baseline interest rate is sensitised to a higher scenario.

DEBT SERVICE RATIO AS A REPLACEMENT TO THE LOAN-TO-INCOME POLICY LEVER

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.

Debt service ratios are the more commonly used affordability tools globally where mortgage measures are implemented. Ireland's mortgage measures are amongst the strictest in the EU. Ireland is one of only three countries in the EU27 using LTI as a measure of affordability, with Denmark applying a 5.0x LTI and the UK a 4.5x LTI (European Systemic Risk Board, A Review of Macroprudential Policy in the EU in 2020, (July 2021)).

Ireland is more of an outlier when you consider that the only two countries other than Ireland in the data that use the LTI are outside the euro-area (Denmark and UK). It is worth noting that the debt service ratio is already being used by mortgage lenders in Ireland, separately from the Central Bank of Ireland's mortgage measures.

Ireland's mortgage measures are amongst the strictest in the EU

Figure 1: ESRB Overview of Active Mortgage Measures in the EEA in Q4 2020

Catagories	Type of measure	AT	BE	BG	CY	CZ	DK	EE	FI	FR	HU	IE	IS	LI	LT	LU	LV	MT	NL	NO	PL	PT	RO	SE	SI	SK	UK
	Debt service-to-income (DSTI)	■	■		■			■		■	■				■		■	■			■	■	■		■	■	
	Debt-to-Income (DTI)		■														■			■						■	
BBMs	Loan amortisation					■								■						■				■		■	
	Loan maturity	■				■		■		■					■		■	■	■		■	■	■		■	■	
	Loan-to-Income (LTI)						■					■															■
	Loan-to-Value (LTV)	■	■		■	■	■	■	■		■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	
	Stress test/Sensitivity test			■	■	■			■			■								■			■				■

Note: BBM = Borrower Based Measure
Source: European Systemic Risk Board (2021) A Review of Macroprudential Policy in the EU in 2020, July.[1]

As the analysis in Section 5.1 shows, 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 DSR 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.

The introduction of the Central Credit Register (CCR) gives lenders more reliable data to adopt the DSR approach

many low to middle income households are in an inflated rental market where monthly outgoings for accommodation far exceed a mortgage payment

Our view on the use of DTI ratios is also in line with the IMF (2016)

"In addition, the Central Bank of Ireland should consider transforming proportionate limits on LTI ratio into caps on DTI ratio after the CCR is successfully implemented. While most countries, which have implemented this type of affordability regulation, use caps on DTI to ensure affordability, Ireland introduced LTI limits. DTI caps are applied on individual household level consolidated all debts, while LTI limits are imposed on individual loan basis in the absence of a reliable credit register. Unlike the former, LTI limits cannot prevent a potential leakage problem, such as the use of unsecured loans to compensate for lower credit availability against the collateral value and income."[1]

Furthermore, Millard, Rubio and Varad (2021) find that overall, DSR limits are welfare improving relative to any other macroprudential tool. (The macroprudential toolkit: Effectiveness and interactions)

The Central Bank should consider aligning with rest of the euro-area which considers DSR a more accurate measure when promoting responsible and prudent lending.

PII are not advocating for the removal of controls as we believe they are a positive addition to the market and provide regulation and stability. However, when compared to other European jurisdictions the constraints in Ireland are too conservative and the measuring mechanisms too blunt. Consequently, many low to middle income households are in an inflated rental market where monthly outgoings for accommodation far exceed a mortgage payment.

[1] (Irelands Financial Sector Assessment Program Technical Note—Macroprudential Policy Framework)

5.1 Worked Examples

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).

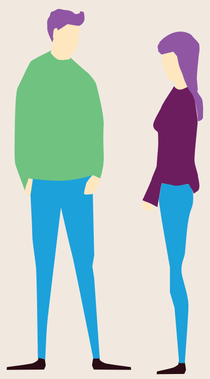
A 35-year-old could be expected to have in the region of 12 years' experience in their chosen field. Key workers in Ireland with this level of experience can expect to earn in the region of €45,000 - €60,000. Below are the salaries of Irish essential workers at this level:

- Garda: €49,000
- Teacher: €54,000
- Nurse: €46,000 (with Clinical Nurse managers earning up to €55,000)
- Executive Officer: €50,000 (with HEOs earning up to €63,000 at the top of the scale)

Taking the example of a household with an income of €50,000, the current maximum house price is €194,444 for two earners. We also look at what the current maximum house price is for two earner households earning €75,000 and €90,000.

€50,000 household income: 3.5 LTI vs DSR %

	3.5 LTI	DSR @ 25%	DSR @ 30%
Gross Income	50000	50000	50000
Maximum mortgage	175000	225410	270492
Maximum house price	**194444**	**250456**	**300547**
Net annual income	44393	44393	44393
Net monthly income	3699	3699	3699
Average mortgage interest rate	2.8%	2.8%	2.8%
Maximum Monthly mortgage repayment	718	925	1110
Debt Service Ratio (DSR)	**19%**	**25%**	**30%**



€75,000 household income: 3.5 LTI vs DSR %

	3.5 LTI	DSR @ 25%	DSR @ 30%
Gross Income	75000	75000	75000
Maximum mortgage	262500	312650	375034
Maximum house price	**291667**	**347389**	**416704**
Net annual income	61570	61570	61570
Net monthly income	5131	5131	5131
Average mortgage interest rate	2.8%	2.8%	2.8%
Maximum Monthly mortgage repayment	1077	1283	1539
Debt Service Ratio (DSR)	**21%**	**25%**	**30%**

€90,000 household income: 3.5 LTI vs DSR %

	3.5 LTI	DSR @ 25%	DSR @ 30%
Gross Income	90000	90000	90000
Maximum mortgage	315000	351884	422065
Maximum house price	**350000**	**390982**	**468961**
Net annual income	69295	69295	69295
Net monthly income	5775	5775	5775
Average mortgage interest rate	2.8%	2.8%	2.8%
Maximum Monthly mortgage repayment	1293	1444	1732
Debt Service Ratio (DSR)	**22%**	**25%**	**30%**

These examples show that for a given DSR a borrower can afford a higher level of borrowings while still adhering to a strict affordability measure.

LOAN-TO-INCOME AND FTBS

As already stated, PII believes the LTI measure is too blunt a policy instrument. We feel this is particularly the case for First Time Buyers. The LTI takes a snapshot of a household income at the time that they purchase a property without factoring in that households projected growth in income and increasing ability to maintain such mortgage, essentially where the mortgage payment as a proportion of their income reduces over time. A DSR would have the advantage of also taking into account legacy debt.

The CBI's own research does note: 'the data showed that there was a substantial difference in default rates between first-time buyers and those moving home (referred to as second and subsequent buyers), with the latter much more likely to default, even when controlling for a wide range of observable factors.' Thus, PII believe FTB purchasers seeking affordable homes (possibly below a certain price threshold) should be allowed higher DSR rates.

While it may be difficult to forecast an individual household's income path into the future and sensitise for economic shocks etc., the LTI is linked to a very low average gross salary base level in Ireland, particularly for first time buyers. With this, the LTI of 3.5 x income locks out a generation of households from home ownership, particularly where they are seeking A-rated green homes in urban / semi-urban areas. At a time when Ireland needs to urgently address climate change the current structure of the mortgage measures are pushing FTBs further from cities, driving unhealthy and unsustainable commuting patterns and further increasing rents.

While a Debt Service Ratio also takes a snapshot in time of a household income, it factors in the credit history and debt service requirements of that household and it also allows for flexibility in lending amounts, particularly if interest rates change or where innovations such as longer-term fixed rates are introduced.

We note the DTSI or DSR ratios in some other European jurisdictions:

- **Netherlands up to 30%**
- **France 35%**
- **Portugal 50%**
- **Austria up to 40%**

We also note that the lenders are innovating in the space, for example 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.

Debt Service Ratio factors in credit history and debt service requirements

ASSOCIATED ISSUES

While 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 are Government policy measures, they cannot be ignored in the conversation around the mortgage measures.

7.1 Climate Change

The current mortgage measures use the mortgage as the total cost of home ownership. This is limiting some households in their wish to purchase a more-energy efficient home with lower running costs. In addition, 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.[1]

The cost to build or purchase a home is higher per square foot than in many similar European jurisdictions. High quality A-rated homes are necessary in the context of climate change. These come at a higher cost, particularly on an island where much of the raw material and a good portion of the labour force comes from abroad. While it is not the purview of the CBI to determine policy on housing supply, it cannot be ignored that CBI measures on lending has a causality and indirect impact on supply.

In addition, there is greater cost to developing homes with an lower overall impact on the environment – as these are located on brownfield rather than greenfield sites and are apartment developments in urban locations as opposed to one-off houses in rural locations.

There are benefits to society if commuting is reduced, with lower emissions.

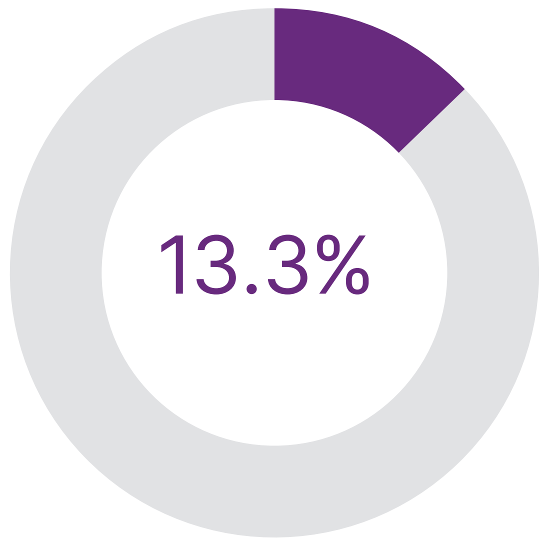
[1] See Ronan Lyons, The Central Bank is reviewing its mortgage rules. Should they be altered – and how? The Currency, November 3rd, 2021.

7.2 Rental Market and Pensions

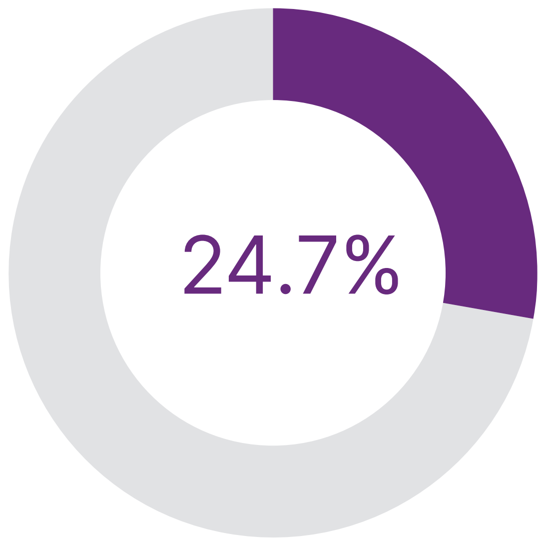
CSO population projections for Ireland show substantial rises in the older population. Irrespective of the combination of assumptions used, there will be between 1.5 and 1.6 million persons aged 65 years and over by 2051, compared with 629,800 in 2016. Therefore, while around 13.3% of the population was aged 65 years and older in 2016, this will rise to between 23.9% and 27.4% in 2051. The number of persons aged 80 years and over is projected to rise from 147,800 in 2016 to between 535,900 (+262.6%) and 549,000 (+271.4%) in 2051, depending on the scenario chosen.

Against this backdrop, Ireland's homeownership trends are all the more worrying. Until relatively recently, Irish people would have expected to have their mortgages paid off by retirement age with no more outgoings for ongoing accommodation costs upon retirement. In most instances, they would also have pension savings accrued in parallel. Unencumbered homeownership and sensible pension planning have always complimented each other. Declining homeownership amongst our younger age cohorts and increased rental costs significantly impair their ability to own a home and save for a pension at the same time. Ireland has recorded declining home ownership which in turn is driving increasing demand for rental accommodation. This has resulted in significant rental inflation. Cronin and McQuinn (2016) apply a model that links the maximum LTV ratio, to an important variable in the housing market, the house price to rent ratio. They find that a lower, binding LTVs result in permanent increases in rents for a given house price level.

While the difference between mortgage servicing and rents may be the result of a range of factors analysis of data from Daft. ie show that in many areas and for many home types there is a significant difference between the cost of renting and the cost of home ownership. For comparison we include in Appendix 1 a similar analysis for Q1 2015 when the mortgage measures were introduced.



13.3% of the population was aged 65 years and older in 2016.



This will rise to between 23.9% and 27.4% in 2051.

Increased rental costs significantly impair the ability to own a home and save for a pension at the same time

Table: Rent minus mortgage service cost by home type and location, Q3 2021					
	1 bed apartment	2 bed house	3 bed house	4 bed house	5 bed house
Dublin 1	669	580	654	476	252
Dublin 2	408	438	315	50	-200
Dublin 3	568	430	302	-226	-6
Dublin 4	382	196	-185	-1211	-930
Dublin 5	786	720	520	-79	-168
Dublin 6	546	312	-125	-1246	-1480
Dublin 6W	638	475	140	-755	-928
Dublin 7	806	723	498	-169	-272
Dublin 8	805	715	475	-224	-335
Dublin 9	784	704	487	-157	-256
Dublin 10	909	916	820	444	419
Dublin 11	883	868	741	292	249
Dublin 12	829	781	606	57	-16
Dublin 13	778	701	485	-151	-249
Dublin 14	671	527	218	-622	-777
Dublin 15	829	801	659	185	131
Dublin 16	711	606	354	-356	-477
Dublin 17	1047	1074	997	640	630
Dublin 18	735	613	333	-449	-587
Dublin 20	806	754	574	18	-58
Dublin 22	888	890	792	408	381
Dublin 24	895	892	783	373	340
North Co Dublin	779	740	589	103	42
South Co Dublin	608	418	44	-935	-1129
West Dublin	836	820	696	264	220
Cork City	636	648	484	3	-149
Galway City	591	601	446	-9	-153
Limerick City	604	628	517	166	61
Waterford City	513	533	437	133	41
Meath	632	654	572	-6	98
Kildare	629	645	548	-85	20
Wicklow	603	596	455	-344	-235
Louth	599	624	555	44	141
Longford	402	425	392	102	164
Offaly	464	479	420	0	75
Westmeath	482	495	425	-42	38
Laois	488	509	452	34	112
Carlow	464	478	416	-19	58
Kilkenny	438	441	357	-146	-70
Wexford	398	399	322	-144	-74
Waterford Co	410	421	321	-151	-89
Kerry	420	440	366	-15	45
Cork Co	473	493	407	-41	28
Clare	419	439	367	-13	48
Limerick Co	430	455	395	53	113
Tipperary	393	412	345	-8	49
Galway Co	497	539	490	93	210
Mayo	389	420	372	25	121
Roscommon	405	443	412	128	219
Sligo	434	473	433	99	200
Leitrim	347	376	339	48	132
Donegal	340	366	321	7	93
Cavan	406	443	405	90	185
Monaghan	380	406	346	-48	52

Source: Own analysis based on data from Daft.ie

Potentially, the greater cost is the long-run implication of changing the tenure structure of the Irish market (namely a reduction in home ownership) without implementing a concurrent system to accommodate the shortfall in pension income that this creates.

The implications for the pensions system are three-fold:

A Reduced savings capacity of those rental accommodation as rents are now more expensive than the mortgage payment on an equivalent property

B Reduced home ownership, leading to a generation continuing to pay rent on retirement or becoming dependent on state-funded housing.

C A strict LTI has resulted in a greater number of intergenerational transfers from parents at or close to retirement to their children. Such deposits to bridge the gap between the maximum about that can be borrowed and the target purchase price reduce the size of any pension lump sum – impacting on the retiree's pension income.

APPENDIX 1

Rent minus mortgage service cost by home type and location, Q1 2015

	1 bed apartment	2 bed house	3 bed house	4 bed house	5 bed house
Dublin City Centre	€338	€406	€761		
North Dublin City	€303	€214	€93	-€189	-€27
South Dublin City	€291	€114	€89	-€264	-€281
North Dublin County	€137	€140	€91	-€284	-€1,090
South Dublin County	€128	€32	€199	-€604	-€414
West Dublin County	€300	€223	€183	-€32	-€359
Cork City	€273	€174	€75	-€169	-€164
Galway City	€160	€102	€130	-€58	-€116
Limerick City	€180	€225	€140	-€32	-€442
Waterford City	€142	€187	€189	-€33	-€90
Dublin Communter Counties	€153	€139	€67	-€211	-€538
West Leinster	€145	€137	€99	-€77	-€222
South-East Leinster	€104	€143	€71	-€199	-€433
Munster	-€31	€93	€41	-€259	-€431
Connaught/Ulster	€9	€80	€123	-€44	-€257

Source: Own analysis based on data from Daft.ie

ADDITIONAL REFERENCES

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Property Industry Ireland
Ibec

84 - 86 Lower Baggot Street
Dublin 2
Ireland.

info@propertyindustry.ie
+353 (0)1 605 1666
www.propertyindustry.ie