SUPPLY AND DEMAND IN THE IRISH HOUSING MARKET - CAN THEY BE ALIGNED?

AIB Real Estate Finance
December 2022

Pat O'Sullivan
Rory McGuckin

CONTENTS

EXECUTIVE SUMMARY

According to the Central Bank of Ireland, "fewer houses are being built, for a given level of house prices relative to incomes, than in the past." A number of significant problems have beset both the demand side and the supply side of the housing market and have prevented the market from functioning efficiently.

In our view, the authorities have done as much as could reasonably be expected on the demand side of the equation, with the introduction of the First Home Scheme, the increase in the loan-to-income limits and the maintenance of the Help To Buy scheme amongst other measures. However, the supply side of the equation still needs urgent attention.

One of the more immediate areas of concern is the lack of viability of apartment development. Apartment viability has been a long standing issue in the Irish market and unfortunately the viability challenge has increased over the past year due to the significant cost inflation that has occurred. Furthermore, viability is likely to deteriorate further over the coming year if, as seems likely, apartment/PRS yields increase in Ireland.

Consequently, we are concerned that there could be a significant decline in apartment completions over the next 12 to 24 months, to the point where new housing supply numbers could actually contract next year and in 2024 from this year's level. Reliance on the public sector as a buyer will have to increase if we are to see any reasonable supply of new apartment developments over the next few years. In this context, the role of the Land Development Agency will become increasingly important along with the activities of the Approved Housing Bodies and local authorities.

However, a greater emphasis on alternative design standards (rather than the near exclusive dependency on apartments to deliver supply in the Dublin market over coming years) could have a material and near immediate impact on supply and viability. Apartments should be concentrated in the city core and along key, well-serviced public transport nodes. Outside of these areas, apartments are not the ideal solution, particularly in an Irish context. However, where densities of 35 to 50 units per hectare are required, there is a reliance on apartments to provide such levels of density. This results in apartments and duplex apartments featuring in locations where they are not the optimum form of housing.

Adopting compact growth design standards would achieve densities of 35 to 50 units per hectare without the need to construct apartments. These compact growth design standards would deliver a high quality housing product that is also affordable for the consumer. These design standards place an emphasis on higher quality outdoor space that is centred on accessibility, functionality and greater utilisation by the local community.

We believe that this proposal has the potential to unlock a significant amount of supply in the Irish market with a near immediate effect.

Separately, a recalibration of the planning system is also required, in particular the underlying demographic assumptions and estimated housing requirements incorporated in the Housing Need and Demand Assessment model used by county councils/local authorities. In particular, these are leading to a significant under-estimation of housing requirements in Ireland, particularly in the Greater Dublin Area and surrounding counties.

Overall, more needs to be done to address the supply side of the market, including more realistic demographic assumptions underpinning the planning framework, creating more effective and viable density solutions, reducing the cost of apartment development, and delivering a more transparent and efficient planning system.

The demand side has been largely addressed. It is now time to focus on the supply side and its many and varied impediments.

1

INTRODUCTION

The Irish housing market is characterised by a significant structural weakness in housing supply compared with the underlying bourgeoning level of demand. According to the Central Bank of Ireland, "fewer houses are being built, for a given level of house prices relative to incomes, than in the past."[1] A number of significant problems have beset both the demand side and the supply side of the housing market and have prevented the market from functioning efficiently.

We have long argued that there has been a viability problem in the Irish housing market, and particularly in the Dublin market. The viability problem was caused by the existence of an affordability wedge between what a two-income household on average incomes could have borrowed at the 3.5 times loan-to-income (LTI) limit and what it costs to buy a typical first-time buyer (FTB) home. This had the effect of widening the gap between latent, underlying demographic demand and actual viable demand. In other words, the affordability wedge had the effect of suppressing much of the long-term demand and turned a significant proportion of it into latent demand (and as a result shifted large swathes of demand into the rental market).

However, much has changed on this front in 2022 with the introduction of the First Home Scheme[2] (FHS) and the increase in the FTB LTI limit to four times gross income. In our view, these two factors, combined with the Help to Buy scheme, have helped to significantly address the demand side viability problem. We discuss these recent changes in more detail later in the report.

In our opinion, the authorities have done as much as could reasonably be expected on the demand side of the equation but, unfortunately, the supply side of the equation still needs urgent attention.

There are legitimate concerns regarding the supply potential of the Irish market when one considers the demand and supply imbalance. These concerns are based on the fact that due to demographic changes, long-term housing demand in Ireland is running at approximately 35,000 new residential units each year.[3] In contrast, fewer than 15,000 residential units on average have been built each year since 2015, with 27,000 units estimated to have been built in 2022.

A number of significant impediments on the supply side have limited the delivery of housing in the Irish market and this report addresses a number of these. In particular, we point to the overreliance on apartments in the delivery of density and we highlight the huge viability issues facing the development and delivery of apartments.

1. As referenced in the Central Bank of Ireland presentation, 'Mortgage measures framework review: Focus on the calibration decision', October 2022.

2. Other significant interventions include the Local Authority Affordable Purchase Priority Agreement and the Croí Cónaithe scheme.

3. This is probably a conservative estimate, with some analysts estimating that the demand could be running as high as 62,000 units per year.

Unfortunately, practically the only type of residential development that will get planning permission in the four local authority areas in Dublin is apartments.

Apartment planning permissions accounted for more than 94% of all units granted planning permissions in 2021 in the four local authority areas. This number has accelerated quite sharply since 2018, when apartments accounted for less than 60% of units granted planning permission. However, the viability of apartment development has been an ongoing challenge in the Dublin market (and apartment development has not been viable outside of the Dublin market for the most part). This has meant that a large proportion of these apartment planning permissions in Dublin have not been converted into commencement or completions.

The viability challenge has increased over the past year due to the significant cost inflation that has occurred. Unfortunately, viability is likely to deteriorate further over the coming year if, as seems likely, apartment/PRS yields increase in Ireland. In fact, we are concerned that there could be a significant decline in apartment completions over the next 12 to 24 months, to the point where new housing supply numbers could actually contract next year and in 2024 from this year's level.

Heretofore, the only realistic buyers of apartment developments were institutional buyers (both the private and public sector). However, private institutional buyers are likely to be considerably less active for the foreseeable future. Consequently, reliance on the public sector as a buyer will have to increase if we are to see any reasonable supply of new apartment developments over the next few years. In this context, the role of the Land Development Agency will become increasingly important along with the activities of the Approved Housing Bodies and local authorities.

To be clear, apartment delivery is essential, particularly in the city core and along key, well-serviced public transport nodes. Outside of these areas, apartments are not the ideal solution, particularly in an Irish context. However, where densities of 35 to 50 units per hectare are required, there is a reliance on apartments to provide such levels of density.

“IN AN ERA OF A SIGNIFICANT HOUSING CRISIS IN THE IRISH MARKET, MORE NEEDS TO BE DONE TO ADDRESS THE SUPPLY SIDE OF THE MARKET, INCLUDING MORE REALISTIC DEMOGRAPHIC ASSUMPTIONS...”

This results in apartments and duplex apartments featuring in locations where they are not the optimum form of housing. We discuss the recent proposal to address this issue, namely compact growth design standards[4] that would achieve densities of 35 to 50 units per hectare without constructing apartments. These compact growth design standards would deliver a high quality housing product that is also affordable for FTBs. These design standards place an emphasis on higher quality outdoor space that is centred on accessibility, functionality and greater utilisation by the local community. We believe that this proposal has the potential to unlock a significant amount of supply in the Irish market with a near immediate effect.

Finally, we address the rather perplexing issue of residential land being de-zoned in the Greater Dublin Area (GDA) and surrounding counties, as was highlighted in a recent Savills' report.[5] Overly conservative demographic assumptions lie at the heart of this problem along with the mechanical application of Housing Need Development Assessments (HNDAs) by county councils/local authorities. As we note in the report, one of the most striking outcomes of the HNDA model is the fact that Fingal is estimated to need a total of just 18,560 new units between 2022 and 2040 (apparently not much more than the 15,500 residential units that is the estimated requirement for Co. Donegal). This level of estimated demand belies the fact that Fingal has been one of the fastest-growing local authority areas over the past two decades, has one of the youngest populations in Ireland, has ample land to grow further, and has significant infrastructure in place. We believe that the demographic assumptions underpinning the National Planning Framework (NPF) and the HNDAs need to be urgently reviewed and updated.

In an era of a significant housing crisis in the Irish market, more needs to be done to address the supply side of the market, including more realistic demographic assumptions underpinning the planning framework, creating more effective and viable density solutions, reducing the cost of apartment development, and delivering a more transparent and efficient planning system.

The demand side has been largely addressed. It is now time to focus on the supply side and its many and varied impediments.

4. Sustainable Compact Growth Design Standards, Glenveagh Properties plc, 2022.
5. The Residential Land Supply Study, Savills, 2022.

2

Mortgage Macroprudential Rules (MPR) changes

The Central Bank of Ireland made a number of important changes in the Mortgage Macroprudential rules (MPR) in October 2022 (effective from 1 January 2023) and these are summarised as follows:

- **First-time buyers (FTBs)**
  - The LTI limit for an FTB[6] is being increased from 3.5 to 4 times gross income.
  - No changes are being made to the FTB loan-to-value (LTV) limit, which remains at 90%.
- **Second and subsequent buyers (SSBs)**
  - The LTI limit for SSBs will remain at 3.5 times gross income.
  - The LTV limit for SSBs is being changed from 80% to 90%.
- **Buy-to-let (BTL) borrowers**
  - No changes are being made to the mortgage measures relating to BTL lending, where a 70% LTV limit will continue to apply.
- **Proportionate lending**
  - The proportion of lending allowed above the limits will now apply at the level of the borrower type (e.g. FTB) rather than the individual limit (e.g. FTB LTI).
    - 15% of FTB lending can take place above the limits.
    - 15% of SSB lending can take place above the limits.
    - 10% of BTL lending can take place above the limits.

6. The Central Bank of Ireland is also making a number of changes in the criteria required for a borrower to be considered an FTB for the purposes of the mortgage measures. From a 'fresh start' perspective, borrowers who are divorced or separated, or who have undergone bankruptcy or insolvency, may be considered FTBs for the mortgage measures (where they no longer have an interest in the previous property). FTBs who get a top-up loan or remortgage with an increase in the principal may be considered FTBs, provided that the property remains their primary home.

Why change now?

The objectives of the MPR are to ensure sustainable lending standards in the mortgage market, and in doing so, the measures aim to:

- Prevent the emergence of an unsustainable relationship between credit and house prices, and
- Support the resilience of borrowers, lenders and the broader economy.

The Central Bank acknowledges that the MPR have inherent benefits and costs for society and it seeks to balance these carefully. The MPR have delivered important economic benefits in terms of enhancing the resilience of the financial system in Ireland. However, the Central Bank has also stated that it does not aim for resilience at any cost. One of the main economic costs of the measures is that they make access to the housing market more difficult. Unfortunately, given the significant demand and supply imbalance within the housing market, this cost has gradually increased over time.[7]

Chronic lack of supply in the housing market

The Irish housing market is characterised by a significant structural weakness in housing supply compared with the underlying bourgeoning level of demand. According to the Central Bank of Ireland, Figure 1 plots the historical relationship between the number of residential unit completions versus the prevailing house price-to-disposable income ratio (an indicator of housing affordability and purchasing power exhibited by households).

"FEWER HOUSES ARE BEING BUILT, FOR A GIVEN LEVEL OF HOUSE PRICES RELATIVE TO INCOMES, THAN IN THE PAST."

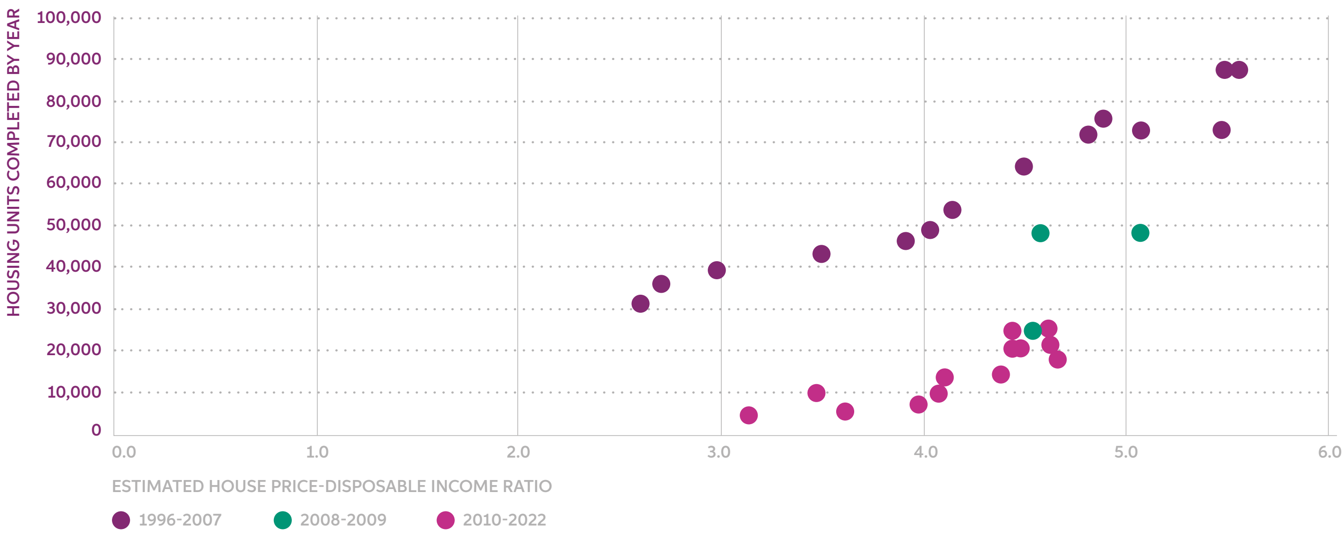
7. As referenced in the Central Bank of Ireland presentation, 'Mortgage measures framework review: Focus on the calibration decision', October 2022.

It is clear from Figure 1 that the number of houses supplied during the period 2010–2022 is substantially (and structurally) lower than what prevailed between 1996 and 2007 and, to a lesser extent, in 2008 and 2009. In economic terms, it appears that the supply curve has shifted inwards to the left, thus resulting in residential units being supplied at a structurally lower level for a given income level. As is well documented, the number of residential units supplied during the period 2010–2022 has fallen far short of the growth in the population and the underlying level of demand, as shown in Figure 2.

Figure 1

Structural weakness in the Irish housing market

Fewer houses are being built now, for a given level of house prices relative to incomes

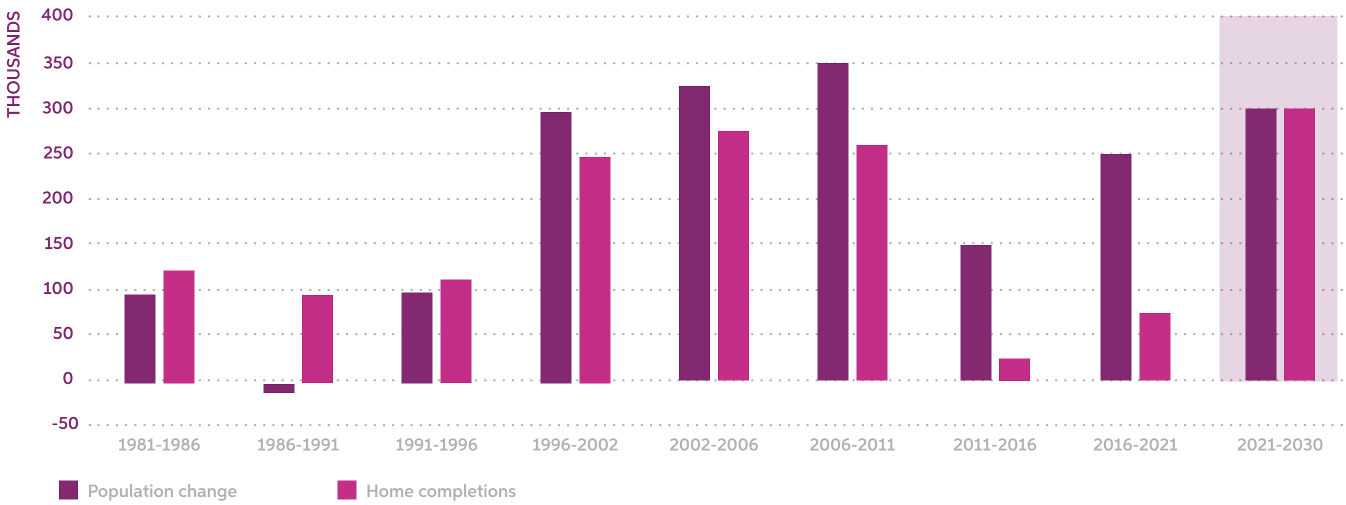


Source: 'An overview of the Irish housing market', Gerard Kennedy and Samantha Myers, CBI Financial Stability Notes

Figure 2

Structural weakness in the Irish housing market

Growth in the housing stock has fallen short of growth in population growth from 2011 to 2021



Source: Central Bank of Ireland

According to the Central Bank of Ireland, "persistent housing supply-demand imbalance has been a key driver of affordability pressures in recent years, with both house prices and rents rising faster than incomes. This contrasts with the period before the financial crisis, when unsustainable mortgage lending standards were driving increases in house prices relative to incomes."[8]

In the pre-Global Financial Crisis (GFC) period, from approximately 2003 to 2007, house prices increased at a faster pace than incomes and, in turn, incomes increased at a faster pace than rents. This points to the fact that the growth in house prices was not primarily driven by income growth; rather, it was driven by expansionary credit conditions.

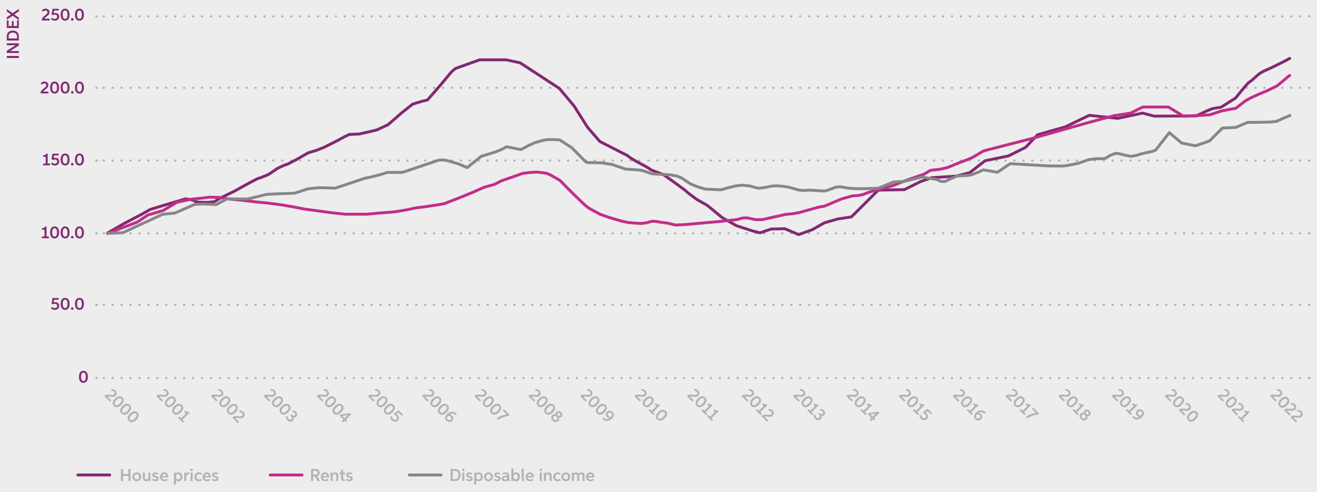
In contrast, in the post-GFC period, from approximately 2012 to date, house price growth and rental growth have been more aligned, and both have been greater than income growth. This indicates that supply-demand imbalances in the residential market are central to the affordability pressures in the market.

The MPR have been important factors in ensuring against weak lending standards in the Irish residential mortgage market. The risk characteristics of the Irish mortgage market have changed significantly as a result. For example, the distribution of LTIs is very different, with much fewer high-debt loans characterising the mortgage marke today compared with periods prior to the introduction of the MPR.

Figure 3

Persistent upward pressures on house prices and rents

Both outpacing the growth in household income



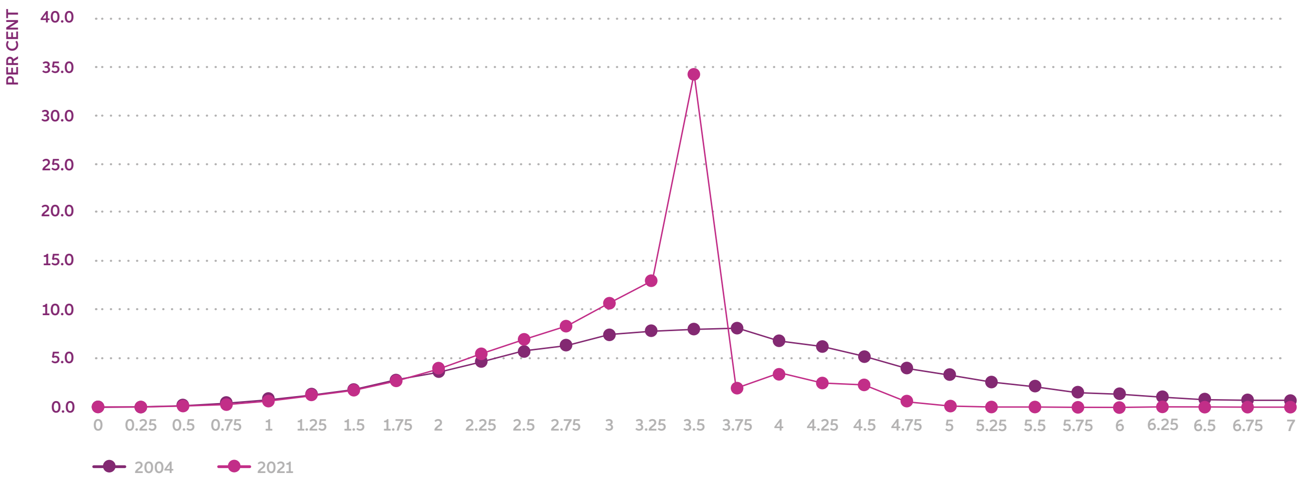
Source: Central Bank of Ireland

8. As referenced in the Central Bank of Ireland presentation, 'Mortgage measures framework review: Focus on the calibration decision', October 2022.

Figure 4

Enhanced resilience for borrowers, lenders and the wider economy

Significantly fewer high-debt loans characterising the mortgage market today



Source: Central Bank of Ireland

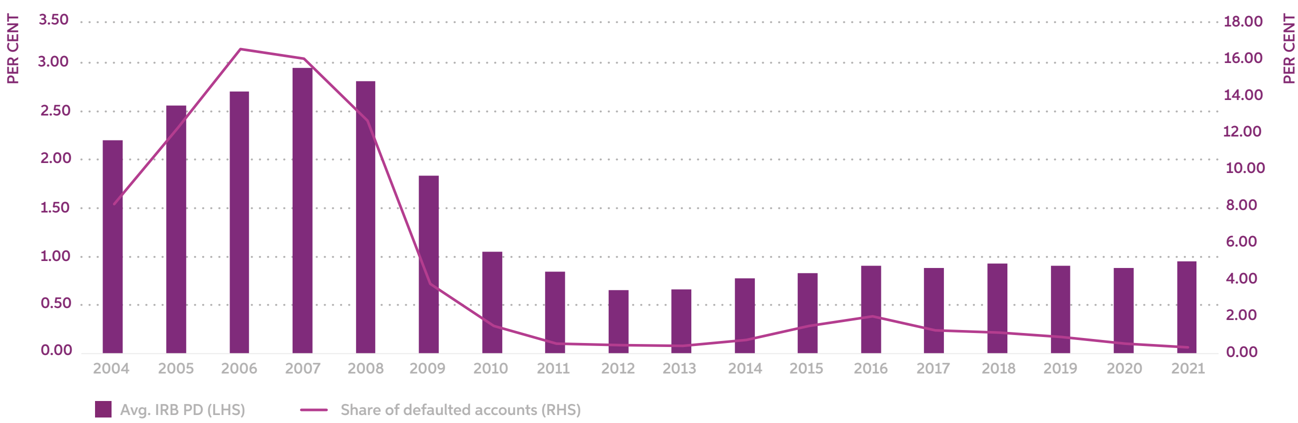
Notes: Percentage of loans at each point on LTI distribution, new lending in each of 2004 and 2021.

Mortgage loans issued since 2010 are inherently less risky. As can be seen in Figure 5 the Probability of Default (PD) of these loans is significantly lower than that of the pre-GFC vintage loans. Similarly, the share of defaulted loans originated since 2010 is materially lower than those originated pre-2010. Loans originated between 2010 and 2015 benefited from depressed house prices, whereas loans originated since 2015 have benefited from the introduction of the MPR.

Figure 5

Enhanced resilience for borrowers, lenders and the wider economy

Lending under the MPR has been much less risky, than loans issued before the financial crisis



Source: 'Risk Weights on Irish Mortgages', by Paul Lyons & Jonathan Rice, CBI Financial Stability Notes

Notes: CBI Loan Level Database. The line shows the average IRB PD on ROI PDH mortgages loans across origination years (for example, the 2012 value of 0.8% means the average PD in June 2021 of loans originated in 2012 is 0.8%). The columns show the shares of defaults occurring between 2018 and 2021 split by year of loan origination.

Economic costs of the measures have also gradually increased

It is clear from the data shown in Figure 5 that the introduction of the MPR has enhanced the resilience of borrowers, lenders, and the wider economy. However, as the Central Bank has stated, the costs associated with the MPR have also gradually increased over time.[9] In the press statement accompanying the announcement, the Central Bank stated that it "is conscious that like all policy interventions, the mortgage measures have both benefits and costs to society. The higher house price-to-income ratios that have resulted from structural developments in housing supply mean that the economic costs of the measures have risen since introduction."[10]

In particular, the Central Bank recognises the fact that the "LTI limit has become increasingly binding, especially for FTBs, due to factors related to the underlying evolution of the housing market."[11] This, combined with the increased resilience of both the domestic banking system and the household sector, has provided the Central Bank with scope to alter the MPR.

Table 1 summarises the more robust position of the banking system since the introduction of the MPR changes in 2015, which is characterised by enhanced capital and liquidity positions and a less risky mortgage portfolio in aggregate.

Aggregate household indebtedness has fallen steadily over the past decade, despite house prices increasing relative to incomes over the intervening years. According to the Central Bank of Ireland Quarterly Financial Accounts, Irish household debt to disposable income stood at 98% in Q1 2022, down from a peak of 210% in Q4 2009. This declining trend continued uninterrupted, despite the fact that house prices have increased by 127.9% from their trough in early 2013.

Table 1

MEASURES OF BANKING SYSTEM RESILIENCE, IN 2015 (INTRODUCTION OF THE MEASURES) AND NOW

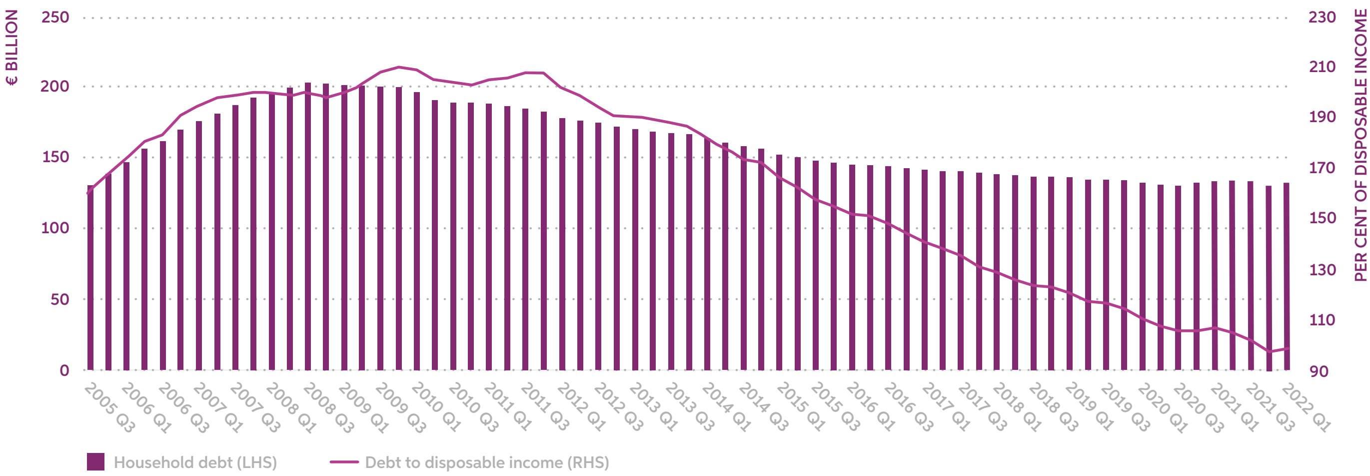
	2015	2022
CET1 capital ratio, fully loaded (%)	12.5%	15.3%
Non-performing loans (%)	18.7%	3.5%
Liquidity coverage ratio (%)	115%	222%
Share of mortgage book issued under measures	N/A	49%

Source: Central Bank of Ireland presentation, 'Mortgage measure framework review: Focus on the calibration decision', October 2022.

Figure 6

Household deleveraging at pace

Aggregate household indebtedness has continued to fall despite rising house prices



Source: Central Statistics Office and Central Bank of Ireland

9. As referenced in the Central Bank of Ireland presentation, 'Mortgage measures framework review: Focus on the calibration decision', October 2022.
10. https://www.centralbank.ie/news/article/central-bank-announces-targeted-changes-to-mortgage-measures-framework
11. As referenced in the Central Bank of Ireland presentation, 'Mortgage measures framework review: Focus on the calibration decision', October 2022.

Minimal impact on the financial resilience of the economy

The above assessment meant that the Central Bank of Ireland was able to make "a judgement that a targeted recalibration of the measures is appropriate."[12]

We agree that that there is significant resilience within the banking system, the household sector and the wider economy to facilitate such a calibration. In fact, the actual impact of the calibration on the overall resilience of the financial system is estimated to be quite modest.

A Financial Stability Note[13] published in October 2022 by the Central Bank of Ireland models the possible impact of the increase in the FTB LTI limit of 3.5 times to 4 times income. It estimates that the portfolio-level weighted average LTI rises from 2.95 times to 3.20 times income in the medium term. The largest increase would be among FTB borrowers, where average LTIs would be estimated to increase from 3.19 times income to 3.47 times income.

These increased LTIs would still be considered reasonably conservative levels of income multiples and at the lower end of LTI multiples that feature in many other European countries. For example, the average LTIs[14] at origination in 2019 for the following countries were:

- **Netherlands** 3.6 times income
- **Sweden** 3.9 times income
- **UK** 4.2 times income

The October 2022 Financial Stability Note describes the initial response of borrowers and lenders to the increase in the LTI limits. The increase in limits can be expected to have 'intensive margin' effects and 'extensive margin' effects. These effects describe the credit channels through which the LTI limits operate. A number of existing borrowers will be able to borrow more due to the increase in the LTI limit and, as such, this will lessen the 'intensive margin' effect. Also, new borrowers will enter the market as the increase in the LTI limit will bring forward their capability to buy a residential unit and, as such, this will lessen the 'extensive effect'. It is the combination of these effects that result in the increase in the portfolio-level weighted average LTI.

Intensive margin effects

The cohort of mortgage borrowers that is likely to change their borrowing amount and take advantage of the increase in the LTI limit is borrowers whose credit amounts are at or just below the existing LTI limit, indicating that they are constrained by the limit. According to the October 2022 Financial Stability Note, it is mortgages[15] above 3.45 LTI and at or below 3.5 LTI that are most likely to increase their credit requirement.

12. As referenced in the Central Bank of Ireland presentation, 'Mortgage measures framework review: Focus on the calibration decision', October 2022.
13. 'Loan-to-income limits and mortgage lending outcomes', Financial Stability Notes, Vol. 2022, No. 10, Edward Gaffney.
14. Risks on the Dutch housing market, Ecorys, March 2021.
15. Gaffney (2019) shows that mortgages between 3.45 and 3.5 LTI limits are disproportionately numerous relative to other LTI bands, and that their borrowers exhibit different characteristics to borrowers at slightly higher or lower LTI levels. For example, their incomes and LTV ratios are significantly lower than incomes and LTV ratios among other comparable groups of borrowers.

However, there is also a large cohort of mortgage borrowers who are not expected to change their required credit amount. These are borrowers with:

1. Mortgages that are sufficiently below the existing 3.5 LTI limit.

2. Mortgages that are above the 3.5 LTI limit but below the new 4.0 LTI limit. This is because the limits would not have reduced the borrower's choice of loan size in either situation.

Finally, there is a cohort of mortgage borrowers who would want a mortgage above the new LTI limit and would require an allowance/exception. However, as the allowance/exception amount is being reduced (from 20% to 15%), this may mean that some in this cohort will not get their required credit amount, thus leading to a reduction in mortgage issuance above the new limit.

Extensive margin effects

There is also a cohort of prospective mortgage borrowers who would enter the market in response to increased credit availability at the higher LTI ratios. Their ability to access a higher debt amount will have accelerated their plans to purchase a residential property without any other change in their financial circumstances.

As a result of the combined impact from the intensive and extensive margin effects, the portfolio-level weighted average LTI is expected to increase to 3.2 times income. For FTBs, it is expected to increase to 3.47 times income.

3

The First Home Scheme

The First Home Scheme (FHS) was launched in July 2022. The aim of the scheme is to help bridge the gap for eligible FTBs between their deposit and their mortgage, and the price of a new home (within price ceilings). The FHS is available to FTBs[16] seeking to purchase a newly built home in a private development anywhere in Ireland.

The FHS will support FTBs on moderate incomes[17] to buy a new home in the form of an equity stake in the home, equivalent to the level of funding provided. There is no income limit for applicants, but price caps apply.

Up to 20% equity support will be available to purchase these homes (or maximum 30% if the Help To Buy scheme is not utilised). The FHS requires borrowers to maximise their mortgage drawdown capacity in terms of the LTI limit (currently 3.5 times the applicant's gross income under the Central Bank mortgage measures and not eligible for any further exemptions) as well as provide a down payment of 10% of the value of the house.

The purchaser will be permitted to redeem or 'buy out' this equity stake at any time, but there will be no compulsion to do so.

Share redemption in the FHS will take place under the following circumstances:

- Mandatory: Sale, refinance of the property, change in the property from principal private residence (PPR) and probate.

- Voluntary: Homeowner has no obligation to redeem as long as the property remains their PPR. Homeowner can elect to redeem all or part of the equity stake.

With regard to service charges, none will apply for years 1–5. From year 6, a service charge is applicable and will increase in increments over the life of the product. Customers will be automatically charged unless they formally choose to defer the payment (at any point from year 6 onwards). If deferred, the service charge obligation will continue to accrue on a simple interest basis (i.e. not compounded). It is important to note that the FHS is not an equity loan scheme, as is the case in the UK, and that it is designed to be an equity support to eligible borrowers. In the UK Help to Buy Equity Loan (HTBEL) scheme, there is both a service fee and interest rate charge, and payment of both are mandatory as they fall due.

16. A number of exemptions have been introduced, which means that applicants may also be eligible for FHS support despite previously purchasing or building a property in Ireland if:
- They did so with a spouse, civil partner, or partner, and that relationship has ended. The applicant must not retain a beneficial interest in the previous property, or
- They have sold (or divested of) that property as part of a personal insolvency or bankruptcy arrangement, or other legal process as a consequence of insolvency.

17. While there is no income limit in the FHS eligibility criteria, the combination of the property price caps and the requirement to maximise the 3.5 times LTI limit means that the scheme is targeted at households with moderate incomes.

The FHS has been designed to avoid causing distortions in the housing market and to ensure that it remains targeted at starter homes for FTBs. The principal measure to prevent market distortion is a price ceiling that applies to the scheme in each local authority area. The price ceilings vary in each local authority area in order to reflect local market conditions, demand for housing, and incomes in each area.

These ceilings will be reviewed within 6 months, and at regular intervals after that, to ensure that they get the balance right between preventing market distortion and ensuring that the scheme is effective in helping FTBs who need it.

The FHS has started quite well, with strong interest from FTBs. According to the FHS, activity in the quarter from July 2022 to September 2022 has been strong, with close to 2,000 registrations of interest and more than 500 Eligibility Certificates[18] issued. For borrowers who obtained an Eligibility Certificate, the average price paid for the house they subsequently purchased was €359,000. The average support being provided by the FHS in these cases was €79,000 (22% of the average purchase price). Unsurprisingly, the majority of Eligibility Certificates (66% of Eligibility Certificates issued) have been for buyers in Dublin, Kildare, Meath and Wicklow, with the remaining 34% spread across 19 counties throughout Ireland.

Comparison and lessons from the UK HTBEL scheme

The UK HTBEL[19] scheme is one of the longer-running equity support schemes. Launched in April 2013 by the Ministry for Housing, Communities and Local Government (MHCLG), it is now administered by Homes England.
To get an assessment of the impact of the FHS over the medium term in Ireland, it is worth looking at the impact of the HTBEL scheme in the UK and to assess the similarities and differences between the two schemes.

18. An Eligibility Certificate is issued by the FHS when an application meets the eligibility criteria. It is not an offer, but it does provide an indicative estimate of the maximum equity a borrower is likely to qualify for based on the information provided.

19. The HTBEL scheme was revised in April 2021. It featured a more targeted scheme focused on FTBs only and it also introduced regional house price caps, among other changes.

4

UK HTBEL scheme

Under the HTBEL scheme, Homes England provides homebuyers with an HTBEL of up to 20% of the price of the home (up to 40% in London from February 2016). Borrowers may choose the equity loan fraction, but 20% is the most common value. Home buyers need a down payment of at least 5%. Households with the minimum down payment (5%) and making full use of the HTBEL (20%) need to obtain a mortgage for the remaining 75%.

Households must meet three other key criteria in order to participate in the scheme:

- The equity loan can only be used to purchase new properties with a purchase price of £600,000 or less.
- The scheme is available to both FTBs and home movers, but not for second homes or buy-to-let investment.
- Borrowers who take out the equity loan must meet affordability requirements in order to ensure that they will be able to repay the mortgage provided by a bank.The affordability measures do not include the equity loan.

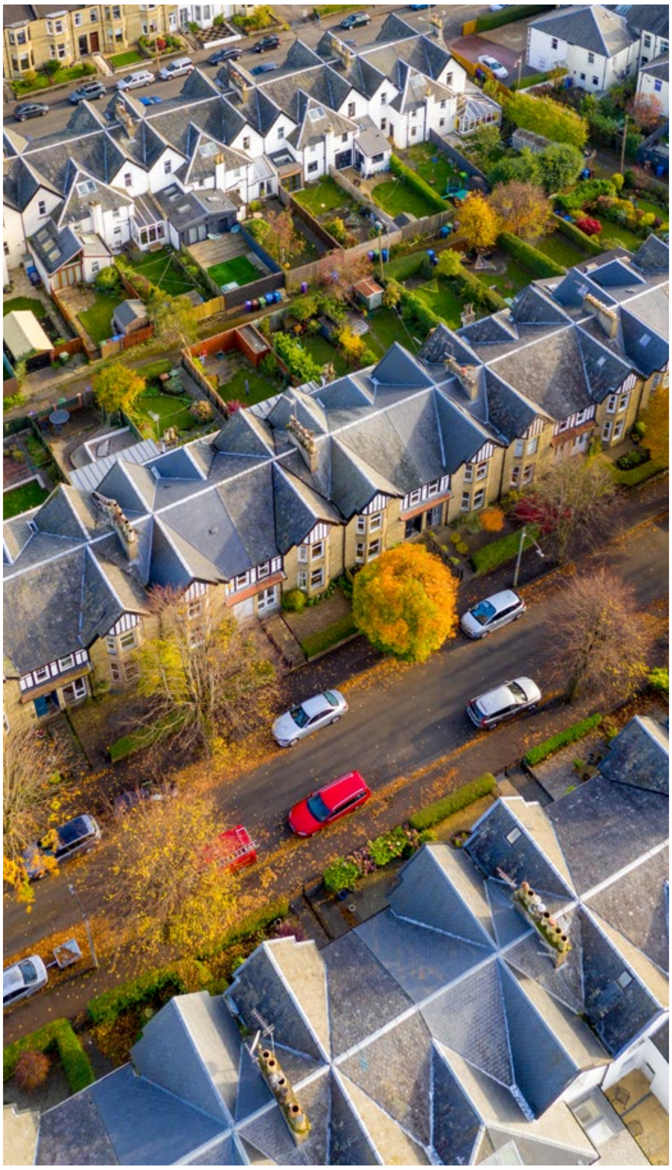
In exchange for the HTBEL, Homes England (the UK Government) is entitled to receive the same fraction of the value of the home at loan termination (i.e. 20% of the future value in the case of an HTBEL for the financing of 20% of the acquisition price). The key terms of the HTBEL are:

- Homes England takes a second charge on the property as security.
- The HTBEL is interest free for five years, (although a £1 per month management fee is payable).
- Borrowers pay interest from year 6 onwards based on 1.75% of the original equity loan figure.
- The interest rate increases in line with inflation (Retail Price Index) plus 1% in April of each financial year.
- The HTBEL has a maturity of 25 years, but borrowers can make partial repayments in 10% tranches at any time.
- Borrowers must repay either the loan on sale of the property or redemption of their mortgage.
- HTBEL is an equity loan and the repayment amount is a percentage of the prevailing property value.

The HTBEL scheme was deliberately designed with minimal criteria, in order to ensure speed to market at inception. However, in April 2021, an updated scheme with more restrictive criteria was launched. The aim of these restrictions is to make the scheme more targeted at the most appropriate households.

Impact of the HTBEL scheme on the UK housing market

The Bank of England Staff Working Paper, Housing consumption and investment: evidence from shared equity mortgages, published in April 2019[20] provides a number of interesting insights into the impact of the HTBEL scheme in the UK. The paper covers the first four years of the HTBEL scheme, from April 2013 to March 2017, by which time it had grown in size to £5.9bn. The authors of the paper had access to a wider database that covers the universe of mortgages originated in the UK, and therefore they were able to compare and contrast the characteristics of mortgage holders who availed of the HTBEL scheme and those who did not.



20. Bank of England Staff Working Paper No. 790, Housing consumption and investment: evidence from shared equity mortgages. Matteo Benetton, Philippe Bracke, Joao F Cocco and Nicola Garbarino, April 2019.

1

The paper indicates that the HTBEL scheme in the UK is reasonably effective in targeting households who need help to acquire a residential property.
It states that:

"…an overwhelming proportion of borrowers would not have, without the equity loan or a larger down payment, been able to borrow the mortgage amount needed to purchase their property."

In fact, it shows that only 8% of HTBEL borrowers would have been able to buy the same property without the help of the HTBEL scheme.

2

By examining the characteristics of households who avail of the scheme to buy properties just below the maximum price threshold[21], it finds that the scheme is largely, although not exclusively, targeting the most appropriate household cohort, namely younger households who are FTBs. It states that:

"… those who buy properties just below the threshold (within £100,000 of the £600,000 threshold) are significantly younger, much more likely to be first-time buyers, and they use a significantly lower down payment than those who buy properties just above the threshold."

Separately, looking at more recent data, it is worth noting that as of September 2020, 82% of all mortgage borrowers who availed of the scheme were FTBs.

3

The paper provides causal evidence on how borrowers react to the availability of different levels of equity finance. The maximum equity loan permitted in London increased from 20% to 40% of the value of a property and the evidence indicated that:

"a large number of individuals took advantage of the higher scheme contribution (in the London market) to buy more expensive properties."

Given this behavioural aspect, calibrating the correct equity contribution is a very important design aspect.

4

The paper examines the repayment behaviour of households who have used the HTBEL and finds that households who have seen their affordability constraints relax, via income growth and house price inflation, will look to repay the equity contribution. In essence, households do not see the HTBEL as a long-term finance option and, in general, will look to repay it as soon as possible.
The analysis shows that:

"those who do so have experienced higher rates of house price appreciation and income growth, which have relaxed affordability constraints."

The paper goes on to show that:

"those households who have repaid the HTBEL (without a house sale) have increased their mortgage balance by an amount similar to the HTBEL repayment due to the Government. They have used the HTBEL as a form of bridging finance, until the constraints that have led them to take out the HTBEL in the first place are no longer binding."

In fact, repayment statistics show that approximately 25% of the HTBEL had been repaid after five years and this rises to nearly 40% after six years.

21. The HTBEL scheme is only available for the purchase of new properties with a maximum price of £600,000. In order to examine the characteristics of households who avail of the scheme and buy properties just below the £600,000 threshold, the paper focuses on London, where property prices are higher and this limit is more likely to be binding.

Very encouraging equity repayment behaviour in the UK

The repayment experience of the HTBEL scheme is that borrowers appear to be highly motivated to repay the equity loan, as a high percentage of loans have already been repaid.

As mentioned, the Bank of England Staff Working Paper only covers the first four years of the HTBEL scheme (from April 2013 to March 2017), but even at that stage, one in four loans that were originated in 2013 had been repaid. Looking at more up-to-date data, this trend of early repayment of HTBEL scheme loans has been maintained. As of 2019/20, approximately 40% of loans had been repaid. Table 2 summarises the repayment activity of borrowers since the launch of the scheme up to the financial year 2019/2020.

Table 2
Repayment behaviour in the HBTEL scheme in the UK

		CUMULATIVE EQUITY LOANS REPAID 2019/20			CUMULATIVE EQUITY LOANS REPAID 2018/19		
Financial year	Number of equity loans issued	Number of loans repaid	Original cost of repaid loans (£m)	Receipt from repaid loans (£m)	Number of loans repaid	Original cost of repaid loans (£m)	Receipt from repaid loans (£m)
2019/20	51,449	28	1.4	1.4	n/a	n/a	n/a
2018/19	52,467	516	28.4	28.1	32	1.6	1.6
2017/18	47,587	3,147	175.6	175.4	358	17.9	18.1
2016/17	39,807	6,262	326.4	337.8	3,460	182	188
2015/16	33,873	11,127	522.9	569.9	6,543	312	400
2014/15	27,874	15,747	690.4	780.4	10,006	440	499
2013/14	19,754	12,193	504	588	10,246	421	494
All years	272,811	49,020	2,249.10	2,481.00	21,645	1,374.30	1,540.40

Source: Homes England, 2020

Triggers for repayment

For repayments without a sale of the property, a large increase in repayments occurs at around the time when the fixed interest rate periods on mortgages mature – the time when households can refinance their mortgages without break costs. Furthermore, it is more likely to be young FTBs who avail of this refinance opportunity to also repay the HTBEL scheme loan. As the Bank of England Staff Working Paper notes, "Affordability constraints are likely to be more binding for these groups of individuals, and these constraints may be relaxed by the subsequent evolution of house prices and household incomes… House price and income growth relaxes LTV and affordability constraints and reverses the factors that initially motivated households to finance the property acquisition with the equity loan."

The UK experience of relatively early repayments from a sizeable number of households is a very encouraging characteristic of the scheme. This trend should be even more evident in an Irish context, as the average two-income household already has the financial capability to fund a mortgage that would cover the cost of the equity contribution.

Households who avail of the HTBEL scheme are disproportionately young FTBs

Despite the lack of restrictions on the original HTBEL scheme in the UK, the Bank of England Staff Working Paper shows that households who avail of the HTBEL scheme are disproportionately young FTBs who would not be able to afford the same property without the HTBEL. The paper highlights various characteristics of the scheme, both positive and negative. However, many of the weaknesses identified in the scheme could be ameliorated by a number of simple amendments. These include limiting the scheme to FTBs and introducing more nuanced price caps.

Indeed, as mentioned, amendments to the UK HTBEL scheme made in April 2021 addressed some of these weaknesses. The amendments to the scheme limited the eligibility to FTBs and introduced regional price caps.

Lessons heeded by the FHS in Ireland

Shared equity schemes have explicit goals of making home ownership more affordable and accessible and, by definition, this means helping households to buy homes which they are unable to buy today, but which they would be able to buy within a number of years due to rising incomes. In order to target the most suitable households and also optimise the effectiveness of such schemes, appropriate criteria are required.

The original UK HTBEL scheme was quite open, with minimal criteria, and the households who used it were not exclusively in the younger FTBs cohort. In contrast, the Irish FHS has tighter criteria than its UK counterpart, thus making the Irish scheme more effective at targeting the most appropriate cohorts. One of the most important elements of the scheme design is the limits on the value of eligible residential units via appropriate price caps. One of the weaknesses in the original UK scheme (prior to April 2021) was that there was only one price cap of £600,000. This price cap was appropriate for London, but probably too high for many parts of England. Homes England recognised this weakness and introduced regional price caps to better reflect residential property price characteristics in different parts of the country. The FHS in Ireland has regional price ceilings to reflect local market conditions, as well as reflect demand for housing and incomes in each area. These price ceilings are important constructs in order to mitigate residential property price inflation in the FTB sector. Consequently, the calibration of the price ceilings to the respective local markets is critical and requires ongoing monitoring. The lack of price ceilings was probably the biggest weakness in the UK HTBEL scheme and contributed to some of the negative externalities that arose.

Another distinction between the Irish and the UK residential markets and the operation of these schemes is around affordability. Normally, these schemes are designed to target marginal households who cannot afford to purchase a residential property today, but could do so over time, based on the expectation of rising incomes. This is the situation that largely prevails in the UK. However, currently in Ireland there is a large cohort of two-income households on average incomes who could afford home ownership today but are constrained from doing so. In other words, these Irish households do not need to see incomes increase in order to afford the repayments associated with a mortgage big enough to accommodate the required equity contribution as well.

The FHS has been designed to target FTBs and to minimise distortions in the wider housing market. Many of the lessons from the UK market have been heeded in the design of the FHS in Ireland. Many of the weaknesses in the UK HTBEL scheme highlighted in the Bank of England Staff Working Paper are unlikely to feature in the Irish market due to these design features.

From a macro perspective, interventions in the residential market with measures like an equity share scheme have explicit goals of making home ownership more affordable and accessible. Ideally, these goals should be achieved while minimising any negative externalities, such as additional house price inflation. For shared equity schemes to work in this manner, a positive response in housing supply is required in order to satisfy the increase in demand generated by the scheme. In other words, housing supply will need to be elastic. Price ceilings help to control residential property price inflation and, in the absence of elastic supply, they are even more important.

Significant inroads have now been made to improve viability, in particular for FTBs

We have long argued that there has been a viability problem in the Irish housing market, and particularly in the Dublin market. The viability problem was caused by the existence of an affordability wedge between what a two-income household on average incomes could have borrowed at the 3.5 LTI limit and what it costs to buy a typical FTB home. This had the effect of widening the gap between latent, underlying demographic demand and actual viable demand. In other words, the affordability wedge had the effect of suppressing much of the long-term demand and turned a significant proportion of it into latent demand (and as a result shifted large swathes of demand into the rental market).

However, much has changed on this front over the past year with the introduction of the FHS[22] and the increase in the FTB LTI limit to four times income. In our view, these two factors, combined with the Help to Buy scheme, have helped to significantly address the demand side viability problem.

In order to maximise the benefits of these interventions, the housing market needs to see an increased supply of residential units, and particularly of FTB scheme/ multi-development houses.

22. Other significant interventions include the Local Authority Affordable Purchase Priority Agreement and the Croí Cónaithe scheme.

5

Irish housing supply – potential not realised

The supply response of the Irish housing market over the past decade has been wholly suboptimal and has not kept pace with underlying demographic demand. In our view, viability, coupled with a less than efficient planning system and a lack of direct build social and affordable units, are the primary factors that have hampered supply. And, unfortunately, the immediate outlook for supply is likely to deteriorate in the face of higher construction costs and higher interest rates.

Demand and supply – never the twain?

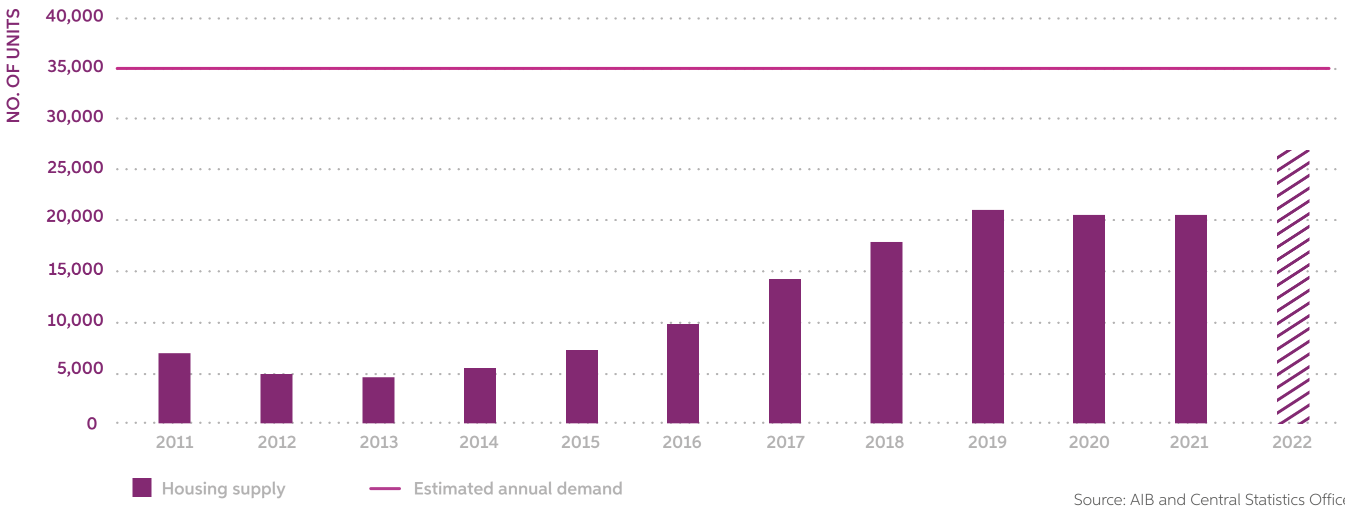
Annual housing supply in Ireland has averaged a little over 12,000 units per year since 2011, but has slowly built momentum over recent years, with the average in the past five years increasing to 18,000 units per year. This year, it is expected that housing supply will be in the region of 27,000 units. However, this level of supply has fallen far short of the estimated annual demand of 35,000. In fact, housing demand estimates[23] have generally been revised upwards in the aftermath of the publication of the Census 2022 Preliminary Results.

23. Dr Ronan Lyons indicates that Ireland likely needs to build between 42,000 and 62,000 new homes per year between 2022 and 2050 depending on assumptions regarding migration, household size and the natural birth rate. Source: 'Housing required in Ireland: The view after Census 2022', presentationto Property Industry Ireland (PII), October 2022.

Figure 7

Housing supply and estimated housing demand

Housing demand likely to exceed 35,000 per annum, however supply struggling to close this gap



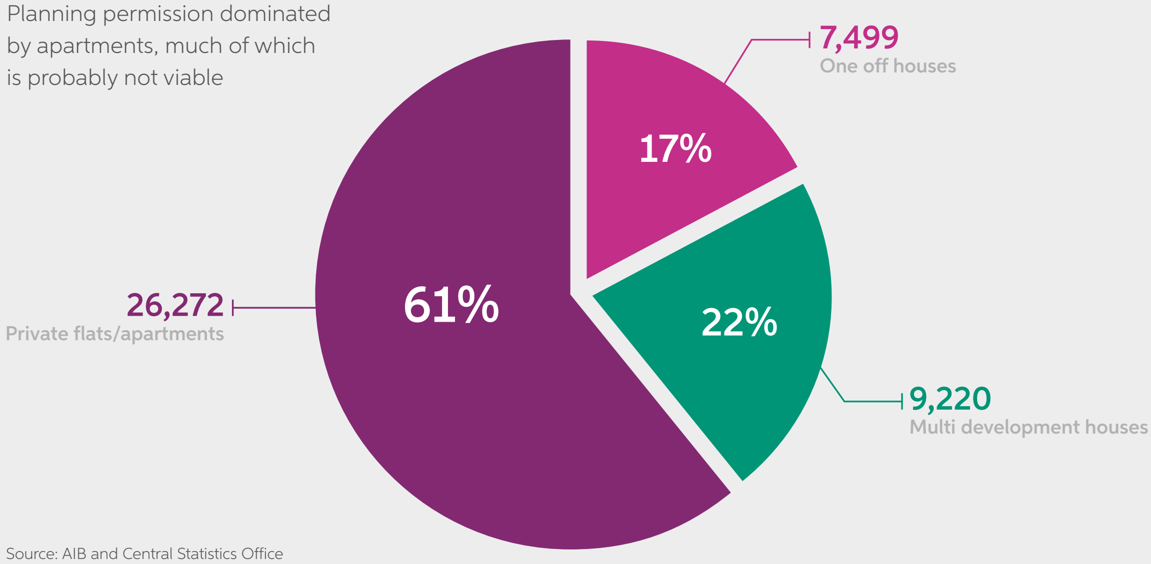
Source: AIB and Central Statistics Office

This lack of supply has occurred despite what appears to be more than sufficient planning permission grants. The total number of new dwelling units granted planning permission nationally in 2021 was 42,991, with one-off houses accounting for 18% of the total, multi-development houses accounting for 21%, and apartments accounting for 61%.

Figure 8

More than sufficient number of planning permissions, apparently

Planning permission dominated by apartments, much of which is probably not viable

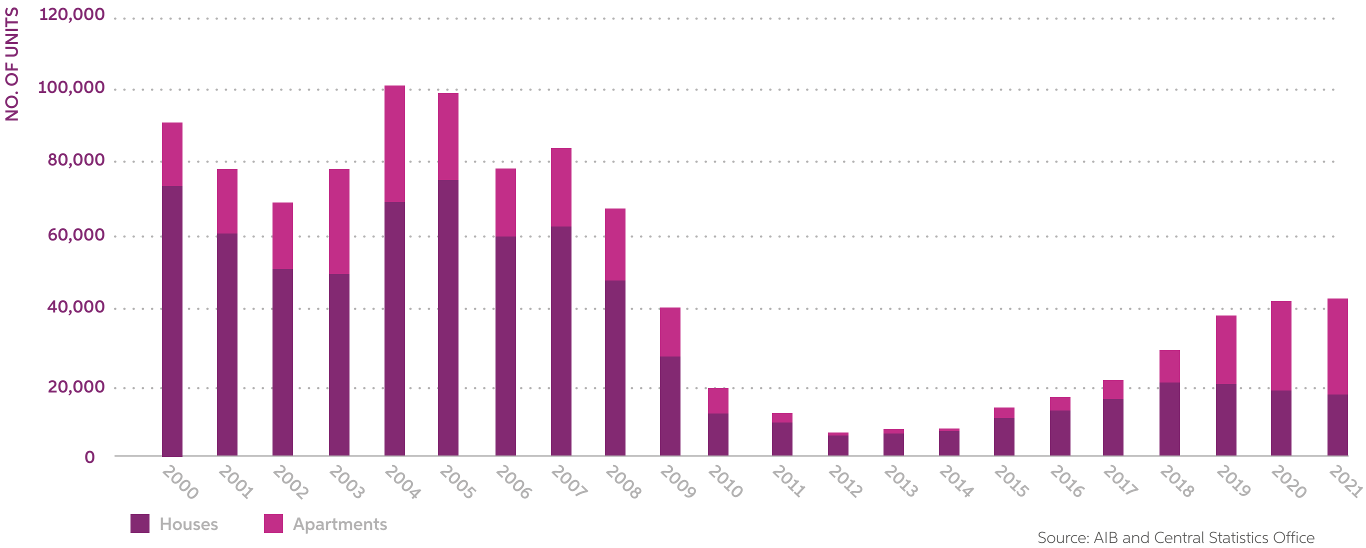


Source: AIB and Central Statistics Office

However, the increased prominence of apartment planning permissions has only been a feature of the market since late 2019/early 2020. Historically, housing applications (scheme houses and one-off houses) have dominated. Figure 9 illustrates the annual number of new residential unit planning permissions since 2000 for houses and apartments. Prior to the 2007/2008 financial crisis, planning permissions for houses were multiples of planning permissions for apartments. In the years after the financial crisis, i.e. up to around 2016, residential building activity and planning permission grants were largely moribund. However, since 2017 (when residential building activity started to recover) the growth in apartment planning permission grants has far outpaced the growth in housing planning permission grants.

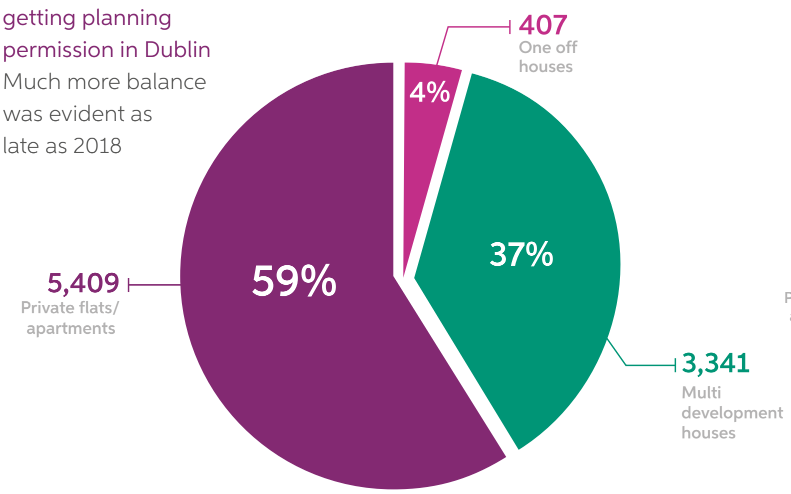
The concentration of apartment unit planning permissions is even more pronounced in Dublin, accounting for over 94% of all permissions granted in 2021. This number has accelerated quite sharply since 2018, when apartments accounted for less than 60% of permissions granted. However, the viability of apartment development has been an ongoing challenge in the Dublin market (and to date has not been viable outside of the Dublin market for the most part). This has meant that a large proportion of these apartment unit planning permissions in Dublin have not been converted into commencements or completions.

Figure 9
Apartments increasingly dominate planning permissions
But costs and rising yields make apartment development increasingly challenged

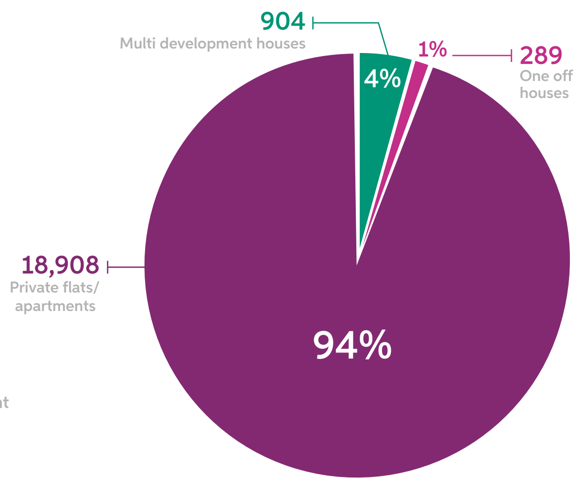


Source: AIB and Central Statistics Office

Figure 10
Nothing but apartments getting planning permission in Dublin
Much more balance was evident as late as 2018



Dublin residential planning permissions 2018



Dublin residential planning permissions 2021

Source: AIB and Central Statistics Office

Apartment viability particularly in question

The viability challenge has increased over the past year due to the significant cost inflation that has occurred. Unfortunately, viability is likely to deteriorate further over the coming year, if as seems likely, apartment/PRS yields increase in Ireland. In fact, we are concerned that there could be a significant decline in apartment completions over the next 12 to 24 months, to the point where new housing supply numbers could actually contract next year and in 2024.

Estimates from various sources[24] indicate that the average development cost for the construction of a two-bedroom apartment in a medium-sized development was in the region of €450,000 to €500,000 prior to 2022 (i.e. before the sharp acceleration in construction cost inflation). These development costs have increased by around 15% over the intervening 12 months. This would indicate that the development cost of a two-bedroom apartment in a medium-sized development has increased to in the region of €520,000 to €575,000. Strong rental growth for new apartments has mitigated some of the viability challenge that these higher costs have caused over the past year.

According to Daft.ie, the average rental prices per month in Dublin in Q2 2022 were:

- North County Dublin €1,987
- North City Dublin €2,111
- South City Dublin €2,264
- City Centre Dublin €2,121
- South County Dublin €2,387
- West County Dublin €2,045

Taking a simple average, this is around €2,150 per month. Based on a €520,000 apartment development cost and an average rent of €2,150, this results in a gross yield of 5.0% and a net yield of 4.0%.[25]

24. The Real Costs of New Apartment Delivery, Society of Chartered Surveyors Ireland (SCSI), January 2021; Institutional Investment & the Private Rental Sector in Ireland, Irish Institutional Property (IIP), June 2021.

25. This analysis is a very simplified, aggregated approach. Each individual apartment development project is unique and with different base costs and capital structures and thus the movement of yields will impact each project differently.

However, the risk is that PRS yields will increase over the coming year given the movement in bond yields to date and the experience of other European PRS markets. Irish 10-year bond yields have increased from 0.25% at the end of 2021 to around 2.80% as of November 2022. This has resulted in the spread between prime PRS yields narrowing from around 325 basis points at the end of 2021 to around 100 basis points in November 2022. The current spread of 100 basis points is not likely to be sustainable and some widening of the spread between prime PRS yields and 10-year Irish Government bond yields is expected to occur over coming months.

Unfortunately, even a 50 basis points increase in net yields (and assuming rents remain unchanged) could result in the capital value of an apartment falling below the cost of development. A 100 basis points increase in yields would result in the capital value of an apartment falling to around €415,000, and thus result in the near cessation of new apartment commencements.

In a rising yield environment, it is evident that the viability of apartment development is going to be even more challenged and will likely result in a sharp drop in apartment commencements and completions over the coming 12 to 24 months.

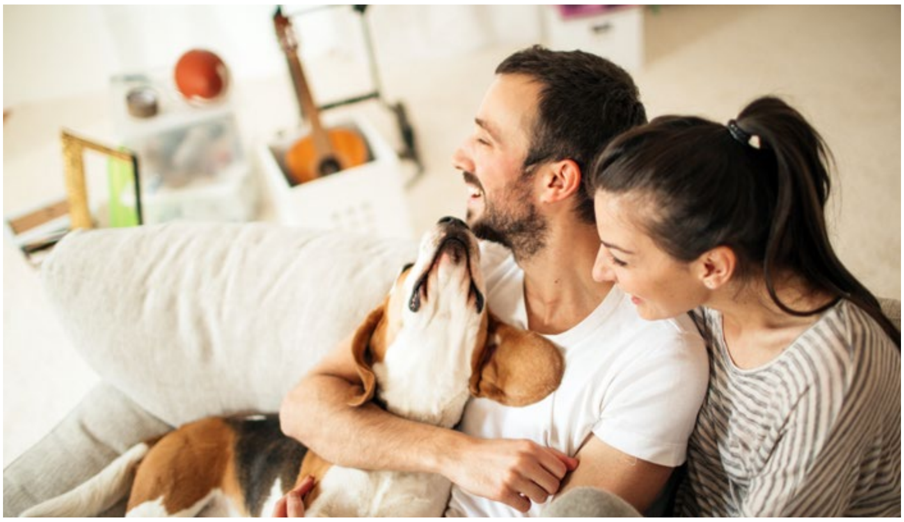
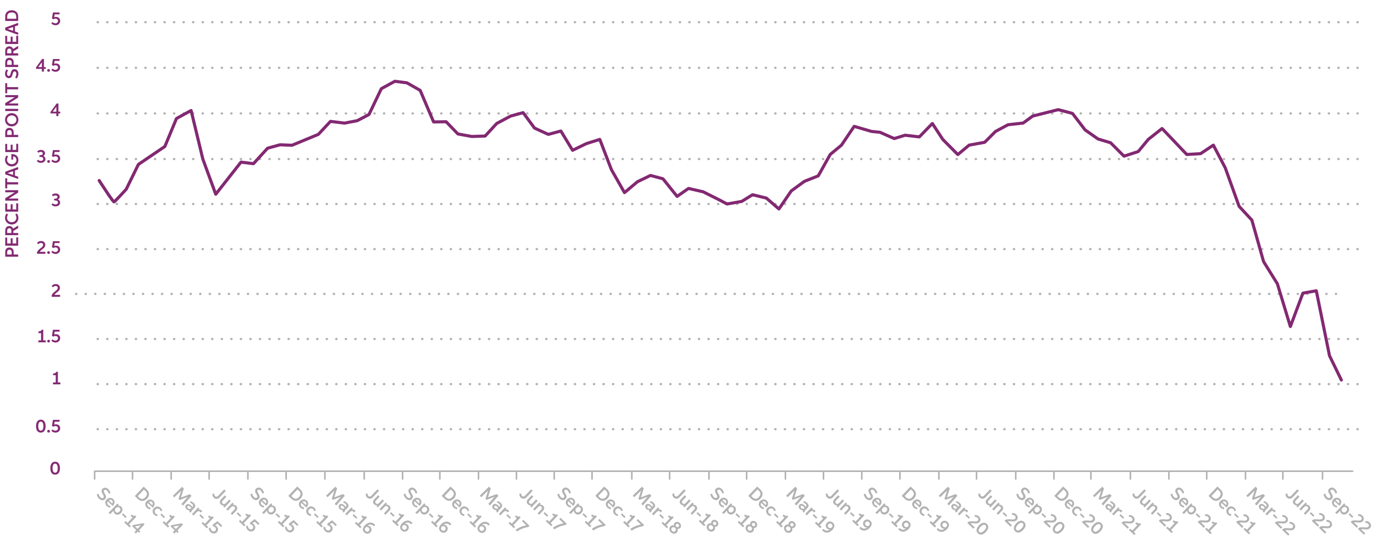


Figure 11

Dramatic narrowing of prime PRS and 10-year bond yield spread

The current spread of 100 basis points is not likely to be sustainable and some widening can be expected



Source: AIB, CBRE and Central Bank of Ireland

Density requirements are driving planning permissions

There are a number of reasons for the near exclusive concentration of apartment planning permissions in the Dublin market. However, the primary reason is the requirement for density by the planners in Dublin, the origins of which date back to the publication of the Urban Development and Building Heights Guidelines for Planning Authorities Guidelines in December 2018. These guidelines "link increased building heights to higher density forms of development and tie both back to considerations of transport interconnectivity, in line with the locational criteria for increased density established by the 2018 Sustainable Urban Housing: Design Standards for New Apartments."[26]

It is well documented[27] that Ireland and its key urban areas have a shortfall in the number of apartments and residential units that are more suited to smaller household sizes. According to the Organisation for Economic Co-operation and Development (OECD), apartments account for 9% of the housing stock in Ireland, whereas the European Union (EU) and OECD averages are 42% and 40%, respectively. However, as discussed above, the viability of apartment construction is a huge challenge and the costs of development make apartments a very expensive option for owner-occupiers.

Heretofore, the only realistic buyers of apartment developments were institutional buyers (both the private and public sector). Private institutional buyers are likely to be considerably less active over the next 12 to 18 months. Reliance on the public sector as a buyer will have to increase if we are to see any reasonable supply of new apartment developments over the next few years. In this context, the role of the Land Development Agency will become increasingly important along with the activities of the Approved Housing Bodies and local authorities.

26. Building Height and Density Guide – Assessing Densities and Building Heights in South Dublin, South Dublin 2022-2028 County Development Plan.

27. https://www.oecd.org/social/family/HM1-5-Housing-stock-by-dwelling-type.pdf
and https://ec.europa.eu/eurostat/web/products-eurostat-news/-/ddn-20210521-1

6

Compact growth design standards – potential for increased supply

Apartments should be concentrated in the city core and along key, well-serviced public transport nodes. Outside of these areas, apartments are not the ideal solution, particularly in an Irish context. However, where densities of 35 to 50 units per hectare are required, there is a reliance on apartments to provide such levels of density. This results in apartments and duplex apartments featuring in locations where they are not the optimum form of housing.

Planning authorities need to consider and accept other forms of density, such as low-rise, medium-density housing, as has been suggested by a wide range of industry participants.[28] Such an approach is more appropriate for suburban locations in our cities and towns. This approach does not replace the requirement for apartment development, but it does provide for more viable optionality in locations where apartments are not suitable.

As Property Industry Ireland (PII) notes: "At present, the solution to the optimisation of land use has been to propose traditional apartment construction rather than housing alternatives based on European best practice which consider consumer need or demand. While apartments are a viable option for some locations – our core city centres as just one example – there are many communities, particularly the suburban areas of our cities and towns, where apartment living is not the optimal choice."[29]

Glenveagh Properties plc has outlined detailed compact growth design standards[30] that would achieve densities of 35 to 50 units per hectare without constructing apartments, thereby still delivering on the national policy of providing compact, sustainable and liveable settlements but on a much more viable basis.

One of the main problems of including apartments and duplexes in residential development schemes is that they raise minimum required prices across the entire development. As mentioned previously, this is because apartments tend to be more expensive to build than houses According to Glenveagh Properties, the replacement of apartments and duplex apartments (45% of a scheme) with 100% own-door housing would result in a cost saving of €802 per square metre or an overall 20% cost saving across the entire development. That would result in the minimum selling price falling from €376,000 per unit in the traditional model to €315,000 per unit if using the new compact growth design standards.

28. Sustainable Compact Growth Design Standards, Glenveagh Properties plc, 2022; 'Why we're not building enough affordable houses', by Tony Reddy, The Irish Times; Property Industry Ireland (PII) Recommendations for New Housing Design Standards, August 2022. Other contributions by the Royal Institute of the Architects of Ireland and the SCSI have been made to argue for medium-density housing development standards to be implemented in Ireland.

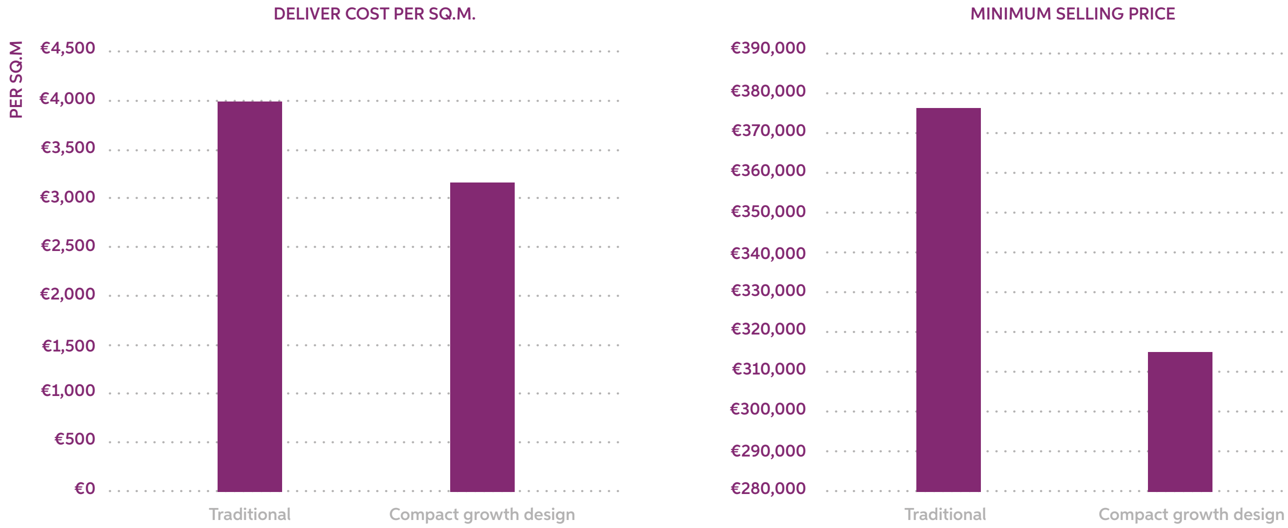
29. Property Industry Ireland (PII) Recommendations for New Housing Design Standards, August 2022.

30. Sustainable Compact Growth Design Standards, Glenveagh Properties plc, 2022

Figure 12

Compact growth design standards-significant reduction in costs

Potential for significant reduction in costs and selling prices while house sizes remain unchanged



Source: Glenveagh Properties plc

In a recent Irish Times opinion piece, Tony Reddy[31] provides an excellent description of the type of low-rise, medium-density, own-door accommodation that should form part of future housing supply in our suburban areas of cities and towns.

He notes: "Yet, many of the most-favoured and sought-after residential areas in our cities and towns – Phibsborough, Portobello, Ranelagh, Rathmines, Turners Cross and Stoneybatter – were designed and constructed prior to the introduction of these standards.[32] These neighbourhoods are attractive precisely because of the compact density and fine urban grain they achieve. They are closer in character to the urban form and densities of new residential communities permitted by modern European planning standards."

31. 'Why we're not building enough affordable houses', by Tony Reddy, The Irish Times, 13 August 2022.

32. The standards referred to are the housing design standards that date back to the period following the First World War when the UK Tudor Walters Report and the principles of the Garden City Movement were first introduced.

There have been a number of misconceptions about the above proposals since they were first published, including:

Misconception 1
'Reduction in house sizes':

There is no reduction in house sizes being proposed. What is being proposed is that the 22 metre separation distance under current development standards is reduced to a 16 metre separation for rear façades. This is applying the same rationale that is currently acceptable to the front façade in certain situations. It also aligns the separation distances with UK best practice standards.

Misconception 2
'Reduction in parking and bin store curtilage area':

No reduction is proposed. Rather, the focus is on ensuring that a higher proportion of occupiers avail of their own private parking and bin/bike stores.

Misconception 3
'Reduction in garden sizes':

This interpretation does not recognise the fact that all own-door residential units will have a 40 square metre private garden/open space. Currently, under the traditional standards, at 40 units per hectare, 45% of the scheme will consist of apartments duplex apartments resulting in private open space in these units being limited to between approximately 5 square metres and 7 square metres (i.e. just balconies). Ultimately, what is being proposed is a more balanced and holistic approach, thus ensuring that a higher percentage of units would avail of better functionality, coupled with an increase in the amount of private open space (25% increase across the scheme).

Misconception 4
'Overhaul of standards':

The proposal is not a complete change in the entire development standards. What is being proposed is three simple 'asks' related to changes that have already been implemented to date in Ireland:

1. Relaxation of the current 22 metre separation distance to 16 metres.
2. Public open space: 10% of the overall scheme.
3. Private open space: minimum of 40 square metres for all own-door housing.

Enhanced public space provision

Traditional public space provision is generally characterised by a single large open space that is provided for all units in the scheme. These spaces lack function and are often desolate and underutilised most of the year. The majority of the units are also situated a considerable distance from the open space.

The compact growth design standards provide for a more innovative design that places an emphasis on higher quality outdoor space and a higher quantum of pedestrian priority streetscapes. This ensures that the open spaces are much more user friendly and accessible to the local community and result in much greater rates of utilisation.

More viable, affordable and ultimately more supply

This form of development would facilitate more completions, as it would underpin a greater flow of viable developments and result in more affordable residential units for consumers. Density would improve, increasing from approximately 32 houses per hectare to 50 houses per hectare without constructing apartments and duplex apartments, while also maintaining unit sizes and enhanced public space provision.

That is, land use will be optimised through the achievement of appropriate densities without the need to construct apartments or duplexes. The compact growth design standards would deliver a high quality housing product that is also affordable for the consumer.

7

De-zoning of land – perplexing in an era of low supply

Savills[33] has recently highlighted the issue of land being de-zoned within the GDA with local authorities de-zoning enough land to deliver more than 100,000 new homes from their housing delivery plans, including de-zoning significant areas of the commuter belt.

The driving force behind the de-zoning is demographic forecasts and estimated housing requirements incorporated in the Housing Need and Demand Assessment (HNDA) model used by county councils/ local authorities.

County councils/local authorities are required to undertake HNDAs to estimate housing requirements as part of their regular development planning process. Underpinning the HNDA model is the National Planning Framework (NPF) 50:50 demographic scenario. This is the recommended housing demand scenario used by planning authorities in their planning functions and it underpins their respective development plans (as per Section 2.9 of the Development Plans Guidelines for Planning Authorities).[34]

The NPF 50:50 city scenario projects housing demand for each local authority dating from the publication of the 2016 Census findings and covering the period 2017–2040. It is based on various assumptions: fertility and mortality; international migration; obsolescence; internal migration; and headship rates. Unfortunately, a number of key assumptions underpinning the 50:50 approach to demographic forecasts and housing requirements are not reflective of what is actually happening in the Irish market.

50:50 balanced growth underestimates the growth of the GDA and surrounding counties

As Savills[35] has highlighted, a key issue with the HNDA model "is that rather than using the baseline spatial population scenario produced by the ESRI, the NPF uses the 50:50 balanced growth scenario. More a policy goal rather than likely outcome, this envisages growth to be equally split between the mid-east region (which incorporates Dublin) and the rest of Ireland, with Dublin city pencilled in to grow by between 20% and 25% by 2040, a rate of growth just ahead of the national average. In contrast, the cities of Cork, Limerick, Galway and Waterford are allocated to grow by 50% over the period, more than double the rate of Dublin. Basing planning on desired growth patterns is flawed because they are unlikely to come to fruition."

33. The Residential Land Supply Study, Savills, 2022.

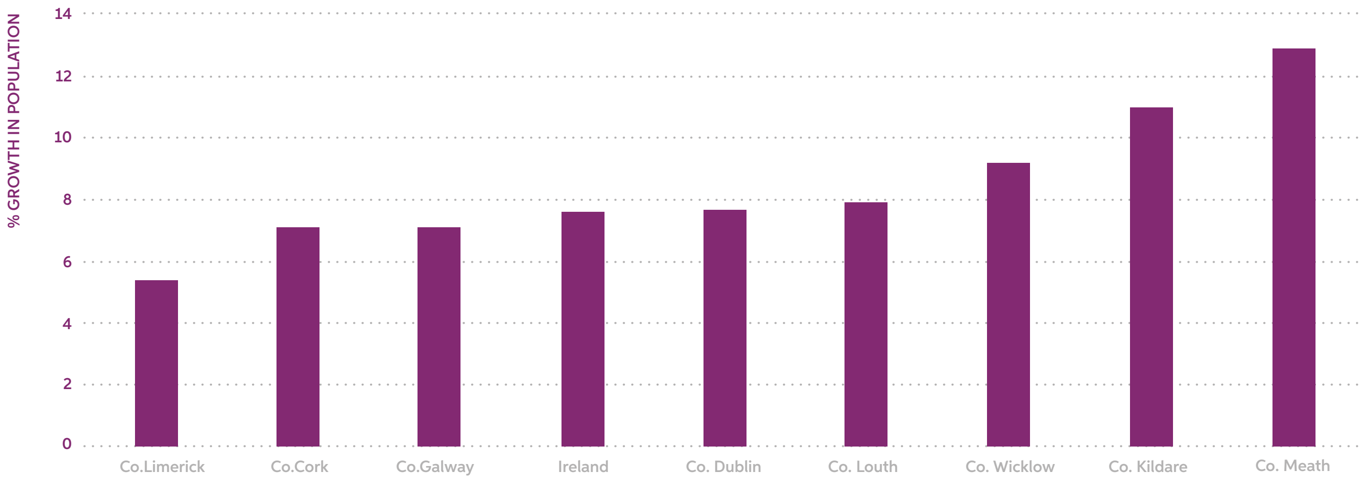
34. The preparation of the HNDA is also set out under the Development Plans Guidelines for Planning Authorities. The requirements of the Housing Supply Target Methodology for Development Planning – Guidelines for Planning Authorities issued under Section 28 of the Planning and Development Act 2000 (as amended) also apply. (Department of Housing, Local Government and Heritage, December 2020).

35. The Residential Land Supply Study, Savills, 2022.

The Census 2022 Preliminary Results highlight that the percentage increase in population numbers in the GDA is outpacing the numbers in counties Cork, Galway and Limerick, as can be seen in Figure 13. Between 2016 and 2022 the population of Co Dublin grew by 7.7%, while the population in the surrounding counties of Meath, Kildare, Wicklow and Louth grew by 12.9%, 11.0%, 9.2% and 7.9%, respectively. However, the population of counties Cork[36] and Galway each grew by 7.1%, while Limerick grew by only 5.4%. In order to be in line with the 50:50 growth plan, these counties would need to be growing at rates of double or more than what they have already experienced or, conversely, the population growth in the GDA and surrounding counties would need to halve or more.

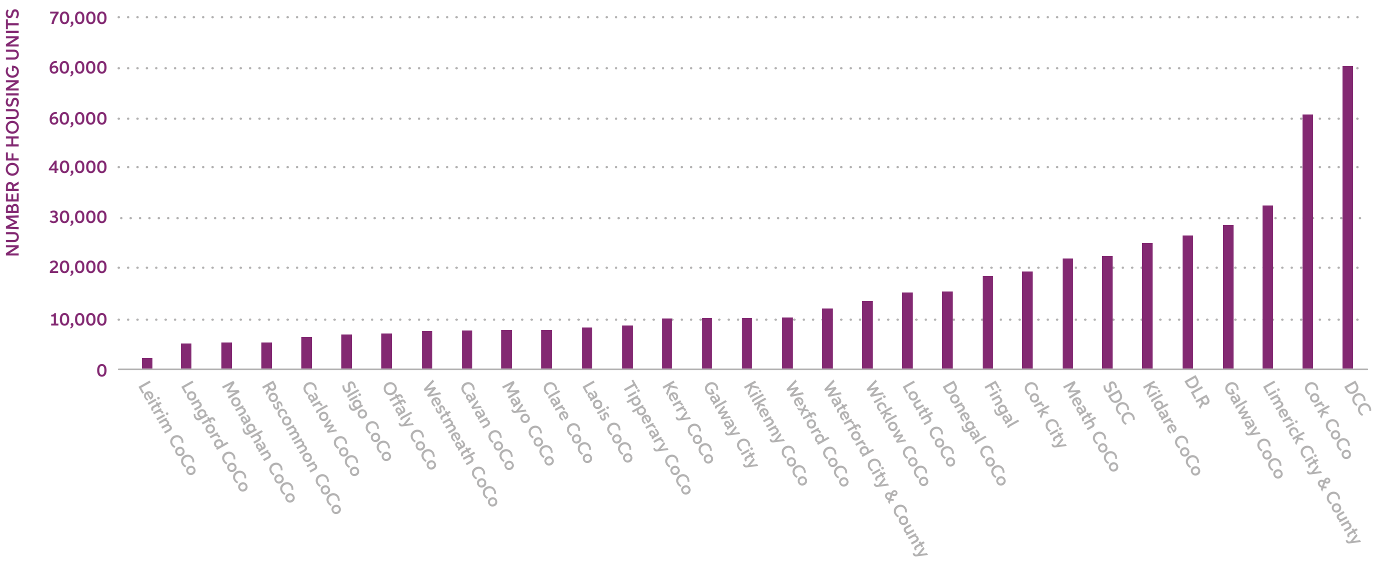
A more detailed analysis of the HNDA model by county/local authority area highlights inherent weaknesses in this approach to setting future supply. Figure 14 shows the number of residential units each county/local authority is estimated to need between 2022 and 2040 under the HNDA model. The impact of the 50:50 component in the HNDA model can clearly be seen in the ranking of the top 10/15 counties/local authorities.

Figure 13
Population growth concentrated in Dublin and the GDA
50:50 demographic projections not panning out



Source: Census 2022, Central Statistics Office

Figure 14
HNDA under estimates housing requirements in Dublin and the GDA
HNDA model assumptions are aspirational in nature, rather than grounded in actual demographic trends



Source: HNDA

36. Inclusive of Cork City and Cork County Council.

Based on the 50:50 approach, Limerick and Galway are estimated to have a greater housing requirement than Dun Laoghaire Rathdown, South County Dublin, Fingal, and Co. Kildare, even though as of 2022 they have smaller populations (and in some cases considerably so). Essentially, the 50:50 component is aspirational in nature, rather than grounded in actual demographic trends.

Fingal – a striking example

One of the most striking observations is the fact that Fingal is estimated to need a total of just 18,560 new units between 2022 and 2040 (apparently not much more than the 15,500 residential units that is the estimated requirement for Co Donegal). This level of estimated demand belies the fact that Fingal has been one of the fastest-growing local authority areas over the past two decades, has one of the youngest populations in Ireland, has ample land to grow further, and has significant infrastructure in place.

This is especially so when one considers some of the key characteristics of Fingal, including:

- Fingal is the third most populous local authority area in Ireland (after Dublin city and Cork county) with a total of 329,218 people in 2022. Between 2006 and 2022 the population in Fingal increased by 37.1%, or by just over 89,000 people. There was an increase of 11.2% (33,198 persons) between 2016 and 2022. This was considerably higher than the national average growth rate of 7.8% for the same period.
- Fingal County Council is the youngest local authority in the State (at 33.8 years) which is 3.7 years lower than the State and 2.5 years lower than Dublin average.
- Fingal County Council estimates that it has an urban residential yield capacity of 35,206 units.[37]
- Fingal benefits from strong transport connections with Dublin Airport, the Dublin Port Tunnel and its strategic road and rail corridors. Among the infrastructure developments planned for Fingal are strategic public transport investments such as MetroLink, BusConnects, LUAS expansion and the DART+ programme.

37. Fingal Development Plan 2023–2029 Draft Plan: Urban Capacity Assessment.

Unmet demand

Another feature of the HNDA model is that it does not take into account unmet demand from under-construction and rates of homelessness. The HNDA model focuses on population and housing need projections and, as a result, it further underestimates the true level of housing demand. Each county council/ local authority must amend the model output to incorporate estimates of unmet demand and homelessness. However, the calculation of unmet demand is the difference between what the HNDA model projected for previous years and the actual level of completions in those years. Again, this level of unmet demand is dependent on the accuracy of the HNDA model itself. For example, calculating the unmet demand for the Fingal Development Plan 2017–2023 is summarised in the following table:

The Economic and Social Research Institute (ESRI) baseline scenario is now probably too conservative

The Census 2022 Preliminary Results also indicate that the Economic and Social Research Institute (ESRI) baseline scenario is too conservative. For example, under the ESRI baseline scenario, the population was expected to increase by around 926,000 people between 2016 and 2040, resulting in a total population of over 5.665 million by the end of the period. However, this forecast was produced in 2020, before the Census 2022 Preliminary Results were released. According to the Preliminary Results, the population increased by 361,671 between 2016 and 2022, and now stands at 5,123,236.

Table 3
Calculations of the unmet demand for the period 2017 - 2023

Year	NPF 50:50 Scenario projections	Actual completions	Unmet demand=NPF 50:50 Scenario projections - Annual completions
2017	2,067	1,438	629
2018	2,332	1,830	502
2019	2,431	1,802	629
2020	2,222	1,640	582
Q1 & Q2 2021	1089 (=2,178/2)	461	628
Q3 & Q4 2021	1,089 (As above)	797	292
2022	1,957	1,594	363
Q1 2023	Projected divided by 4(1,778/4) = 445	398	47
Total unmet demand for period 2017 - 2023			**3,672**

Source: Fingal Housing Strategy Draft (2023-2029)

Maintaining the ESRI baseline scenario implies that the growth in the population between 2022 and 2040 is restricted to just around 542,000, or close to 10%. In the past 10 years alone, the population has increased by 11.5% or around 529,000. Given underlying demographic trends, there is no reasonable basis to assume that the population will grow by only 10% over the coming 38 years. Furthermore, as highlighted by Dr Ronan Lyons, "the HNDA is based on a view of the future where Ireland's net migration is just 15,000 per year. Even averaged over the past 25 years, net migration has been over 22,000 per year… net migration for the rest of the decade could be twice that long-run average and three times the number in the HNDA."[38]

Change urgently required

Consequently, it is increasingly apparent that the NPF, and as a consequence the HNDA, are built on overly conservative forecasts for demographic change and housing demand. Also inherent in the 50:50 plan are unbalanced assumptions about the centres of population growth and housing demand in Ireland.

The actual levels of population growth in the GDA are placing significant pressures on these housing markets, but the local authorities are constrained from responding fully to these pressures due to the HNDA. In fact, the demographic assumptions underpinning the NPF, and in turn the HNDA, are resulting in residential lands being de-zoned. The NPF and the HNDA need to be urgently reviewed and updated and they need to incorporate the following:

- The Census 2022 Preliminary Results population numbers.
- The ESRI baseline assumptions.
- The 50:50 model and the assumptions underpinning this approach.

38. 'Official Ireland can't comprehend how fast the country is growing. That's a big problem', By Dr Ronan Lyons, The Currency, June 28, 2022.

CONCLUSION

We have long argued that there has been a viability problem in the Irish housing market, and particularly in the Dublin market. The viability problem was caused by the existence of an affordability wedge between what a two-income household on average incomes could have borrowed at the 3.5 LTI limit and what it costs to buy a typical FTB home. This had the effect of widening the gap between latent, underlying demographic demand and actual viable demand. In other words, the affordability wedge had the effect of suppressing much of the long-term demand and turned a significant proportion of it into latent demand (and as a result shifted large swathes of demand into the rental market).

However, much has changed on this front over the past year with the introduction of the FHS and the increase in the FTB LTI limit to four times income. In our view, these two factors, combined with the Help to Buy scheme, have helped to significantly address the demand side viability problem.

In order to maximise the benefits of these interventions, the housing market needs to see an increased supply of residential units, and particularly of FTB scheme/multi-development houses. Unfortunately, notwithstanding the above supports for households, the viability of apartment construction remains a huge challenge and a very expensive (and probably unrealistic) option for FTBs.

Heretofore, the only realistic buyers of apartment developments were institutional buyers (both the private and public sector). However, private institutional buyers are likely to be considerably less active over the next 12 to 18 months.

Consequently, reliance on the public sector as a buyer will have to increase if we are to see any reasonable supply of new apartment developments over the next few years. In this context, the role of the Land Development Agency will become increasingly important along with the activities of the Approved Housing Bodies and local authorities.

In any event, apartments should be concentrated in the city core and along key, well-serviced public transport nodes. Outside of these areas, apartments are not the ideal solution, particularly in an Irish context. However, where densities of 35 to 50 units per hectare are required, there is a reliance on apartments to provide such levels of density. This results in apartments and duplex apartments featuring in locations where they are not the optimum form of housing.

Planning authorities need to consider and accept other forms of density, such as the compact growth design standards. Such an approach is more appropriate for suburban locations in our cities and towns. This approach does not replace the requirement for apartment development, but it does provide for more viable optionality in locations where apartments are not suitable.

This form of development would facilitate more completions, as it would underpin a greater flow of viable developments and result in more affordable residential units for consumers. Density would improve while also maintaining unit sizes and enhanced public space provision. It would provide real viability at scale to FTBs and ensure that the interventions by the authorities on the demand side of the market would be fully realised.

DISCLAIMER

Donall O'Shea
Head of Real Estate Finance
Donall.a.o'shea@aib.ie

Derek O'Shea
Head of Development Finance
Derek.p.o'shea@aib.ie

Patrick O'Sullivan
Head of Real Estate Research
Pat.p.o'sullivan@aib.ie

AIB
10 Molesworth Street
Dublin 2

+353 (0)1 660 0311