The Irish Housing Market – 'Progress, But Challenges Remain'

AIB Real Estate Finance

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January 2019

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Introduction

Increased supply, but still lagging behind demand

Housing supply saw a reasonably sharp increase in output in 2018. We estimate that between 18,000 and 18,500 units were built last year, up from 14,500 in 2017. Unfortunately, this increase in output still lags significantly behind underlying demand which is running at an annual rate of approximately 35,000 units. A number of factors have hampered the supply of housing in Ireland over the past 12 months, but the primary reason remains the fact that 'the costs of building houses and apartments – especially the starter-home market and the affordable housing market – are, in general, still too high.' This was the main point that we made in last year's *AIB Housing Supply in Ireland report*. This, and the other main recommendations we made in last year's report still stand.

The Government made policy changes with respect to apartment development that should help improve the sector's viability. However, the viability of starter homes remains very challenging. We still believe that the combination of levies, taxation and higher building standards imposes significant costs that continue to constrain supply of starter homes.

Longer-term, we still remain of the view that the key to solving the housing crisis is to increase the supply of serviced land available to builders. In this regard, we broadly welcome the creation of the Land Development Agency (LDA). The aim of the LDA is to provide land for up to 150,000 houses over the coming 20 years. With a budget of €1.25 billion, the plan proposes to focus on managing lands already owned by the State where new homes can be developed, and to regenerate under-utilised sites. The agency will also assemble strategic land banks in the long term from a mix of public and private land. The LDA should greatly help the supply of land for residential development but its true impact will only be felt over the medium to long term.

This report is a follow-up to the AIB Housing Supply in Ireland report, published in early 2018. It looks at what has changed in the past year, and what needs to be done in order to create a functioning and sustainable housing market in Ireland.

The table below summarises the main recommendations contained in last year's report and details any changes that have occurred in the intervening 12 months:

Original recommendation	Update over past 12 months
Reduction in VAT - in lieu of a reduction in levies, a targeted cut in the rate of VAT should be considered for a period of time.	We still believe that the costs of building new houses for the starter home market and affordable home market are too high and need to be addressed.
Reform tax code for private landlords - we believe individual private landlords should be encouraged back into the market and placed on a more equal footing with their institutional equivalents.	No significant change in terms of tax reform for private landlords occured last year. This sector has a key part to play in providing rental accommodation.
Encourage downsizing - help develop a senior housing market in Ireland in order to free up under-utilised family houses.	An area of vast potential to free up under-utilised family homes.
Comprehensive review of building standards and requirements with a focus on apartments.	The published review and updated standards is very helpful and should result in more apartment developments coming to the market.
Certain parts of Dublin city should be designated for even greater height and density than what the current regulations permit.	The recent changes to planning guidelines with respect to height and density will result in more apartment schemes being built.
The maximum residential price at which levies can be waived should be increased to €400,000 in Dublin and €350,000 in Cork.	No change here and should be considered, especially in lieu of no changes to other development costs.
Increase resourcing in the main planning authorities.	Some progress made in this regard, but more resourcing and greater efficiency of existing resources required.
Attract institutional capital into the Irish social and affordable housing market.	Progress made on this front with the launch of the Enhanced Long Term Social Housing Scheme in January 2018.

Key Points

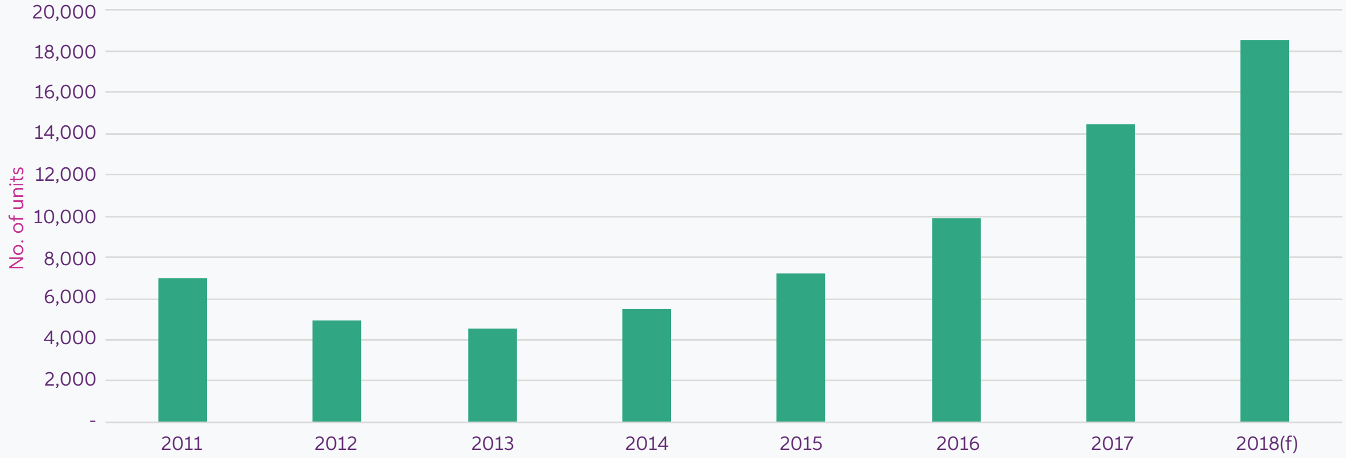
- Housing supply is increasing, but the estimated 18,000 to 18,500 new units completed in 2018 is still not enough to satisfy underlying demand.
- As we stated in last year's report, 'the combination of the cost to build starter homes and the LTI limits on incomes of the typical first time buyer has caused an affordability wedge that is not easily resolved.'
- This affordability wedge and the resultant difficulty for households on average incomes to purchase new homes means that the pressure to increase the provision of social and affordable homes will continue to grow over the coming years.
- Over the course of the past 12 months while viability has improved (due to higher residential prices), we believe that costs such as levies, taxation and higher building standards still pose a real impediment to increased output and supply, in particular for households on average incomes and below.
- Government policy and interventions should focus on the provision of new builds / supply of social and affordable housing. The best way this could be achieved is in conjunction with the construction sector combined with a targeted approach to reduce the costs of new residential units.
- More investment in, and the promotion of, construction apprenticeships will be necessary to attract new entrants into the industry. In addition, the sector will have to widen its net to non-EU nationals in order to attract construction workers.
- Apartments will play a key role in helping to solve the housing problems facing our key urban centres especially as apartments are under-represented as an accommodation type in the Irish market.
- We would welcome a decision to extend the Help-to-Buy scheme. However, we suggest that it is not delayed until the announcement of the Irish Budget in October, and should instead be announced as early as possible in 2019. An early decision would avoid an inevitable scramble by prospective first-time buyers (FTBs) trying to transact in the months leading up to October and would allow developers to plan with greater certainty for 2019 and beyond.
- The Enhanced Long Term Social Housing Leasing Scheme has already attracted a number of institutional investors who have raised capital specifically to develop / acquire residential units in order to participate in this scheme and we believe that additional institutional investors will emerge in 2019

1. Housing Supply

Supply accelerating, but from a low base

Housing supply increased strongly (albeit from a low base) in 2018 with 12,582 units completed in the first three quarters of the year compared with 14,435 units built in all of 2017. For 2018 as a whole, we expect 18,000 to 18,500 units to be completed which is 25% to 28% higher than in 2017.

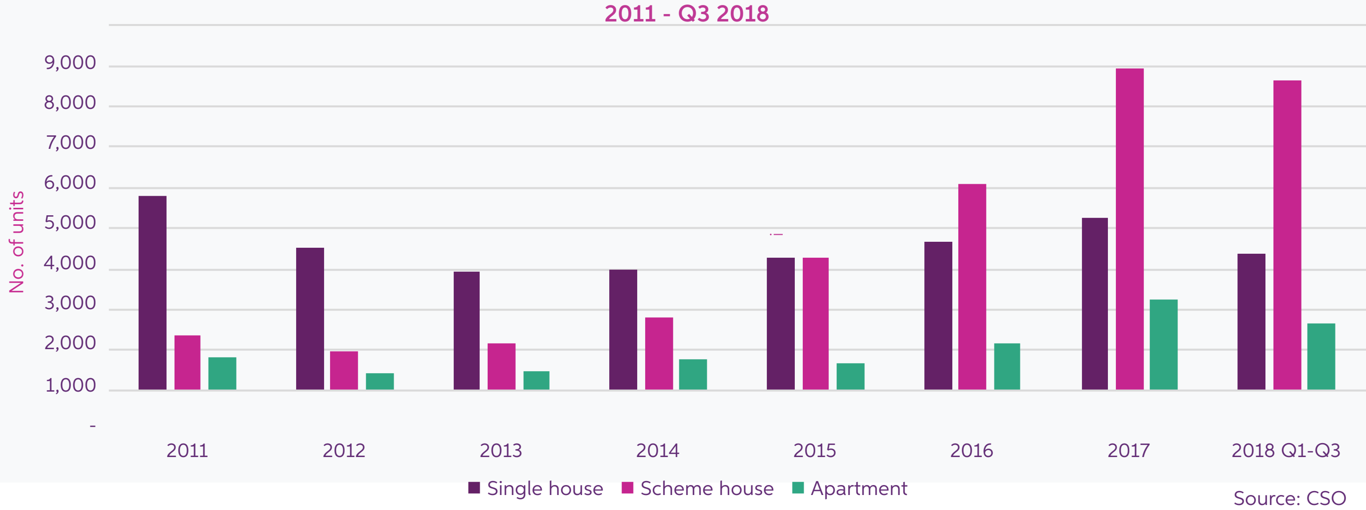
Figure 1: Residential units - total completions



Source: CSO

In terms of the mix of housing, scheme houses accounted for 60.5% of all units completed during 2018 up to Q3, whereas apartments accounted for just 12.9% of all units in the same period. The construction of scheme houses has exhibited much stronger growth than the construction of apartments over the last three years, as it was generally not viable to build apartments due to the higher costs of development. However, it is expected that the construction of apartment developments will increase over the coming years due to recent changes to planning guidelines for apartment standards, in addition to guidelines for height and density. Nevertheless, the issue of viability is still a challenge as discussed in section 4 of the report.

Figure 2: New dwelling completions (No. of units) 2011 - Q3 2018

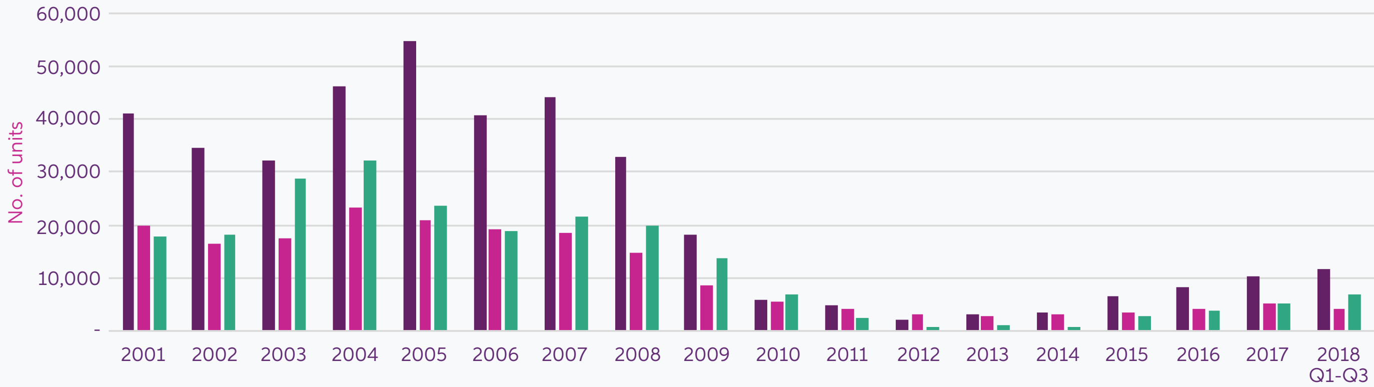


Source: CSO

Strong increase in planning permissions

The upward trend in new housing supply looks set to continue, with 22,561 units granted planning permission in the first three quarters of 2018, across 5,129 projects. This represents a 63% increase on the 13,842 units approved in the same period in 2017, and a 10.3% rise in the number of schemes. While it is encouraging to see such a strong percentage increase in the number of units receiving planning permission, the actual level of planning permissions still falls far short of the number required in order to meet underlying demand.

Figure 3: Units for which planning permission granted
By type of dwelling, national



Source: CSO

Regional housing supply requirements

Table 1 summarises housing unit forecasts for various local authorities in Ireland sourced from their respective Regional Planning Guidelines (RPG). The housing unit forecasts are an estimation of the number of new units required by 2022. It is clear from Table 1 that the required number of new residential units between 2019 and 2022 far exceeds the respective number of planning permissions currently in place.

Table 1: Future housing supply requirements

Housing units			Forecast	Required supply increase	Required units per annum 2019-2022	Completions 2017	Completions 2018 Q1-Q3	Planning permissions 2017 (units)	Planning permissions 2018 Q1-Q3 (units)
Local Authority	2010	2016	2022						
Cork City	52,377	62,730	74,638	11,908	2,905	130	159	310	1,092
Cork County	170,217	196,314	220,358	24,044	5,423	1,266	1,085	1,521	2,951
Dublin City	223,098	265,519	319,903	54,384	12,895	1,589	1,215	2,706	1,759
Dun Laoghaire-Rathdown	77,508	98,023	117,893	19,870	4,438	1,189	930	907	2,472
Fingal	89,909	118,646	142,144	23,498	5,018	1,827	1,600	2,522	1,811
South Dublin	87,484	115,373	137,948	22,575	5,115	980	1,137	654	1,334
Kildare	68,840	93,748	112,477	18,729	4,230	983	825	2,172	2,653
Meath	61,257	79,729	95,458	15,729	3,398	1,108	1,031	1,307	1,209
Wicklow	49,088	68,351	82,012	13,661	3,198	481	387	1,051	694

Source: Regional Planning Guidelines 2010-2022

For example, the RPG forecasts that Dublin City will require a total of 319,903 residential units by 2022, an increase of 54,384 from 2016. After allowing for the number of completions between 2017 and Q3 2018 (2,804), this means that the required number of new residential units per annum between 2019 and 2022 is 12,895. However, the actual number of residential unit planning permissions for Dublin City falls way short of this number with only 2,706 in 2017 and 1,759 up to Q3' 2018. This pattern is evident in all of the other local authorities outlined in Table 1.

Actual number of residential units in planning comes nowhere near Dublin City's requirement of 12,895

From an overall perspective, AIB's Economic Research Unit, in its December Housing Market Bulletin, stated that 'Housing output needs to double from its 2018 levels to meet annual demand and indeed, rise well above this level to meet the pent-up demand in the sector from the years of under-supply. It could be well into the next decade before supply and demand come close to balance, unless the pace of growth in house building accelerates from here.' Table 2 summarises AIB's forecasts for housing supply and demand.

Table 2: AIB model of estimated housing demand

Calendar Year		2016	2017	2018	2019	2020
Household Formation		26,500	26,500	26,500	27,500	27,500
Of which	*Indigenous population growth*	*18,000*	*18,500*	*17,500*	*16,500*	*14,500*
	Migration flows	*8,500*	*9,500*	*12,000*	*13,000*	*13,000*
	Headship change	*0*	*0*	*0*	*0*	*0*
Second homes		500	500	500	500	500
Replacement of obsolete units		5,000	5,000	5,000	5,000	5,000
Estimated demand		32,000	33,500	35,000	35,000	33,000
Completions		9,900	14,500	18,500	23,000	27,000
Shortfall in supply		-22,100	-19,000	-16,500	-12,000	-6,000

The model assumes no change in headship in 2016-2020. It should be noted that the long-term trend is upwards, and if it resumes in Ireland, this would add to the above demand estimates.

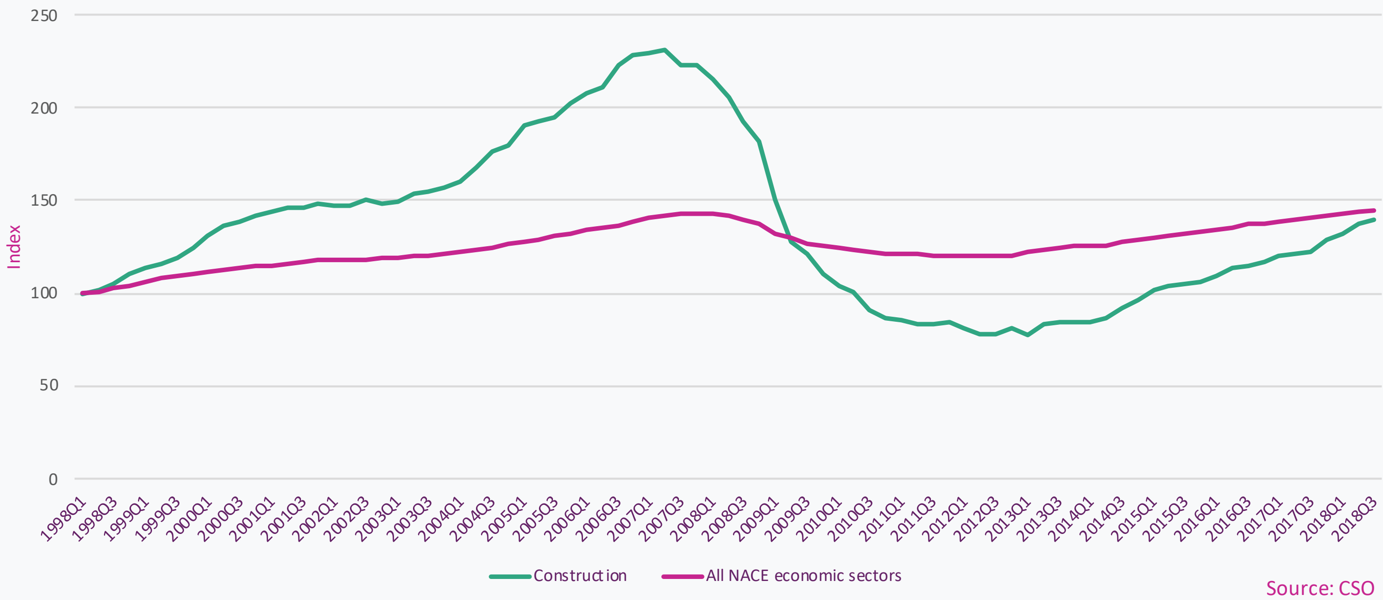
Source: AIB Economics Research Unit

2. Construction labour market

Construction labour – a scarce resource and a challenge for new housing supply

A consequence of Ireland's economic crash was large-scale job losses in the construction sector. From peak to trough, the numbers of people employed in Ireland fell by 16.2%. However, in the construction sector, the numbers employed fell by 67.9% between 2007 and 2013. Prior to the crash, construction accounted for just under 11% of total employment, with 241,000 people working in the sector in Q2 2007. This contrasts sharply with the current size of the construction labour force, with only 146,300 construction workers in Ireland, representing 6.5% of all employment. [1]

Figure 4: Index of total employment vs construction employment



Source: CSO

Ireland's building boom prior to the economic downturn was facilitated by a large number of non-Irish workers, particularly from Eastern Europe. At the beginning of 2007, non-Irish workers accounted for 17% of all construction employment, 75% of which were workers from Central and Eastern European countries. There are currently 12,100 construction workers in Ireland from these countries, less than half of the 30,000 that were employed in the industry in 2007.

Significant increase in additional workers required

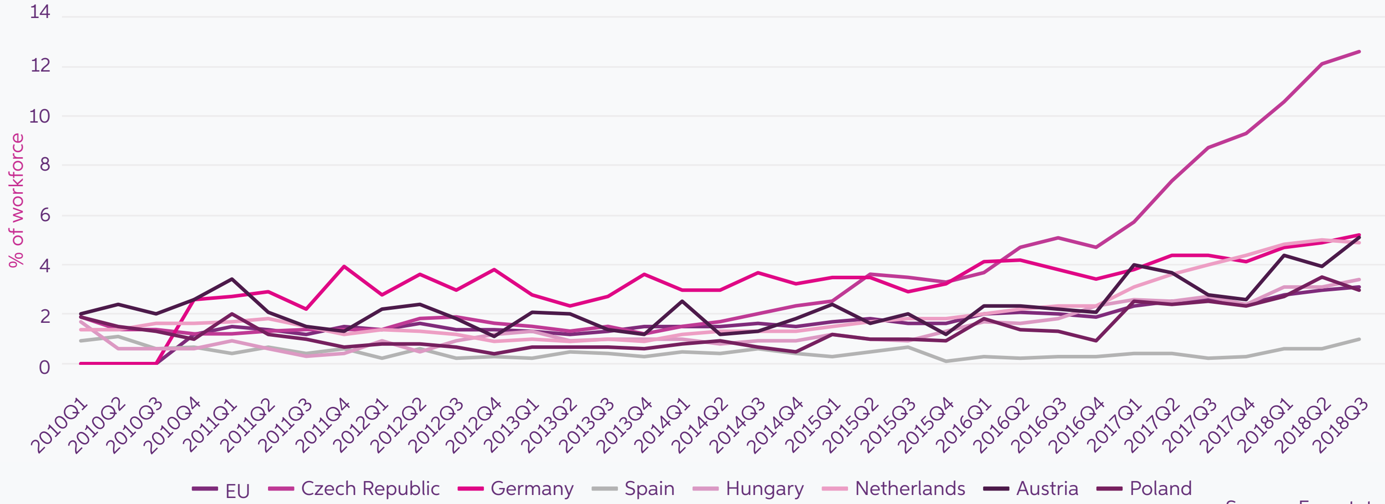
A report by the Construction Industry Federation (CIF) in early 2018 stated that at least 112,000 additional construction workers are required up to 2020 in order to help deliver the additional housing supply needed in Ireland. However with Ireland nearing full employment, it is likely that employers will need to look abroad for the necessary labour, but there are a number of factors which make an influx of workers similar to that seen pre-recession unlikely. These include the strong performance of many of the Central and Eastern European economies, particularly Poland and the Czech Republic and high living costs in Ireland, in particular high rental costs.

[1] The original CSO QNHS (re-labelled LFS) series from Q1 1998 to Q2 2017 has been adjusted to enable comparability with the new LFS for a number of headline indicators.

Shortage of construction workers not just an Irish problem

Ireland is not the only country that is facing a shortage of construction workers; many countries across Europe are experiencing similar problems. Figure 5 illustrates that construction vacancies as a percentage of the overall workforce have risen sharply over the last number of years, with construction vacancies being particularly pronounced in the Czech Republic (12.6%), Germany (5.2%), Austria (5.1%), the Netherlands (4.9%), Hungary (3.4%) and Poland (3.0%).

Figure 5: Rising job vacancies in construction indicate skill shortgages



Source: Eurostat

Higher labour costs appear inevitable

Higher construction labour costs appear inevitable as:

- There is no large pool of unemployed construction workers in Ireland.
- The numbers in apprenticeship are exceptionally low.
- Many countries across Europe face construction worker shortages similar to Ireland.

To try to mitigate this problem, more investment in, and promotion of, construction apprenticeships will be necessary in order to attract new entrants into the industry. In addition, the sector will have to widen its net to include non-EU nationals if it wants order to attract construction workers.

Increased demand for construction workers at a time of low unemployment is likely to result in upward wage pressures in the construction sector as it competes with other sectors to attract labour, which in turn pushes up the costs of construction

3. Review of recent housing policy changes

Key policy changes impacting supply

The Government introduced two new key policy initiatives in 2018 to help support the supply of housing:

- Land Development Agency (LDA).
- New guidelines on urban developments and building heights.

Land Development Agency

- In mid-September 2018, the Department of Housing, Planning, and Local Government announced details of the new Land Development Agency (LDA), which aims to provide land for up to 150,000 houses over the next 20 years. With a budget of €1.25 billion, the LDA proposes to focus on managing lands already owned by the State where new homes can be developed, and to regenerate under-utilised sites.
- In addition, the agency proposes to assemble strategic land banks in the long term from a mix of public and private land. Approximately 30 zones in Dublin City Centre and 10 in Cork City Centre are to be designated as special regeneration areas, in which State lands will be released for residential development. There is an immediate pipeline of state land capable of delivering 10,000 homes, with 3,000 of these homes on lands that have already been secured. These include 1,500 units on the site of the Central Mental Hospital in Dundrum, 600 units in Balbriggan, and a further 200 units in Skerries. The regeneration of the Cork Docklands could provide sufficient land for up to 15,000 homes, according to the Department of Housing, Planning and Local Government.

New guidelines on urban developments and building heights

- In December 2018, the Department of Housing, Planning and Local Government published details of new guidelines for planning authorities in Ireland, relating to urban development and building heights. The new guidelines are primarily aimed at tackling Ireland's housing shortage without further contributing to urban sprawl, and addressing what the Minister for Housing, Planning and Local Government describes as 'empty suburbs by day and empty city and town cores by night'.
- Traditional building heights in most urban areas in Ireland vary within a limited and generally low-rise range. In Ireland's cities and large towns, buildings are typically no higher than six to eight storeys in height. It is proposed that in the key centres identified in the National Planning Framework – Dublin, Cork, Limerick, Galway, and Waterford – it would be appropriate to support the consideration of building heights of at least six storeys at street level as a default objective, with the scope to consider even greater building heights.
- The new guidelines remove what was an arbitrary height cap, and will allow planning decisions to be made on a case-by-case basis, with building types being approved depending on their suitability to a specific area.
- If Local Authorities allow greater height in planning permissions as a result of these changes then this should help to address Ireland's housing shortage by developing on urban brownfield sites, reducing urban sprawl, and encouraging a move from low-rise to higher-density cities.

Land Development Agency – longer-term solution

The LDA is a welcome development and will help to increase the supply of residential development land over time. However, the impact of the LDA will only be felt over the longer term and will have a limited impact on the supply of new housing in the short term.

Of more immediate impact should be the new guidelines on urban density and building heights. These new guidelines in conjunction with the apartment guidelines published in 2017, should see an increased supply of apartments over the coming years. Apartments will play a key role in helping to solve the housing problems facing our key urban centres especially as apartments are under-represented as an accommodation type in the Irish market. As we stated in a previous report, The *Private Rented Sector in Ireland,* 'the stock of apartments in Ireland is among the lowest in Europe, with apartments accounting for just 10% of the housing stock, compared with between 30% and 50% in Europe. Just 26% of Dublin's housing stock comprises of apartments, one-third of that seen in similar European cities including Frankfurt and Copenhagen, and less than half that of Belfast.'

Help-to-Buy scheme – working effectively

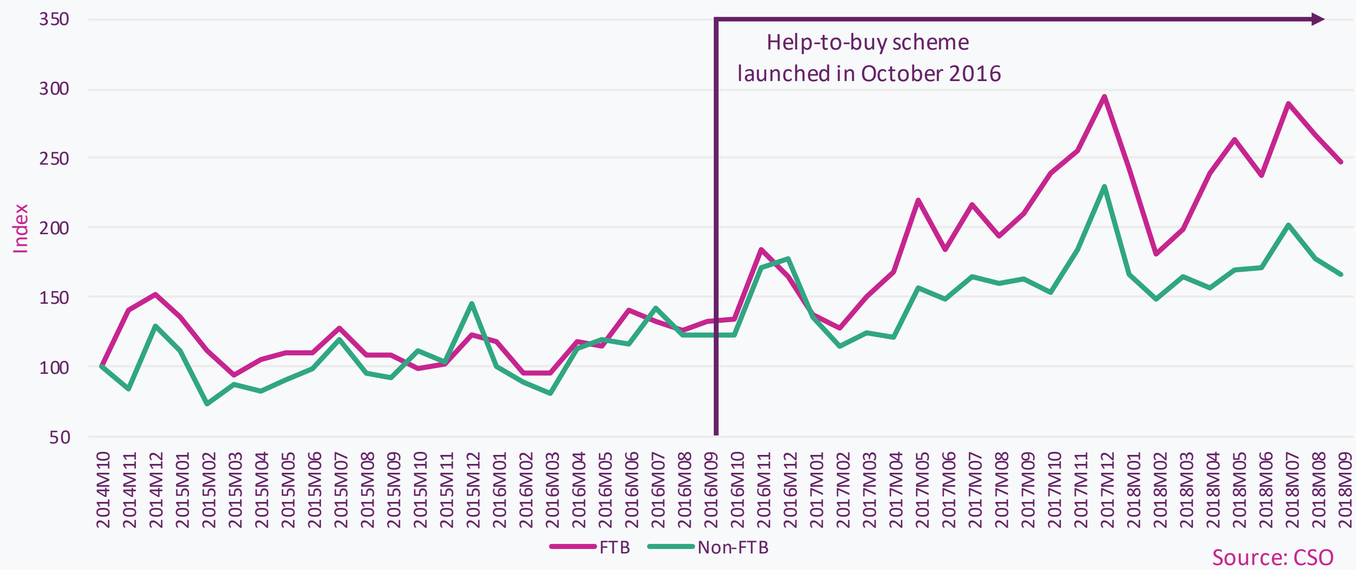
The Help-to-Buy scheme launched in October 2016, is a demand-side policy to support FTBs by offering a tax rebate on income tax paid, which can be used for a deposit on a newly built home. The scheme is due to expire in October 2019 and, from the evidence shown below, there is huge merit in it being extended. According to an analysis of house sales data from the Central Statistics Office, the Help-to-Buy scheme has been successful in improving affordability and attracting FTBs to the housing market.

Figure 6 presents market based sales of new residential dwellings by FTBs and non-FTBs in indexed form, in the periods before and after the Help-to-Buy scheme was introduced. It is clear that in the years leading up to 2017, the volumes of new homes bought by both cohorts were generally in line with each other. However, as highlighted in Figure 6, there was a notable upswing in the volume of new homes bought by FTBs in the immediate aftermath of the scheme being introduced, and since then FTBs have continued to outstrip non-FTBs.

Table 3 analyses the specific 12-month time period of October of the preceding year to October of the following year for each year, starting in 2011 and continuing to October 2018. These 12-month periods have been selected as they coincide with the October 2016 launch of the Help-to-Buy scheme and allow for like-for-like comparisons.

As highlighted in Figure 6, it is evident that since October 2016 there has been a sharp increase in the number of FTB new home transactions. These transactions increased from 2,107 in the year to October 2016, to 3,144 in the year to October 2017 and to 4,387 in the year to October 2018, representing annual increases of 49% and 40%, respectively.

Figure 6: Market-based sales of residential dwellings pre and post Help-to-Buy, (New dwellings only)



Source: CSO

Table 3: Household buyer – First time buyer, owner occupier – New homes only

	Volume of sales (number)	Value of sales (euro million)	Average sales price (% change)*
Oct'17 to Oct'18	4,387	1,443	10.1
Oct'16 to Oct'17	3,144	947	14.1
Oct'15 to Oct'16	2,107	556	17.8
Oct'14 to Oct'15	2,060	459	21.8
Oct'13 to Oct'14	1,917	354	5.9
Oct'12 to Oct'13	1,758	310	-7.9
Oct'11 to Oct'12	1,412	268	-11.0

*Price change calculated using rolling 12-month average
Source: CSO

Help-to-Buy - limited impact on residential property prices

Despite this heightened level of activity in the FTB new homes market, the rate of residential property price inflation in this category was in line with the general rates of house price inflation in the year to 2018. On average, however, new build house price inflation has outpaced house price growth for second-hand homes.

Table 4: Average residential property price inflation* by buyer type

	First time buyer Owner occupier New	All buyer types All dwellings	All buyer types New dwellings	All buyer types Existing	First time buyer Owner occupier Existing
Oct'17 to Oct'18	10.1	8.7	12.9	6.4	5.4
Oct'16 to Oct'17	14.1	11.0	15.5	8.6	10.3
Oct'15 to Oct'16	17.8	8.0	23.5	5.7	6.8
Oct'14 to Oct'15	21.8	6.7	21.2	4.6	8.4
Oct'13 to Oct'14	5.9	14.0	3.3	15.8	14.2
Oct'12 to Oct'13	-7.9	4.6	-7.3	7.3	-3.3
Oct'11 to Oct'12	-11.0	-9.9	-8.9	-8.0	-12.8

*Price change calculated using rolling 12-month average
Source: CSO

Measured over the two-year period since October 2016, the cumulative rate of residential property price inflation for FTB new homes was 25%, which is slightly higher than the rate of 20% experienced by the all buyer types, all dwellings category.

Help-to-Buy should be extended beyond 2019

The Help-to-Buy scheme is a demand-side incentive scheme and consequently there were concerns when this scheme was introduced that it would fuel residential property price inflation and do little to help FTBs get on the property ladder.

Based on the experience of the last two years since its inception, the level of FTB new home transactions has increased markedly, with a modest acceleration in the rate of inflation. One of the main reasons why inflation has remained in check is because of the restraining influence of the Central Bank mortgage macro prudential rules.

However, the demand side of the market is still faced with many constraints and is not functioning freely. Due to the affordability gap between the cost of new homes and the amount that FTBs can borrow, the introduction of the Help-to-Buy scheme was a necessary intervention.

As this affordability gap is unlikely to be resolved in the short term and will be a feature of the Irish residential market for some time to come, we would strongly recommend that the Help-to-Buy scheme be extended beyond 2019. As the scheme is due to run out in October 2019, it would be preferable that any decision to extend the scheme is not left to Budget time and be announced as early as possible in 2019. An early announcement of the decision to extend the Help-to-Buy scheme would avoid an inevitable scramble by prospective FTBs trying to transact in the months leading up to October, and would allow developers to plan with certainty for 2019 and beyond.

An early decision to extend Help-to-Buy would avoid an inevitable scramble by prospective FTBs to transact in the months leading up to October and would allow developers plan with greater certainty for 2019 and beyond.

Central Bank macro prudential mortgage rules

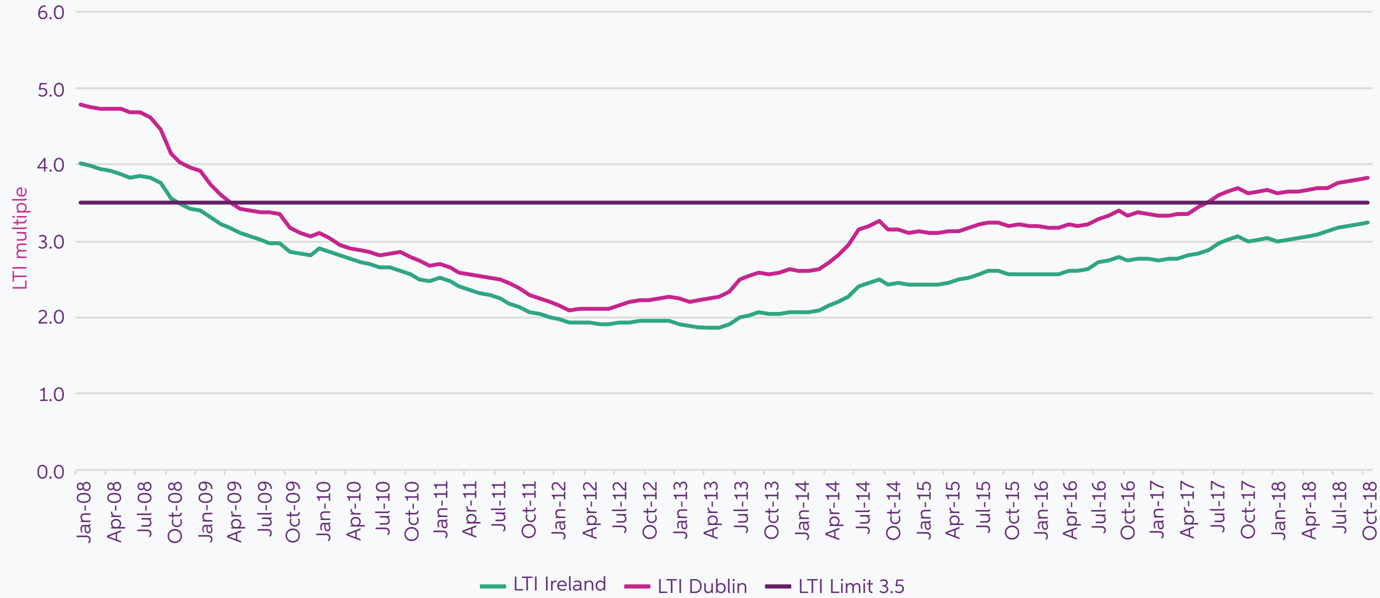
In its latest review of the macro prudential mortgage rules, the Central Bank decided to keep the rules unchanged, with the loan-to-value (LTV) and loan-to-income (LTI) limits and the related lending allowances above those limits remaining unaltered.

As evidenced from house price inflation and mortgage related data, the macro prudential rules are having a significant impact on the Irish housing market. House price inflation in the Dublin market has slowed markedly compared with the rest of the country and this is where the mortgage rules, and specifically the LTI rule, are particularly binding. Along with increased supply of new residential units in the Dublin market, the combined effect has been to moderate house price growth.

There is also evidence of increased seasonality in the mortgage numbers at an industry level, with activity (approvals) concentrated in the first three quarters of the year and a drop-off in approvals in the last quarter. This indicates that some banks have utilised all of their exemptions in the earlier part of the year and are constrained in the latter months of the year.

The following chart (Figure 7) clearly illustrates that the LTI limits are a binding constraint on low to average income workers. Figure 7 calculates the income multiple required to afford the average new house price in Dublin and Ireland for a two income household on average incomes with a 90% mortgage. It is evident that the LTI rule is particularly binding for those in the Dublin market. Furthermore, it is now an increasingly binding constraint in the broader market as well, as house price inflation in the regional markets outpaces wage growth.

Figure 7: Loan-to-income ratios in Ireland and Dublin

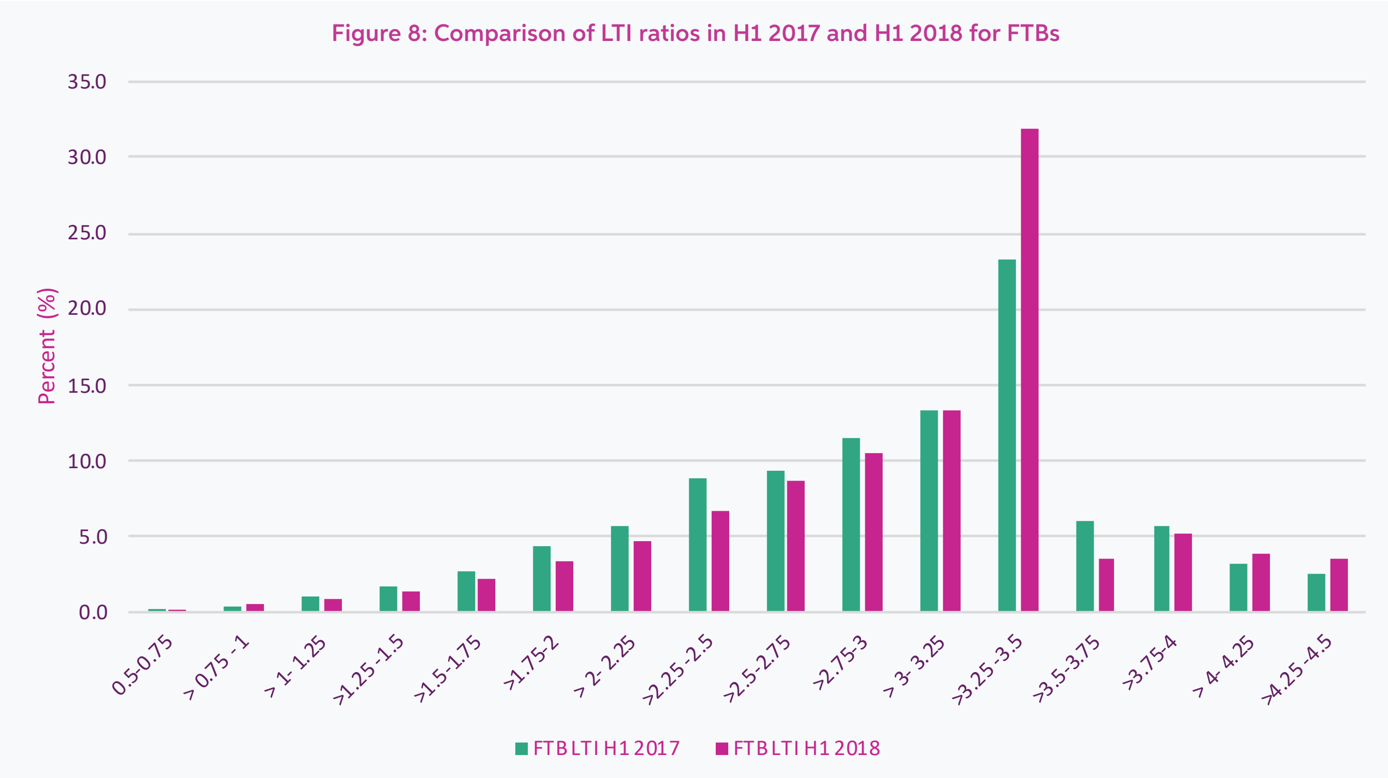


Source: AIB (based on average incomes of a two income household and 90% mortgage of average new house prices in Dublin and Ireland)

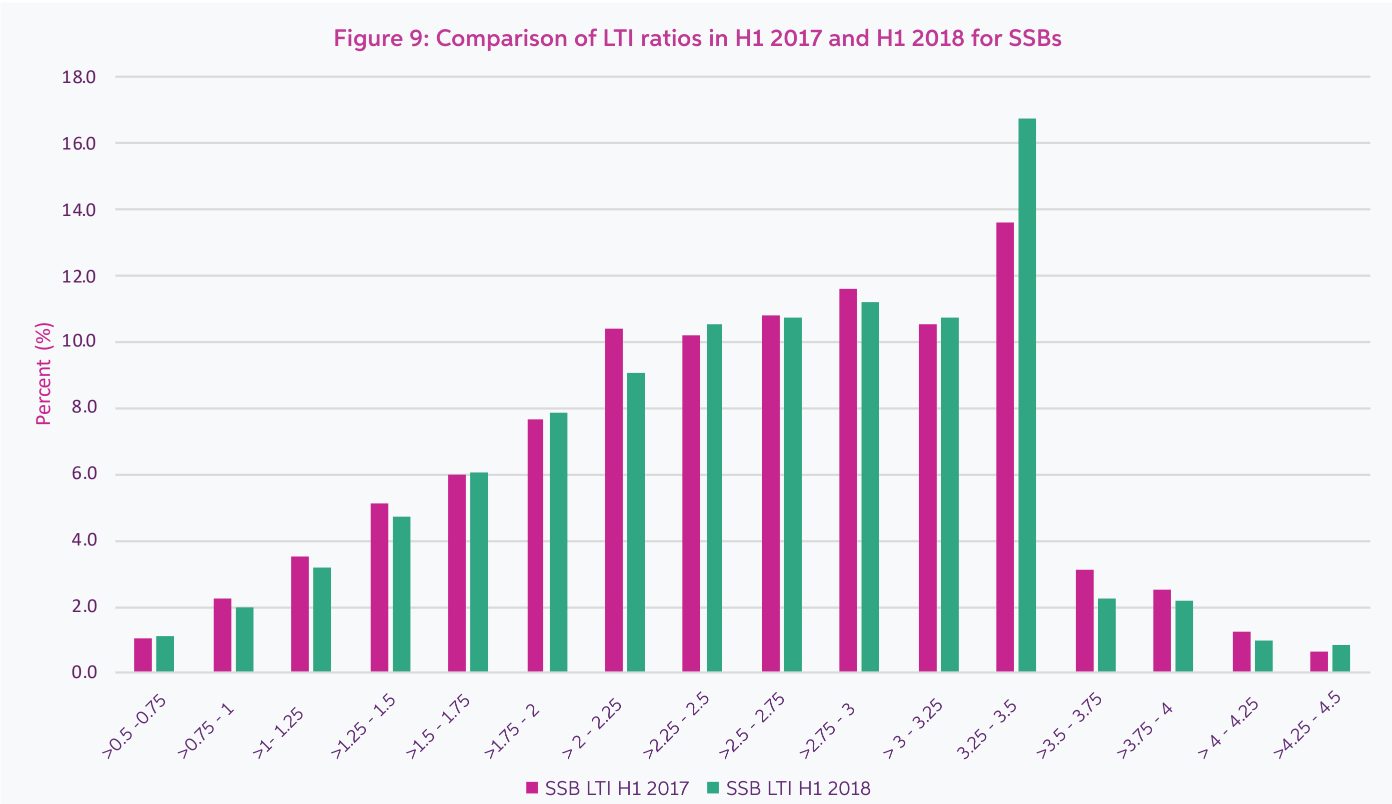
Increased numbers avail of higher LTIs

Further evidence that the LTI ratios are becoming an increasingly binding constraint can be seen by the greater number of mortgage applicants availing of higher LTIs in the first half of 2018 compared with the first half of 2017:

- As outlined in Figure 8, there is a marked increase in the percentage of FTB loans with LTIs in the range of 3.25-3.5 in the first half of 2018 (31.8%) versus the first half of 2017 (23.4%).
- For second and subsequent buyers (SSB) there was also an increase in the percentage of loans in the 3.25-3.5 LTI bracket in the first half of this year compared with the first half of 2017, but the increase was less pronounced (16.8% in the first-half of 2018 versus 13.6% in the first-half of 2017), as can be seen in Figure 9.



Source: Central Bank of Ireland



Source: Central Bank of Ireland

Objectives of the Central Bank rules being achieved

According to the Central Bank the objectives of the mortgage macro prudential rules are to:

- Increase the resilience of banks and borrowers to deal with negative economic and financial shocks, and
- Dampen the pro-cyclicality of credit and house prices so that a damaging credit-house price spiral does not emerge.

To date, these objectives are being met. However, as we stated in last year's *Housing Supply in Ireland* report, 'the combination of the cost to build starter homes and the LTI limits on incomes of the typical first-time buyer has caused an affordability wedge that is not easily resolved.'

4. Viability – still a significant challenge

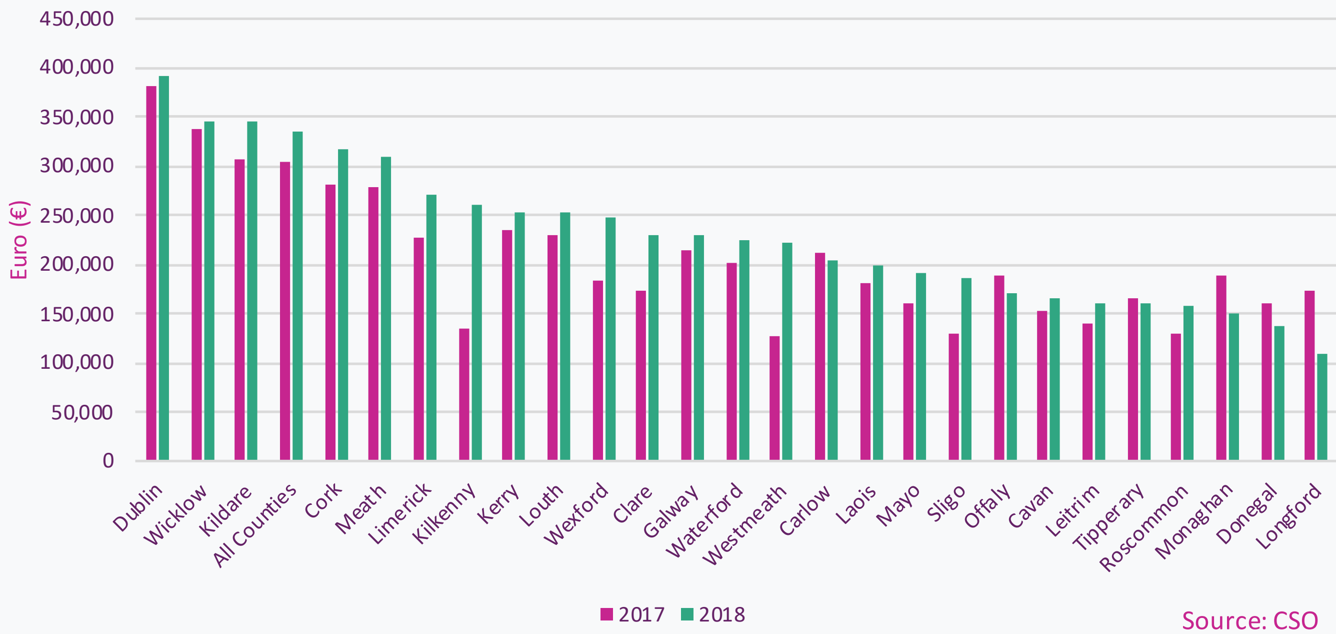
Viability is still a challenge, particularly for the FTB sector

In last year's *Housing Supply in Ireland* report we stated: 'Construction costs for residential development in Ireland are high compared with many other European countries. While the hard costs, such as materials, are on a par with other countries, it is a combination of levies, taxation and higher building standards that elevate the costs. House prices have now reached a level that make the construction of mid-market houses and above viable in the key urban locations, their suburbs and the key commuter counties around Dublin. However, the viability of starter homes is still challenging and is very much a function of the level of service infrastructure in place.'

Over the course of the last 12 months viability has not improved significantly and costs such as levies, taxation and higher building standards still pose a real impediment to increased output and supply.

Figure 10 shows the 2018 average price paid by first-time owner-occupier buyers for new homes in each county in Ireland versus the 2017 average price paid. Prices have risen in the majority of counties in Ireland over the last 12 months, but still not to levels which make house building universally viable. On average, as new house prices outside of the Greater Dublin Area need to be in the region of €300,000, and to be in the region of €350,000 in the Greater Dublin Area, then it is clear that the viability of starter homes still remains very challenging. Viability has improved in Dublin, with the average price of new homes for FTB owner occupiers rising to €390,000 in 2018; and in Wicklow and Kildare with average prices of new homes for FTB owner occupiers rising to close to €350,000; and in Cork and Meath with average prices for FTB owner occupier now exceeding €300,000.

Figure 10: Mean selling price for new houses bought by FTB owner occupiers



Source: CSO

Higher houses prices improves viability, but undermines affordability

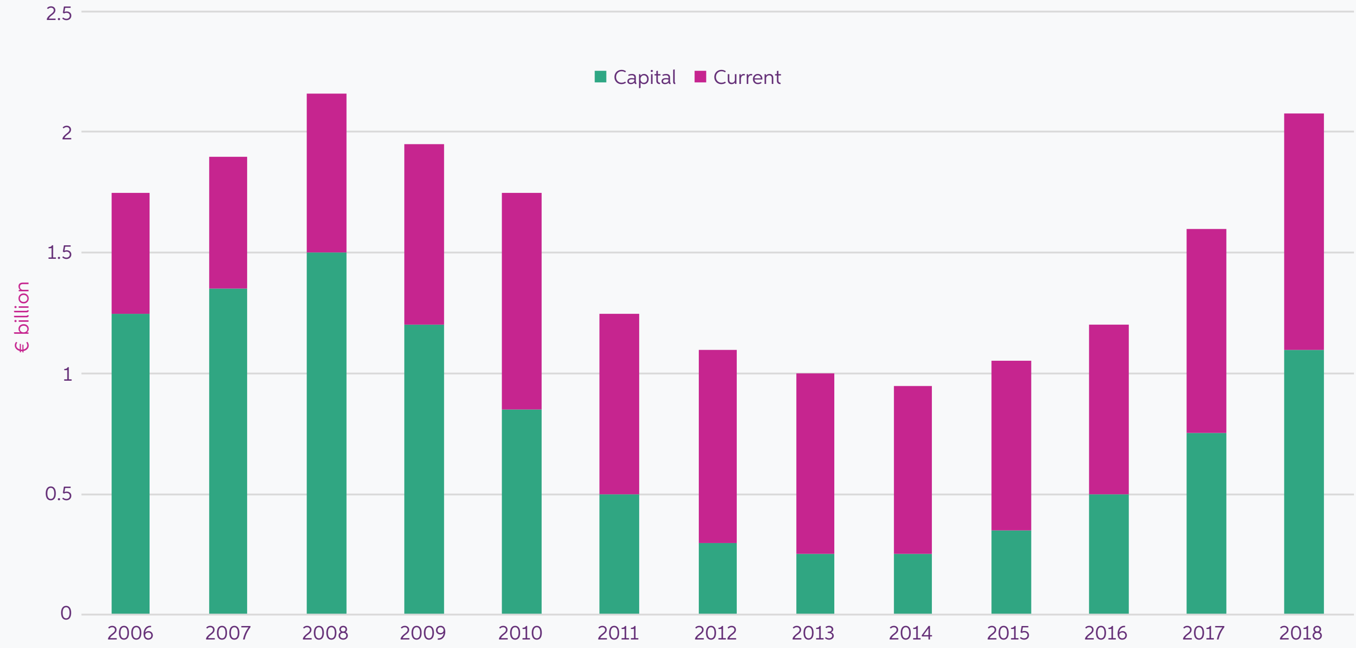
However, the problem with rising prices is that it makes it increasingly difficult for workers/households on average incomes to be able to borrow a mortgage of sufficient size to afford a starter home given the LTI rules. For example, if we assume a two-income household on average industrial incomes (around €77,000 combined income) and apply the 3.5 LTI multiple with a 10% deposit, it means they can afford to purchase a house for around €300,000. As €300,000 is the price point that is just about viable for housebuilding outside of Dublin and not really viable within Dublin, it means that transactions will be curtailed, as a very large cohort of potential buyers are constrained by the LTI borrowing limits.

5. Social and affordable housing – marked increase in expenditure

Social housing expenditure has increased sharply

Government expenditure on housing has doubled since 2014, reaching just under €2.1 billion in 2018, and is now back to levels last seen in 2008. Government expenditure on housing (primarily capital expenditure) fell sharply during the economic crisis. Since 2014, the growth in overall housing expenditure has been driven by a recovery in capital expenditure and it accounted for approximately 55% of housing expenditure in 2018, as Figure 11 shows.

Figure 11: Public expenditure on housing, 2006-2018



Source: DPER Databank and DHPLG. Note: Current and capital expenditure between 2015 and 2018 include LPT own fundig.
Current expenditure includes Rent Supplement and Mortgage Supplement through DEASP.

According to the National Development Plan 2018–2027, the Government is planning €11.6 billion in capital expenditure on social housing provision and a further €2 billion on urban regeneration and development over the lifetime of the plan. The capital expenditure on social housing is expected to add an additional 112,000 social housing units by 2027, or 11,200 social housing units per year. This is an ambitious target, as the highest number of social housing units delivered by way of new builds and acquisition was 8,673 in 2007 and has averaged only around 4,600 in the period 2004 to 2017.

Enhanced Long Term Social Housing Leasing Scheme

In addition to new builds and direct acquisition, the Government also provides funding to local authorities and other agencies to lease and rent properties for the provision of social housing. As we stated in last year's report, we believe that the potential to attract long-term institutional capital into the sector is a very viable proposition. The launch of the Enhanced Long Term Social Housing Leasing scheme in January 2018 by the Department of Housing, Planning and Local Government should further enhance the attractiveness of this sector to long-term capital.

The key characteristics of the scheme are:

- The lease term is 25 years.
- The Local Authority (the lessee) pays up to 95% of an agreed market rent at commencement of the lease to the lessor (owner of the property).
- Rent is reviewed every three years, linked to the Harmonised Index of Consumer Prices (HICP).
- The lessor is obliged to provide management services for the properties.
- The relevant Local Authority is the landlord to the tenant and collects differential rent from them.
- Each proposal should include a minimum of 20 properties in any Local Authority area (that units can be on multiple sites).

The Enhanced Long Term Social Housing Leasing scheme has already attracted a number of institutional investors that have raised capital specifically to develop / acquire residential units in order to participate in this scheme and we believe that additional institutional investors will emerge in 2019.

Focus on new builds for the supply of social and affordable housing

It would be preferable if the focus of Government policy and incentives was on the provision of new builds / supply of social and affordable housing. The best way this could be achieved is in conjunction with the construction sector combined with a targeted approach to reduce the costs of developing new residential units. As we stated in our report last year (*Housing Supply in Ireland*):

'Direct build by local authorities as a way of solving the housing crisis has been debated at length in recent months. The merits of direct State house building is open for discussion, but the practical issue is that the State and local authorities have not built housing directly on a large scale for over 40 years. Consequently, the resources, experience and ability are absent, and it would take many years to build up this capacity again.

Furthermore, the construction industry is already facing resource constraints on the employment front and any concerted attempt by the Government or local authorities to hire a direct workforce would drive up labour costs significantly and ultimately would prove counterproductive. The main argument in favour of direct provision is that the Government would be able to slash costs, as it would not have to pay VAT, levies and developer profit margins. However, these cost savings could be readily achieved without going to the expense and time of resourcing direct building provision.'

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