Macro-prudential policy for residential mortgage lending

Consultation paper CP87

Submission by

Irish Mortgage Brokers

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Evidence based decision making must be reliant on the facts.

Thus far in this consultation empirical facts are being construed to suit an ideological agenda, which doesn't mean facts become insignificant, rather the inference does.

The fact is that when faced with a supply constraint that LTV limits don't work, the reality of which is best demonstrated by the very poster child being used in the Central Banks thesis, that of Hong Kong[1], where a similar problem is underway[2] and where LTV caps have made little or no difference.

There is a worrying historical reversion taking place in the Central Bank narrative on this topic to date. The record should clearly state that in Hong Kong this move has not changed the volatility in the Hong Kong real estate market, and it certainly didn't cool it down.

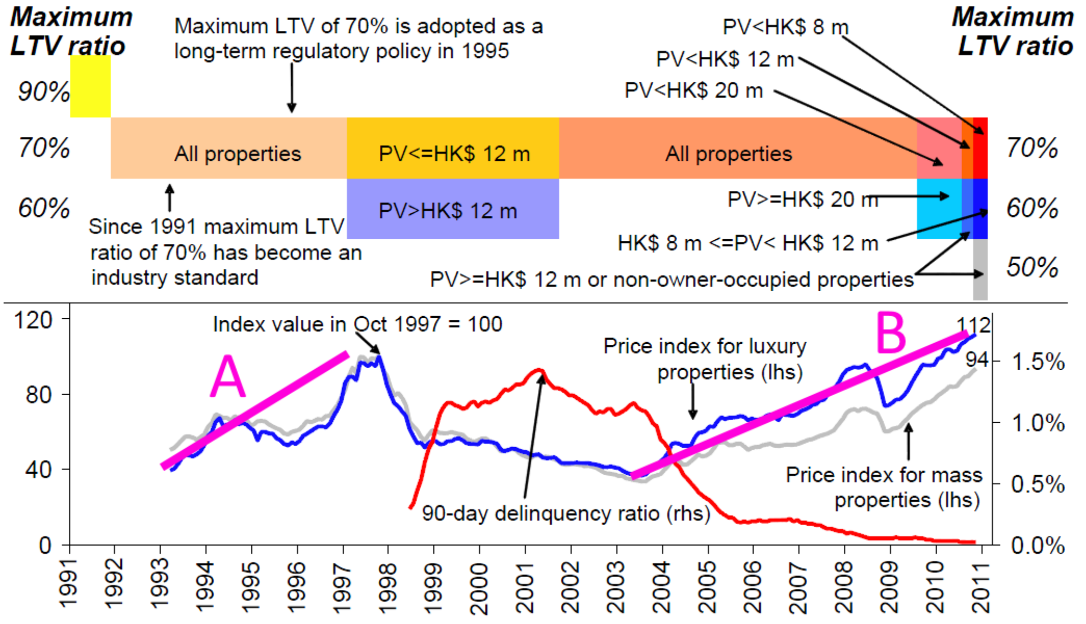
The graph below[3] shows that (at line A) property prices sky rocketed after the policy was first introduced in 1991. The default rate during that time is not known, what we do know is that it rose rapidly in the crash as is commonplace experience across nations.

From 2004 (line B) prices again have boomed and a replicated crash therefore hasn't occurred with which to make a definitive call on the policy. That LTV policy enhances bank stability is in light of the negative impact it can have on households and while mortgage insurance programmes may mitigate this they have issues which we will later discuss.

In Hong Kong recent HKMA concerns state that the main problems are in the commercial sector, so why is this proposal directed so heavily at residential lending only? They also propose a higher stress test which is a key absence from our own copy-cat version[4].

Graph 1

LTV policy, property prices and mortgage delinquency ratio in Hong Kong SAR



PV = property value

Source: HKMA.

[1] HK property prices continue to rise, Financial Times 3rd November 2014.

[2] http://www.nytimes.com/2014/11/19/realestate/hong-kongs-tiny-apartments.html

[3] Hong Kong Monetary Authority

[4] HKMA ref B4/1C Feb 2013 briefing.

In Ireland as in Hong Kong, now that prices are rising arrears are falling. In Hong Kong even while mortgage insurance was in place defaults rose after a crash, this policy won't change that, the empirical argument for it 'working' is not expressed in these statistics apart from there being an absence of a banking crisis due to it, which given the low default rates was unlikely to occur anyway.

Part of the issue in Ireland was no in how we created the crisis through credit and property speculation, but rather how we dealt with the fall out.

Regulatory directions such as a ban on repossessions and the blockages in the initial CCMA created a set of incentives that meant our fundamental default rate was out of line with unemployment or price drops (as many nations had broadly similar value destruction and many such as Spain had a higher unemployment rate).

This regulatory failure cannot be overlooked in the prescription of forward looking polices. Although historical the following table gives a pan-European demonstration of vastly differing outcomes, in the main due to other nations not implementing ill thought out policy.

	Repo's 2009	Repo's 2010	Repo's 2011	Repo's 2012	Typical loan rate	outstanding loans (m) q2, 2012	Housing stock (m)	Population (m)	Unemploy-ment	Number of loans	number of loans in arrears	Arrears as % of loans
Ireland	293	633	525		3.27%	128,681	1.66	4.49	14.10%	792,096	94,448	11.90%
UK	46000	36300	37300	33900	3.56%	1,546,295	27.26	62.64	7.80%		160,300	
Finland		450			2.58%	81,781	2.56	5.39	8.70%			
Malta	-	-	-	-	3.90%	2,893	0.19	0.42	6.60%			
Spain*	56686	93319	77854	67537	3.47%	666,946	26.99	46.23	26.02%			3.50%
Denmark	1000	2184	2612	1861	4.14%	241,324	2.78	5.57	4.70%			
Russia					11.90%	49,561	60.13	141.93	6.00%	1,982,433	0	3.10%
Germany					3.54%	1,167,711	40460	81.73	5.90%			
France					3.90%	857,600	32850	65.44	10.60%			
Belgium					3.69%	169,726	5.13	11	7.40%			
Netherland	2256	2106	2811	2705	4.07%	644,271	7.31	16.69	7.50%			
Austria					2.86%	83,863	4.17	8.7	8.70%			
Poland					7.00%	76,142	13.42	38.2	14.20%			
Romania					5.61%	8,289	8.38	21.39	6.60%			
Greece					4.18%	78,393	6.57	11.31	26.40%			
Turkey**					14.35%	37,510	17	73.64	9.50%	1,368,855	0	0.83%
Italy					4.30%	362,000	33.07	60.77	11.70%	2,661,764		3.00%
Lithuania					3.63%	5,866	1.35	3.2	13.00%			
Latvia					3.80%	6,020	1.04	2.2	13.80%			
Luxembourg					2.26%	20,255	0.189	0.52	3.34%			

When countries such as Spain with double our unemployment at the time have only a quarter of our arrears, there are other forces at play. Italy with similar unemployment (and higher loan rates) were far below us, as were Turkey where loan rates are in excess of 14% with high unemployment.

Russia, with more than twice the loans, almost four times the interest rates charged and moderate unemployment still managed to have on a fraction of the arrears we had.

These past mistakes will not be resolved by policies which are just as destructive on the opposite side of the curve.

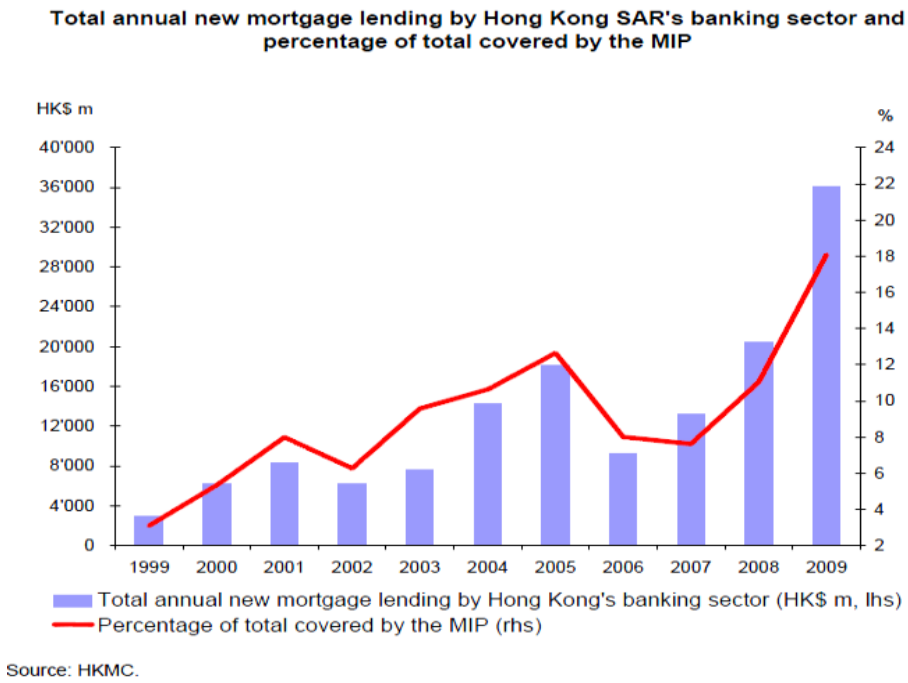
Another concern with Asian comparisons is that of the Asian propensity for savings, this helps absorb income and expenditure shocks, equally, the default rate on insured loans was not decoupled from those without insurance at lower LTV's which indicate that the policy suggestion is simply nonsensical, one cannot have it both ways, if high LTV was the culprit the insured loans should have a far higher default rate[5].

The following graph shows that total new mortgage lending and the amount covered by mortgage insurance (therefore being of high LTV) demonstrates that in the first instance a market is created for mortgage insurers and that their LTV rules, apart from not working, represent the majority of loans.

[5] Hong Kong MIP loan book had historic high of 0.39% in 09/03 while banking sector was at 1.05%

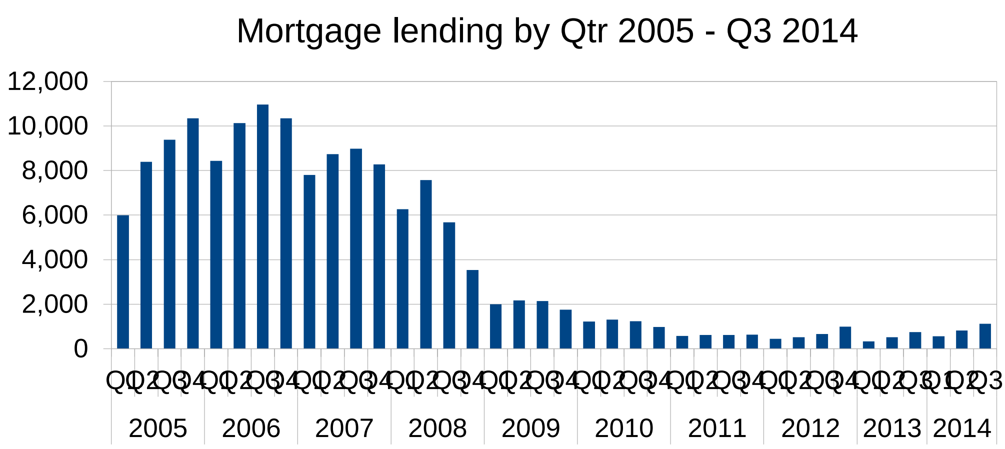
That we are so readily considering the creation of a profit layer for an insurer in the form of mortgage insurance is also a concern. Apart from there being unusual incentives such as said insurers supporting policies which prevent repossessions (and thus the payment of potential claims on the risk they underwrote), it will also increase transaction costs because these policies don't come for free.

That will most likely result in a one off payment, or perhaps in recouping the cost over time in the form of higher costs to the borrowers, and this at a time when Ireland already has (by European standards) high mortgage interest rates.



Why we shouldn't hurt first time buyers.

For better or worse this policy is aimed at first time buyers. That is because, as per the BPFI statistics on mortgage credit, there are several important numbers which cannot be readily overlooked.



The market has an unusually high level of first time buyer participants versus times past, which is both in our firms experience and as per the BPFI figures[6].

[6] http://www.bpfi.ie/news/new-mortgage-lending-in-q3-2014/

The difference between the last two censuses' indicate that people renting increased 47%[7]. This is heavily represented by Dublin where current supply shortage and the impact of the macro-prudential proposal will hurt people the most. The number of tenancies registered with the PRTB as at the end of Q2 2014 is 300,425. PRTB data show that Dublin accounted for 39 per cent of the rental market in quarter 2, 2014.

This same cohort represents the people who didn't buy as the market fell, this can be discerned by considering household formation, the low transaction levels in purchases[8], and low credit drawdowns.

Now that the market is no longer in free-fall the same groups is looking at purchasing and this is resulting in higher prices and stock shortages, that aside, the issue remains one of stock and this proposal does nothing to alleviate that.

The market is segmented broadly into the people in negative equity or who have trackers and are unlikely to move, those in arrears for whom this policy has no impact, cash buyers who are not impacted and new entrants who are over-represented for structural reasons, whom we expect to remain over represented for some time due to supply constraints meeting demand.

Using a macro-prudential tool to resolve a supply shortage is akin to giving a person with cancer a plaster cast. Like medicine, macro-prudential policy making has particular appropriate applications, this is not one of them. Nor should such wide ranging policy be taken as a knee jerk reaction to property bubbles on the back of what many agree was a once in a generation speculative bubble and crash.

		FTB Purchase		Mover Purchase		RIL Purchase		Re-mortgage		Top-up		Total Drawdowns
		No.	%	No.	%	No.	%	No.	%	No.	%	No.
2014	Q3	**3,260**	**51.7%**	**2,239**	**35.5%**	**264**	**4.2%**	**126**	**2.0%**	**419**	**6.6%**	**6,308**
	Q2	2,440	50.8%	1,709	35.6%	188	3.9%	108	2.2%	358	7.5%	4,803
	Q1	1,737	50.7%	1,206	35.2%	183	5.3%	68	2.0%	231	6.8%	3,425
2013	Q4	2,708	52.0%	1,862	35.8%	191	3.7%	86	1.6%	359	6.9%	5,206
	Q3	2,299	51.3%	1,556	34.7%	196	4.4%	75	1.7%	356	7.9%	4,482
	Q2	1,600	49.5%	1,152	35.7%	105	3.2%	70	2.2%	302	9.4%	3,229
	Q1	928	44.9%	770	37.2%	105	5.1%	61	2.9%	204	9.9%	2,068

We can see that in terms of 'drawdowns' that first time buyers represent more than half of the market in almost every quarter for the last two years, this again has to do with their pent up demand. In our experience, and in wide market research[9] the most common requirements are a 90% loan and a 30 year term.

When you look at the 'over borrowing' side of the argument we don't know if it is supported because within these figures the average loan is demonstrated (next table), it shows that first time buyers are not borrowing as much as movers, and tend to be on par or below those re-mortgaging.

		FTB Purchase	Mover Purchase	RIL Purchase	Re-mortgage	Top-up
		€	€	€	€	€
2014	Q3	**166,516**	**224,431**	**116,806**	**190,246**	**61,615**
	Q2	162,171	209,756	101,606	196,235	71,229
	Q1	151,123	211,602	115,172	153,688	82,338
2013	Q4	157,035	218,982	123,918	152,648	73,127
	Q3	151,097	218,124	115,530	209,677	69,065
	Q2	151,370	199,219	114,210	197,188	66,493
	Q1	150,292	202,737	106,186	138,465	77,351

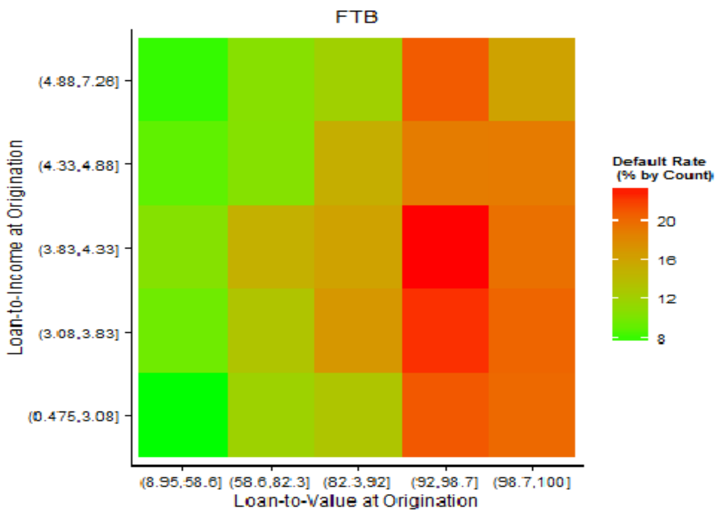
[7] Census 2011 - 475,000 households were renting their accommodation
[8] Available from the property price register, and implied by mortgage draw-downs as well as from high levels of listings during that time.
[9] PIBA mortgage market surveys

The ‘*save people from over-extending themselves*’ argument may also be questionable in light of this.

Why we hear stories of the need to protect people from themselves is curios given that much of our problem was due to incentives.

While nobody is calling for the return of 100% mortgages which made up about 20% of loans at the peak in both credit and property prices, it is interesting to note that their default rate is lower than that of lower LVT and LTI loans.

This is taken from the Central Banks own research[10].



We also find it bothersome that people look at only one side of the individual’s balance sheet when determining the core issues. Many on tracker mortgages are in arrears, even while on interest only. A €1,000,000 loan on interest only is currently costing €833 a month which is less than you can rent for in most regions on the country.

The problem is that net incomes have suffered even in homes without job loss due to higher taxes and other reductions in income. Unemployment alone cannot explain our arrears and the Central Bank’s own economists have shown this despite the conventional wisdom that job loss is the sole driver[11], 80% of households in arrears have no unemployed adult member in the home. When it comes to heads of households in arrears.

In 75% of arrears cases the head of the household is fully employed.

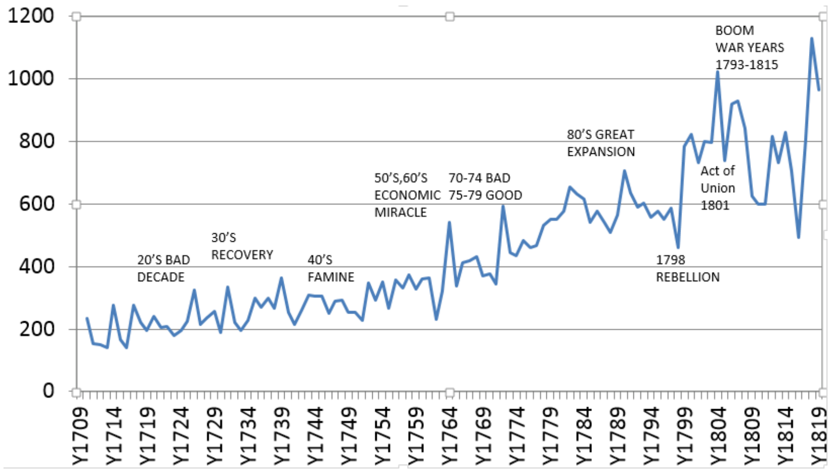
<u>This is the wrong solution (that it won’t work is another issue):</u>

The ‘credit bubble’ prevention is so premature that only an academic could ignore the reality of the situation on the ground. For the last five years credit has been anaemic, aggregate household credit is in contraction[12]. Since 2008 debt has reduced by 17%. The stock and flow of credit are in contraction and look set to remain that way. There is no need to choke off that which is already dead.

In their own words the HKMA state that LTV policy can lead to liquidity constraints for households, this is a concern when these same households are now backlogged in the purchase process and we now see pent up demand.

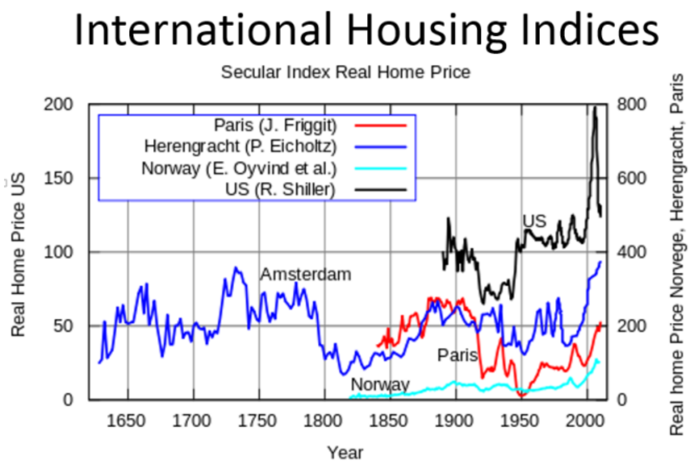
[10] Macro-prudential Tools and Credit Risk of Property Lending at Irish banks 2014
[11] Yvonne McCarthy Barrington lecture – ‘Disentangling the mortgage arrears crisis’.
[12] https://www.davy.ie/research/emailHtm/article.htm?id=economicsmonthly20140423_22042014.htm

That we have had crashes for many years is not in dispute, but even before there was a mortgage market we had property booms and busts, so if that can happen when there is no credit involved how does limiting credit alleviate it? The graph below shows house price movements in Dublin in the 1700's, you'll note that even then there was volatility.



This experience was, like the last one, not unique or confined to Ireland. Historically many other jurisdictions had property crashes, sometimes due to what was happening elsewhere such as the boom the Irish economy experienced due to the Napoleonic wars.

The international experience is in the next graph and demonstrates that in every developed country with records being kept that property prices do not remain static and have cycles.



It is also worth noting that the HM Treasury report[13] they noted that LTV/LTI limits were rarely implemented without mortgage insurance schemes, and could create household liquidity traps, in the consultation paper this seems to have been overlooked and is only being mentioned ex post which is worrisome in terms of the foresight industry expects from their regulators.

Classist delineation:

It is worth noting that for incumbent home owners this policy will make little difference, it is a most unusual position that would typically be made by an incumbent.

Banks will naturally cater any product with scarcity towards the most preferred clients (those with the most money). That they may price this scarcity upwards is an obvious side effect, but more worrisome is that the

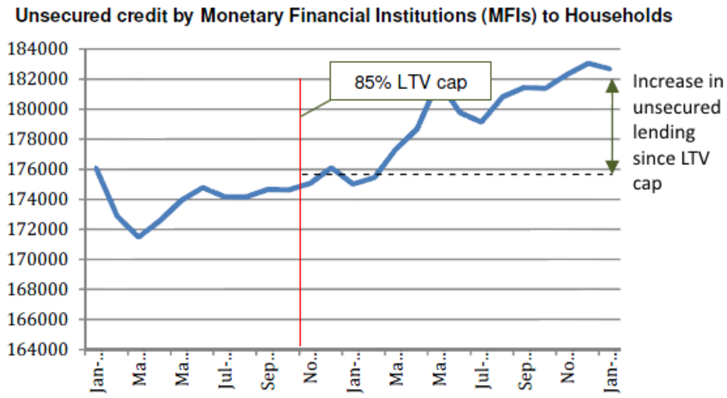
[13] HM Treasury, financial services bill report Cm8434 Sept 2012 page 34

alternative is for people to be kept out of the market and save or get help from elsewhere as bankers have seen occurring in Sweden (where the same policy is currently not working). These 'other areas of finance' can be family members, or loan sharks.

The Swedish experience demonstrates that this is the response of the prospective homeowner, they obtain this credit at much higher interest rates than the mortgage which will increase financial risk to the individual[14].

The risk that people could find either formal or informal sources of funding should be a concern, as should the likelihood that it would be at a higher rate as past experience shows that short term debt can impact upon long term debt in periods of household income or expenditure shocks.

This policy will ensure that many people fall prey to a policy that in protecting banks hurts their future wealth. We are, and will remain, strongly opposed to measures that have societal engineering outcomes such as this.



The people who seek such loans are also likely to be closer to 'sub-prime'. It is known that "The use of unsecured loans has increased somewhat following the introduction of the mortgage cap, although from low levels" which is taken directly from their H1 2012 Financial Stability Report.

We need not tell you that, it is already known by the Central Bank of Ireland which is why at a presentation at NUI Galway in April 2012, Mr Stefan Gerlach said that "However, the narrow focus may enable borrowers and lenders to seek to circumvent the restrictions. For instance, Crowe et al. (2011a) report that, in Korea lower LTV limits were implemented for loans of less than 3 years substantially increasing the popularity of loans of three years and one day.

Furthermore, LTV limits have been circumvented by taking out a personal loan to cover a portion of the house price". This proposal is not only a wilful avoidance of evidence, it is contrary to the Central Banks own acceptance of this evidence.

For people who don't have rich parents to lean on it will occur in a lock out from the market or make decisions as they do in Sweden which are nearly as negative in outcome. This can have huge future impacts on wealth and this impact can last for more than one generation as we will demonstrate later.

The end result can and will be social engineering where, based upon financial means, some people will have superior odds of home ownership than others, not based on their record of performance, future earnings potential or many other such considerations. Only an academic could willingly ignore such a reality.

Our firm deals with families looking to buy homes, we've helped thousands of them to do that without any complaint to the Central Bank or FSO. We believe our work is honourable and important, and it is within that context that we believe, having dealt with such families for over a decade, that it will hurt them while inflicting nothing on the incumbents who are due for special treatment.

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[14] Genworth briefing note to Liikenan report on macro-prudential lending limits.

Equality in this instance is therefore not met, fairness by extension both vertically and horizontally is not met (horizontally because a certain cohort will be able to obtain the higher LTV's). We don't believe the Central Bank should have any role in creating a market for private insurance firms which is what the end result of this is most likely to be.

And most worryingly, to do so in the knowledge that the trigger for the insurance is a repossession while at the same time it was the Central Bank who were key to driving up arrears and lowering repossessions. It's a rigged game and the people affected don't want or require your help.

It may also cause considerable displacement. Much has been made of people 'trapped' in negative equity who, in the past bought properties not consistent with their long term ownership objectives in order to 'get on the property ladder'.

If a person saved €40,000 hoping to buy a home for €400,000 but was unable to obtain a 90% mortgage they might opt to buy a €200,000 home to simply have bought something. This may be sub-optimal but we saw many examples of this in the past and to an extent due to harder criteria we see it now as well.

If there is a market correction in the future they may be insulated to an extent, but they will also likely suffer displacement because the ability to realise a larger deposit will still be difficult, when such people go on to form families and outgrow smaller homes it creates damaging financial compression. The proposed LTV limits will help to see this occur more often.

Life on the Coal Face:

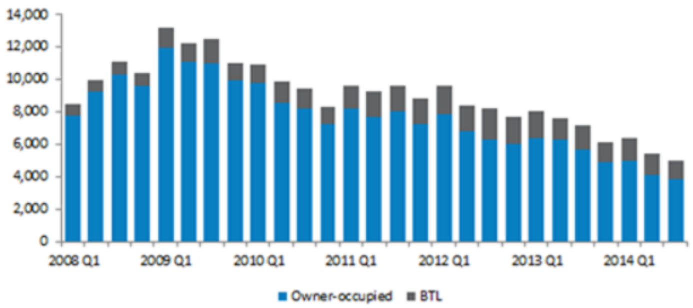
There is no mention of current lending practice, other than to imply that they can somehow spiral out of control and create a credit fuelled boom bust cycle. Higher stress tests as already suggested would help ensure people have the repayment capacity to deal with interest rate hikes.

In the UK the Building Society Association demonstrated that there are two primary drivers of arrears[15] (in Ireland there is third which is a combination of our regulatory system and rulings like the Justice Dunne case). The LTV policy won't alleviate either, nor will an LTI approach if income collapses.

There is mandatory life cover with residential loans as per section 126 of the CCA 1995 with some exceptions which don't constitute the general pool of lending. It may be an idea to have borrowers contribute towards some kind of repayment insurance scheme which all borrowers contribute towards.

The issue with mortgage indemnity guarantees is that the payment of the claim is usually predicated on a repossession which we tend to avoid as a national policy. Such schemes have been tried in the Netherlands with their National Mortgage Guarantee scheme and other add on policies which allow a person to have their employer garnish wages for mortgage payments.

Our high arrears are largely due to not repossessing homes, figures from the UK show that of their 25m households that they take back about 0.01% of the housing stock every year.



[15] http://www.bsa.org.uk/information/publications/industry-publications/understanding-mortgage-arrears/

We have historically been far below this and it creates a legacy of arrears that have not otherwise cured. In part it explains how we created such a protracted problem. Thankfully, we now have organisations like the insolvency service of Ireland and better bankruptcy so that next time this can be avoided in part as people didn't have these options prior to and during the rump of the crisis.

Future wealth considerations:

We noted from Patrick Honohan's Oireachtas committee appearance that over use of credit can create greater inequality. The US example is fraught with both analytical and inferential problems.

The paper that perhaps best considers the point at hand[16] considers rolling ten year periods with comparisons restricted to those times only which ignores the improved personal statement of financial position that many households had during the same period, while also making an assumption that any difference on the side of the renter only is invested which skews the data in favour of a stock market who's volatility took away much of the same wealth it apparently built during the same period.

In addition, it overlooked non-financial factors or considerations which benefit the home owner (such as avoiding rent volatility or substandard housing) while also ignoring the transactional costs of being a renter (average tenancies are longer in the US, but in Ireland they are shorter meaning more moves and higher costs), the trade-off being deduced to either buy stocks or pay off debt, which in truth is far more complex.

His own words were "*The empirical evidence is, however, suggestive of the positive role played by financial development in reducing poverty and easing inequality*[17]". While not speaking specifically of debt, there is an abundance of research which points to the contrary[18], that a few papers can be referenced while ignoring the weight of the much larger body of research on the positive wealth effect of home ownership is concerning.

We think of mortgages as a type of 'forced savings' which substitute the variable cost of a fixed overhead. The fixed overhead is 'housing' the variable cost being the price that changes over time for said overhead. In a country with low pension provision and low individual investment rates (as opposed to savings rates) it cannot be said or argued that people are naturally putting aside large tranches of cash for future cost absorption and thus well managed debt, in practice, actually does have a wealth effect over time.

In the USA, the example cited as showing the downside, the evidence is once more to the contrary when taking a longer term view, if a 10yr base is moved to a 15yr base the effect is that every year of homeownership increases net wealth to the tune of $13,700 per year[19], a study which was released at the height of the downturn.

This even extends to creating racial inequality, which in Ireland takes the less obvious route of classist inequality. The Institute on Assets and Social Policy showed that[20] amongst the biggest drivers of wealth inequality are years of homeownership, to the tune of 27% of the difference, a bigger contributing factor than both household income or college education (5%).

That homeownership is the largest predictor of wealth on a relative comparison basis does not fit with the idea that homeownership is an inequality driver except for where a person takes a stylised view with parameter set to prove the opposite, namely, by taking short term snap-shots which compare a once in a generation housing market with secular bull market. This is bad inference, unfair representation of fact and statistically abusive use of information, on ethical grounds those comments should be retracted.

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[16] Rappaport, KC Fed: The effectiveness of homeownership in building household wealth
[17] IIS 399: Honohan & King 2012.
[18] Wealth accumulation and home ownership: evidence from low income households, Boehm & Schlottman, 2008
[19] Homeownership, wealth accumulation & income status, Journal of Housing Economics, 2009
[20] Roots of the widening racial wealth gap: explaining the black-white economic divide 2013

Children also benefit from growing up in a home owning household, that growing up in a home owning family exerts positive effects on children's development and outcomes has been extensively[21] studied. To implement policies which will have home owning reduction at its core will create an intergenerational inequality for which the Regulator, although its creator, will not be held responsible for, nor will they bear the brunt of the cost of such a policy. The 'unaffected third party' nature of this cannot be overlooked.

A significant body of literature demonstrates with acceptable empirical evidence that home ownership creates better life satisfaction, increases self-esteem, this leads to a better home environment for children[22] and that this derives from its asset function which is the important aspect we are trying to articulate. We would strongly suggest a widened reading list for the decision makers in your firm.

In the event of death of a spouse renters typically don't have life insurance which is mandatory for owners[23] and this can have negative financial impacts on future wealth where death occurs.

We cannot fathom why a Regulator feels the need to contribute to lower future household wealth of families, that position has not been acknowledged as it is an uncomfortable fact which is difficult to defend, but equally, it has not been mentioned which must imply, given the source, that it was overlooked.

At the risk of overbearing repetition, we wish to state that the vast body of research on housing shows that it is a wealth creator over time[24] not a wealth destroyer.

The alluded argument that we need to 'save people from themselves' is, quite frankly, ridiculous, even when made by using the international financial crisis as a backdrop. The Centre for Social Development did just that and found that *"After balancing renters and owners on observed characteristics and adjusting for influential outlying cases, we find that low- and moderate-income homeowners experience greater short-run increases in net worth, assets, and non-housing net worth than renters do. These findings are particularly interesting because **the period of study coincides with the housing crisis**, periods of shrinking home values, and declining equity in the housing market as a whole[25]".*

We deal with real people with real concerns and financial goals every single day and have found that this idea of people not being smart enough to make good decisions is baseless, false and patronising. Income shocks are not predictable, but equally, if they hit hard enough no LTV can change the outcome.

<u>Write-downs may be prevented</u>

Firms that buy loans often have an exit strategy that is founded on the borrower re-mortgaging elsewhere. As per the consultation paper, the negative equity portion might be ignored, but they will still require a deposit for the new loan to bring their LTV in line with common practice. This will mean they are in competition against first time buyers for the same pool of credit which will have a natural constraint[26].

If a person owed €400,000 and is offered a deal whereby they can get a substantial write-down if they re-mortgage with a different lender for €200,000 there is an argument for the sensible and proper use of a 100% mortgage. We are not saying we support the idea of 100% mortgages, but are making the point that anybody asked 'are 100% mortgages a good idea' will say no in general, but yes in particular to the situation where the person then gets a €200,000 write down.

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[21] Green & White 1997; Aaronson 2000; Boehm & Schlottman 1999; Haurin, Parcel, & Haurin 2000
[22] Balfour and Smith 1999, Rossi & Weber 1996; Rohe & Basolo 1997; Rohe & Stegman 1994b
[23] As per s126 of the 1995 CCA
[24] Assets for the Poor: The Benefits of Spreading Asset Ownership 1983-1998
[25] Homeownership and wealth among low and moderate income families 2013
[26] Due to the proposed limits but also due to loan to deposit constraints and other capital requirements on mortgages.

These proposed rules will inhibit that exit strategy of firms like Lonestar and thus will inhibit household wealth of those affected, and prevent write-down's that would otherwise have positive effects on all participants. At a minimum there should be a concession for people re-mortgaging away from loan buyers in that there is no LTV constraint and that these loans are not factored into the new business pool for high LTV lending once the new loan is lower than the existing loan because this will have wide ranging positive financial effects.

What about social housing?

We have a social housing crisis and the vacancy rate in Dublin City Council is a mere 1.4%, the lowest it has been in 200 years[27]. If people are forced to rent for longer than is normally expected it means the stock of available rented accommodation will be oversubscribed given that we have a housing supply constraint. In turn it will mean that Department of Environment plans to ease the social housing crisis through the use of private accommodation will not be able to succeed.

There are trade-offs which will be made as a result of this proposed policy, many will be unforeseen, but of those that are foreseeable this should be amongst the most glaringly obvious and it has not been described or mentioned in the list of positive or negative outcomes in any Central Bank commentary, again, we can only assume this is an oversight which, in the rush to gain acceptance of this strategy has been ignored.

Supply creation

The most worrying aspect of this proposal is that it will neither fix supply (which is the core problem) nor address affordability, arguably it will make the cost of entry or opportunity cost higher to the detriment of the potential buyer.

It may even hamper supply because credit constraint in an already constrained market may mean that purchases which require a certain price in order to obtain higher than cost selling values will take longer to occur and prevent the next unit of supply. Virtually all housing supply at present in the capital is marginal supply.

Current underwriting and lending is being done in the most responsible manner we have seen since our firm's inception and beyond that for the duration of any of our staff's memories. Perhaps some method that enshrines current lending standards for the next five years would be a better tool than one which has obvious circumvention opportunities such as mortgage insurance.

If lending was kept the same there would be no opportunity for 'reckless lending' under current standards, it is the easing of underwriting standards more than anything which contributed to bad lending, the LTV was of secondary concern.

Suggestions for something that might work better

A 3% stress test is probably a better tool that would require very little change from existing policy or regulatory infrastructure to implement. The current 2% model may, in light of the trend of interest rates coming down, be a good counter measure that won't spook the market, or have many of the negative outcomes we have mentioned so far.

Mortgage insurance may have a place, and while we are against it primarily because it gives validity to the lower LTV policy, it could be a hedge to risk that the Central Bank could impose upon lenders, a consideration being how they then deal with capital buffers because in other countries the insured part of the loan requires no capital set aside.

A freeze on current underwriting policy would also work as current lending is prudent, this would simply mean that whatever way a bank is lending now would be set in stone for a period of five years unless the Central Bank gave them authorisation to loosen (tightening should not require permission). In doing that you could stem irresponsible credit – whereas with an LTV or LTI rule you can only hope for the best.

[27] Statistic mentioned at 'Hidden Rooms' which took place on the 7th floor of the Central bank in November 2014.

Also, as suggested by the Lincoln Institute, a policy of countercyclical capital provisions may also help as it has in Spain. Now we will consider the individual cash position of the borrowers who may be impacted.

Examples of couples impacted

Lastly we have some examples of the outcomes that people would face were this implemented, they are styled upon the basis that there are buyers who have 10% saved but are then asked to come up with another 10% and how they would be affected on a cash and asset basis.

Several scenarios which are described below. In each we make an assumption that inflation in prices and rents will be straight-line unless otherwise described and consistent on both values and rental costs, lending is done over 25yrs at 4.2%, we sent the calculator in already so you can try alternative scenarios. The figures are not combined, although they could be added up to give a 'total wealth effect'.

Couple 1: John and Joanne have a 10% deposit saved and hope to buy a home valued at €250,000 they currently rent for €1,250 per month, prices and rents are expected to grow at 3% annually and it will take them 5 years to save the additional 10%.

Cost comparison

From a cash perspective they are worse off by:	€2,805
From a capital perspective they are worse off by:	€33,327
Over the course of 25yrs on a cash basis they are worse off by[28]:	€171,702

Couple 2: Mary and Jessica have a 10% deposit saved and hope to buy a property valued at €300,000 they rent a one bed apartment for €1,100 per month. They expect prices of houses and rents to go up by 5% next year, 4% in the second year, 3% the third year 2% in year 4 then 1% per year after that.

Cost comparison

From a cash perspective they are better off by:	€5,661
From a capital perspective they are worse off by:	€33,106

The 25yr cash comparison is not used as straight-line assumptions were not used.

Couple 3: Alex and Amy have a 10% deposit saved and hope to buy a property valued at €150,000 they rent a house for €780 per month. They expect prices to rise by 6% and have seen their rent do the same, it will take them 4 years to save up the additional 10%

From a cash perspective they are worse off by:	€29,521
From a capital perspective they are worse off by:	€26,228
Over the course of 25yrs on a cash basis they are worse off by:	€257,022

[28] Note: this calculation is on a 'cash cost only' basis and doesn't consider capital values or accrued savings values.

Couple 4: Pat and Anne have 10% deposit, they want to buy a home for €350,000 they have kids and rent a house costing €1,300 per month, it will take them 5 years to save the additional 10%. They expect a steady state economy with prices and rents going up 1% a year.

From a cash perspective they are better off by:	€24,418
From a capital perspective they are worse off by:	€8,463
Over the course of 25yrs on a cash basis they are better[29] off by:	€41,266

We have demonstrated some of the counter arguments to this policy in terms of empirical economic research from trusted sources, from a policy perspective, from an operational perspective and finally in terms of its impact upon individual balance sheets. In light of this we would hope that the proposed limits do not go ahead as planned without considering alternative options that may have better outcomes.

We would like to thank the Central Bank for taking the time to read our submission and are open to discussion, contribution or attendance at any meetings where this can be further discussed, in the main we believe it is a policy that will have negative outcomes and should not be implemented.

Sincerely,

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[29] As this is 'cash only' it doesn't consider that they would own an asset that is worth considerably more than the cash saved.