Central Bank Macro-Prudential Policy Proposals Submission

December 2014

Policy@scsi.ie

SCSI RED C Poll and Member Surveys

SCSI commissioned a RED C Poll of prospective purchasers to inform our recommendations in relation to the Central Bank Macro Prudential Policy Proposals which found that:

- 7 in 10 feel the 20% deposit would be too restrictive if they were to buy a property
- 4 in 5 agree that the new deposit rules will favour the more well off / cash buyers
- 1 in 2 said that they would source the deposit from a Credit Union or Bank Loans

SCSI also surveyed its members who were supportive of the principle of the Macro Prudential tools but felt the proposed limits were too restrictive. The survey found that:

- Over 8 in 10 respondents to the survey felt that the proposed 80% LTV limits were too restrictive
- 9 in 10 believe that an 85-90% LTV is more reasonable
- 40% believe that a 3.5 times income limit is reasonable

The main SCSI comments are as follows:

- The SCSI welcomes the introduction of the proposed macro prudential tools in principle to ensure more prudent lending and to help mitigate credit risk and indebtedness levels of households in the future

- SCSI recommends that a more reasonable LTV limit would be in the 85-90% range

- It is also recommended that the LTV limits are introduced on a phased basis and not fully on the proposed 1st January 2015 deadline

- A key consideration for the Central Bank must be to weigh up the level of LTV requirements with the associated risk of an increase in households sourcing the deposit from other unsecured sources (our RED C poll showed 1 in 2 would source the 20% from unsecured lending sources – credit union loan)

- There should be some flexibility in relation to the income limit somewhere between 3.5-4.5 income levels, depending on the location of the property

- It is recommended that a strong credit history and a track record of paying rent over a 2 year period should be taken into consideration as part of the process

- The SCSI would welcome in principle the possibility of a mortgage insurance scheme being introduced by the financial institutions

- The SCSI believes that these policies must be part of a more strategic plan for the sales and rented sectors and be combined with broader measures to address the supply shortage which is the key issue to stabilising property prices [i.e. increased development finance provision by financial institutions for SME builders]

- An essential component of credit risk mitigation around residential property is ensuring the integrity of the valuation process. Valuation standards such as the RICS Red Book which is in full compliance with the International Valuation Standards (IVS) should be required by financial institutions for residential mortgage lending purposes

Introduction

The Society of Chartered Surveyors Ireland (SCSI) is the independent professional body for Chartered Surveyors working and practicing in Ireland. Working in partnership with the Royal Institution of Chartered Surveyors (RICS), the global body for Chartered Surveyors, our role is to work and act in the public interest by setting and maintaining the highest standards of competence and integrity among the profession; and providing impartial, authoritative advice on key issues for business, society and government.

The Society welcomes the principal of the new Central Bank of Ireland proposed measures to reduce the credit risk on households through macro-prudential tools and to try to protect consumers against the cyclical nature of the property market.

Around one in five home loans, worth some €23bn combined, are in distress in the country and in principle, the introduction of prudent lending policies is a good idea to protect consumers and to ensure such a situation does not reoccur.

The new proposals are likely to dampen down some of the excessive demand in the property market and ensure more prudent savings and lending practices.

Currently, there is no direct regulation on credit limits which has meant that households have been able to accumulate liabilities more easily than consumers in countries where there is stricter regulation, i.e. France or Germany.

That being said, it is also important that any macro- prudential tools that are introduced are done so in an appropriate manner to ensure that those who are in a financial position to buy a home can do so and are not hindered by the current market dysfunction which is mainly due to a lack of supply, as opposed to credit, which is causing price increases in both the sales and rental markets.

In developing any policy to support households, we must ensure that the housing needs of the population including first time buyers, movers, renters and those in need of social housing can be adequately met in a sustainable manner. We must also ensure that our competiveness as a nation is retained in order to continue to attract inward investment and support job creation in Ireland.

It is the view of the SCSI that the proposals in their current format are overly restrictive and do not fully take into account the dynamics of the property market.

There are also some potential unintended consequences including the risk that the proposed limit proposals will preclude first time buyers who would usually meet the criteria for a mortgage and put further pressure on the private rental sector which is already experiencing a supply shortage. This could push up rents and further marginalise those on lower incomes as well as the estimated 89,000 people in need of social housing support which relies heavily on the private rented sector.

It is also important to remember that the property market is no longer a single market, but rather a series of micro-markets and a ‘one size fits all’ approach may be overly crude. A more tiered or phased approach to the loan to income and deposit requirements should be considered depending on location.

The SCSI would also like to highlight the importance of valuation standards in the context of the consultation which is aimed at strengthening credit risk mitigation tools. In 2012, the Central Bank published *‘Valuation Processes in the Banking Crisis – Lesson s Learned – Guiding the Future’*. The report highlighted that many professionals in the banking industry lacked the appreciation and significance of property valuations in the lending process. The report referred to the valuation standards and principles developed by the RICS/SCSI, in accordance with international valuation standards, also known as the Red Book.

Central Bank Macro-Prudential Proposals

The Central Bank proposes to introduce regulations placing ceilings on the proportion of mortgage lending at high loan-to-value (LTV) ratios (i.e. a maximum fraction of the purchase price to the fraction financed by bank credit) and on the proportion of mortgage lending at high loan-to-income (LTI) ratio (i.e. a maximum multiple of the borrower's gross income before tax or other deductions) by regulated financial services providers.

The proposed measures will require banks to restrict lending for primary dwelling purchases above 80 per cent LTV to no more than 15 per cent of the aggregate value of the flow of all housing loans for principal dwelling home purposes; and to restrict lending for primary dwelling purchases above 3.5 times LTI to no more than 20 per cent of that aggregate value.

The Central Bank also proposes a lower threshold for buy-to-let (BTL) properties, requiring banks to limit Buy to Let (BTL) loans above 70 per cent LTV to 10 per cent of all BTL loans.

The SCSI agrees with the principle of the macro-prudential tools but that the proposed limits in their current format are overly restrictive.

The SCSI has commissioned a RED C Poll to assess the impact on prospective purchasers (detailed below) and **7 in 10 feel the 20% deposit would be too restrictive if they were to buy a property.**

The SCSI also surveyed its members operating in estate agency (also detailed below) which showed **that 8 in 10 respondents to the survey felt that the proposed 80% LTV limits were too restrictive.**

UK Case Study: The Financial Services Bill - the Financial Policy Committee's macro-prudential tools

According to The Financial Services Bill in the UK, the benefits of macro-prudential regulation accrue by reducing the likelihood of a crisis occurring in any given year, which will mean that financial crises should occur less often.

Macro-prudential regulation involves the identification, monitoring and mitigation of systemic risks before they can crystallise, preventing those risks from triggering instability in the financial sector. Financial crises often cause significant output losses and can have permanent or highly persistent impacts on the growth potential of the economy.

The UK Government believes that counter-cyclical macro-prudential policy should also reduce the severity of crises by mitigating the effects of unsustainable behaviours during the boom and can potentially help to moderate the impact of crises once losses materialise. Building resilience during the upswing should increase the loss absorbing capacity of firms and help them maintain credit supply in the downturn instead of deleveraging.

The Government notes that other countries' experiences of tightening mortgage terms and conditions (including setting maximum LTV/LTI ratios) suggest this had been a somewhat effective way to limit financial instability. However, this tool has rarely been implemented in isolation from other measures, such as mortgage insurance. The Government also notes that this type of requirement can prevent borrowers who would otherwise be considered creditworthy from receiving mortgage financing.

Irish Property Market – Economic Impact Assessment

The introduction of macro-prudential policy tools must be considered in the context of the current dynamic in the Irish property market and the potential impact of the proposals being introduced in their current format.

1. **Impact on Housing Supply**

There is currently a shortage of supply in Dublin and other urban areas. This shortage of supply is largely due to the fact that very few new homes were developed over the past 5 years. Just 8,301 new homes were constructed in 2013, down from around 89,000 in 2006. While the latter level of output was clearly unsustainable, the Housing Agency has projected a requirement for 80,000 units between now and 2018.

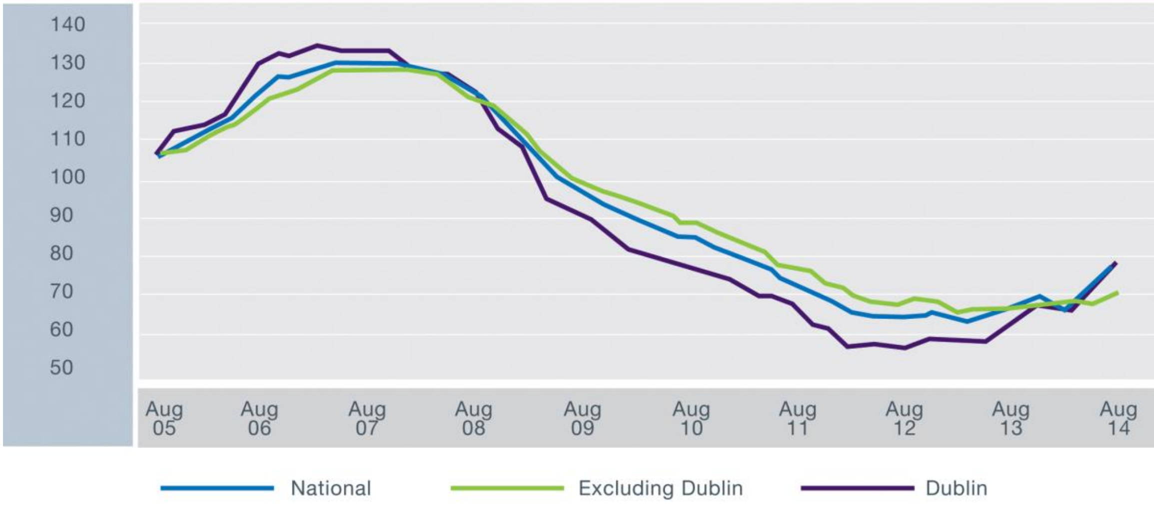
Source: Department of Enviroment, Community & Local Government

In Dublin, where the sharpest level of price inflation has occurred, there is a minimum requirement for 35,000 units over the next 5 years according to the 'Housing Supply Capacity in Dublin 2014-18' Report, published by the Society of Chartered Surveyors. The SCSI report also showed that there is a 25% shortfall in available planning permissions to meet the minimum requirement levels in Dublin over the next 4 years.

It is clear that the lack of construction in new homes in recent years has led to a shortage of supply which is in turn leading to sharp price volatility.

According to the latest CSO Residential Property Price Index, average property prices increased by c17% nationally and by c24% in Dublin over the past 12 months.

» Fig 2: CSO Residential Property Price Index



Source: CSO Residential Property price Index

The fact is that property prices are largely increasing due to a lack of supply and that the Central Bank measures and intentions of reducing the impact of property cycles on households will only be effective if introduced as part of a combined suite of measures to improve the sustainability of the property market.

These largely revolve around increasing the construction of new homes and the provision of development finance for developers to purchase land and construct new homes.

Any measures being introduced to reduce credit risk in relation to residential property must therefore be considered in the context of the impact that the current supply shortage is having on the property market and on the economic viability of development.

There is a real risk that developments which were due to go ahead will now stall due to the uncertainty these proposals have introduced into the market and the impact on the ability of prospective purchasers to secure mortgages. If the supply shortage continues, it is likely that price volatility could also continue.

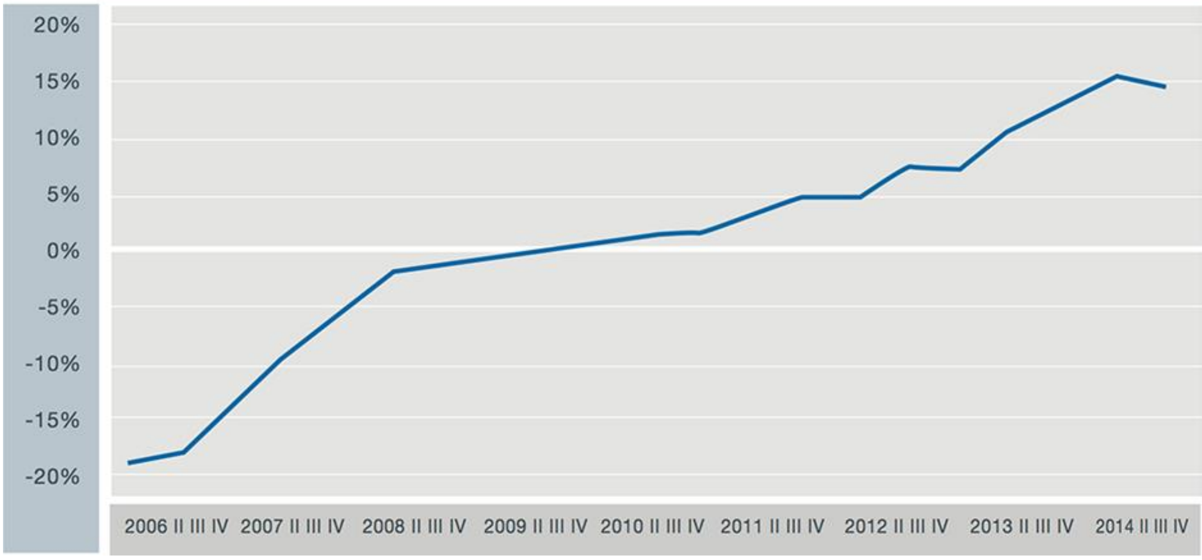
Private Rented Sector

Approximately one in five households in the country are in private rented accommodation.

According to the latest Daft.ie rental market report, rents have increased by approximately 10% in Dublin over the past 12 months. The increases in rents are largely due to increased demand and a lack of supply.

The below chart illustrates the pace of rental price inflation in Dublin.

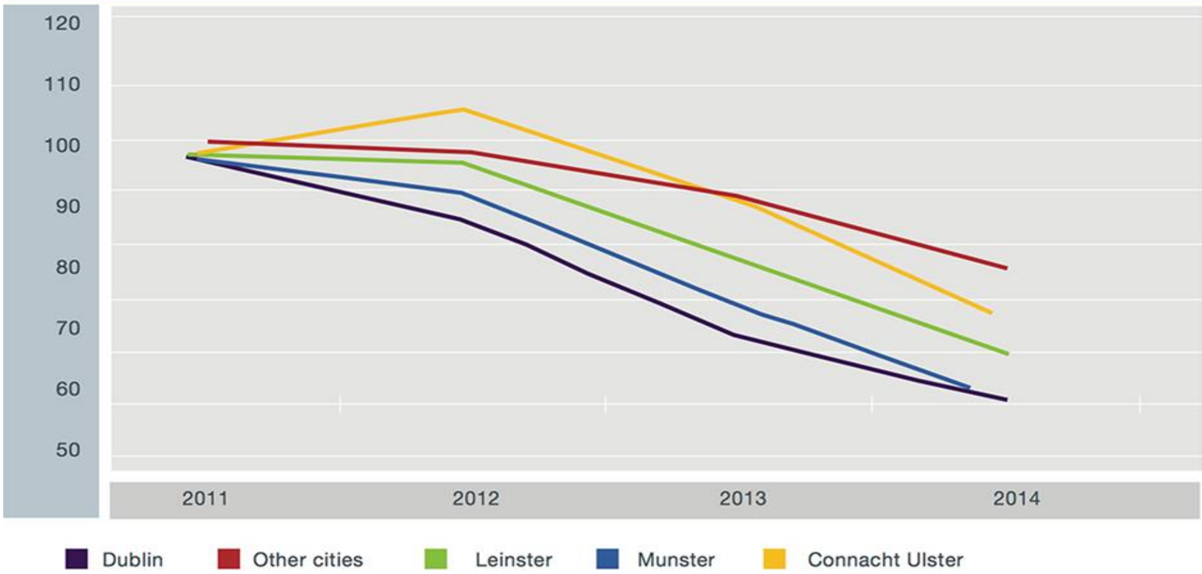
» Fig 3: Annual Change in Dublin Rents



Source: Daft.ie

The low levels of stock of property in the private rented sector is also concerning. As the chart below shows, there has been a steady decline in the number of rental properties largely due to the lack of construction activity and a lack of supply.

» Fig 4: Fall in Number of Rental Properties



The lack of supply of properties to rent is clearly fuelling the increase in rents in Dublin and nationally. The risk is that the Central Bank proposals, in particular the LTV limits which require a 20% deposit will be too onerous for prospective purchasers who are currently paying rent and will preclude them from buying.

As a result, there will be increased competition for properties to rent with the possibility of rents continuing to increase thus having a further negative impact on social housing provision which relies heavily on the private rented sector as well as our overall economic competitiveness.

Central Bank Macro Prudential Proposals

(i) Loan to Value (LTV) proposed restrictions

The proposed measures will require banks to restrict lending for primary dwelling purchases above 80 per cent LTV to no more than 15 per cent of all housing loans for principal dwelling home purposes.

RED C Poll Results

In order to understand the impact of the Central Bank proposals on people who are likely to buy a home, the SCSI commissioned independent research company RED C to undertake a poll.

The poll asked a sample of people a series of questions about their attitudes to the proposed 80% LTV / 20% deposit rule.

- 4 in 5 agree that the new deposit rules will favour the more well off / cash buyers
- 7 in 10 feel the 20% deposit would be too restrictive if they were to buy a property

SCSI Member Survey Results

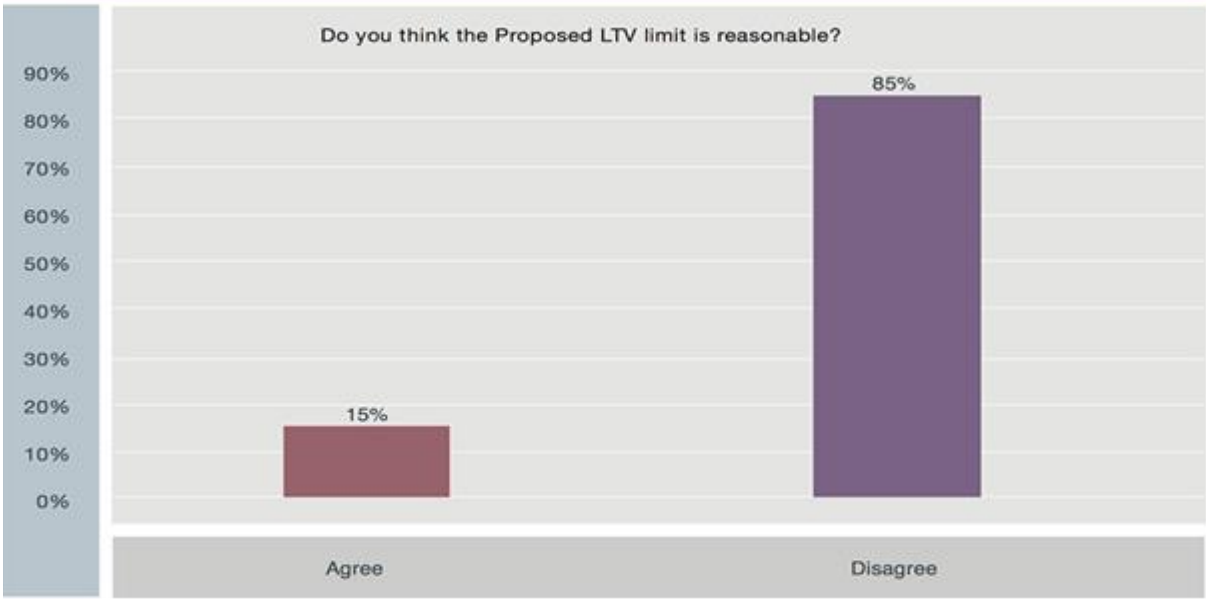
The SCSI also conducted a survey of its Residential Property Surveyors/Estate agents to assess their views on the proposed Central Bank Deposit restrictions.

The importance of the introduction of a Macro-prudential policy to support more prudent lending was widely acknowledged among the membership.

The proposed levels of the LTV limits, were however, viewed as overly restrictive and 'crude' measures for a multi-tiered property market currently constrained due to supply shortages in urban areas resulting in increasing property prices.

Over 8 in 10 respondents to the survey felt that the proposed 80% LTV limits were too restrictive.

» Fig 5: SCSI Member Survey – Proposed LTV Limits



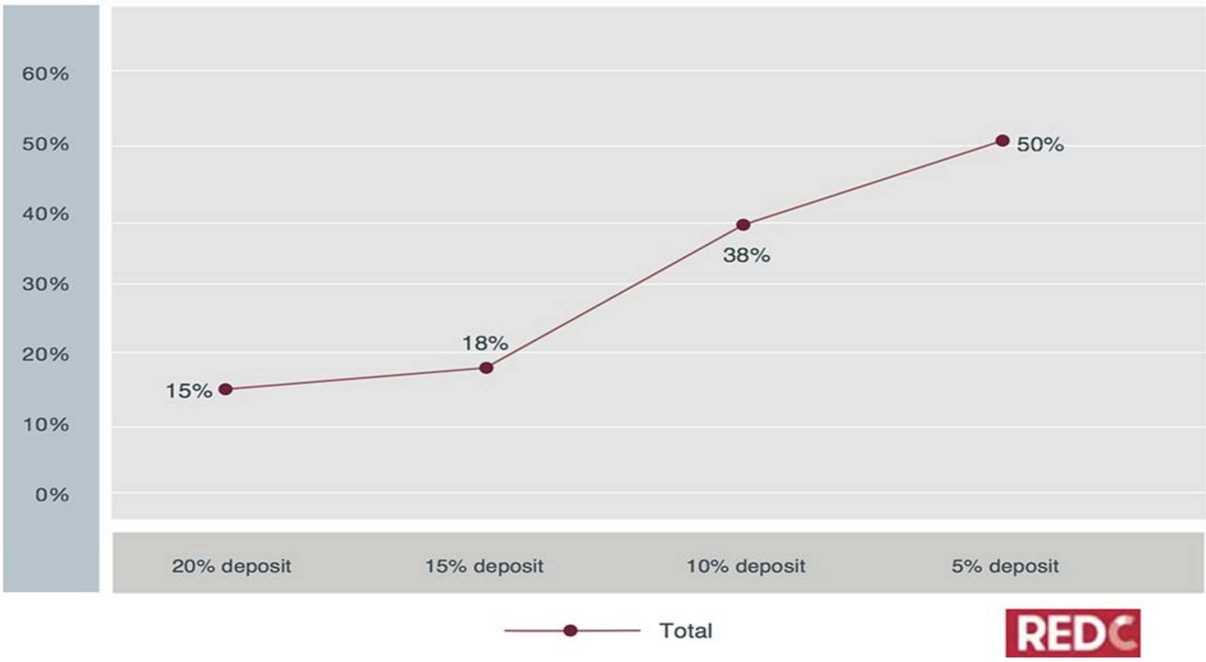
The results of both the RED C Poll and SCSI Member survey suggest that while the principle of the LTV limits is acknowledged, the proposed level of the limits at 80% is overly restrictive and could have a negative impact on the affordability levels of prospective purchasers in the market.

Furthermore, the proposed limits, if set at 20% are likely to impact the viability of residential housing development sites being developed, thus further impacting the availability of supply – which is a key issue in the market.

It has only recently become viable to build homes in Dublin as house prices increased beyond the costs of construction and these measures could have a negative impact on the economics of developments going ahead and the supply shortage could be further compounded.

The SCSI therefore asked both the RED C Poll and SCSI member Survey respondents what a reasonable LTV limit might be, in their opinion.

» Fig 6: Red C Poll – Level of Deposit Affordability



In terms of affordability, 2 in 3 claim they would be unlikely to be able to source a 20% deposit amount. Half claim they would be able to source a 5% deposit.

As Figure 6 illustrates, the larger the deposit required, the ability of people to fund the deposit declines significantly.

- 15% say they could afford a 20% deposit
- Almost 20% say they could afford a 15% deposit
- 40% say they could afford a 10% deposit
- 50% say they could afford a 5% deposit

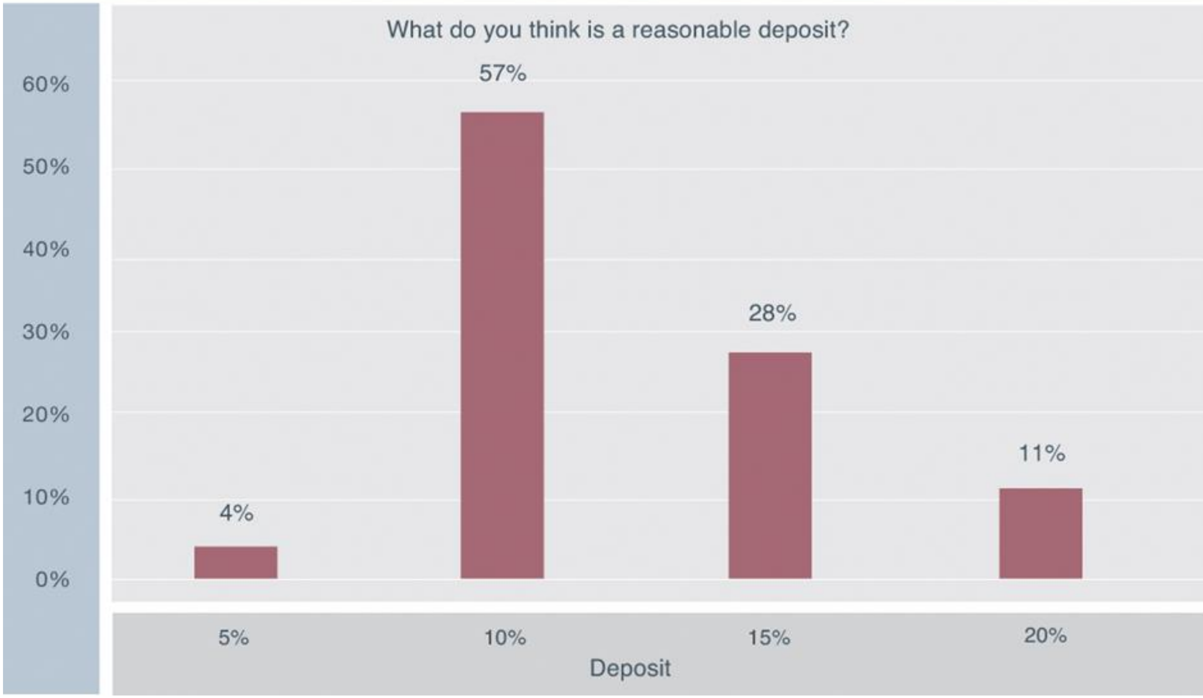
The SCSI's view is that the 5% deposit is too low and would contravene the principles set out by the Central Bank in its Macro Prudential Policy paper.

Case Study: There are significant variations in terms of the LTV limit requirements depending on location. In addition the ability of a buyer, who is renting, to save in Dublin is further restricted due to higher rents.

Location	House Type	Price	Deposit	Monthly Rent
Finea, Co. Cavan	3 bed Semi	€175000	€35000	€400
Glasnevin, Dublin	3 bed Semi	€375000	€75000	€1400

The SCSI also asked its members what they thought were reasonable LTV limits:

» Fig 7: SCSI Member Survey on Deposits



According to the SCSI Member Survey:

- 4% feel that a 5% deposit is reasonable
- 60% feel that a 10% deposit is reasonable
- 30% feel that a 15% deposit is reasonable
- 11% feel that the 20% deposit is reasonable

SCSI Recommendations

While we acknowledge that there is a degree of flexibility around 15% of loans in terms of LTV limits, we would recommend that a more reasonable LTV limit would be in the 85-90% range. It is also recommended that the LTV limits are introduced on a phased basis and not on the proposed 1st January 2015 deadline.

It should also be noted that prudent lending practices by the financial institutions around repayment capacity is very important.

Sources of Funding for the Deposit

A key issue in relation to the level of deposit required is how prospective purchasers will fund the deposit.

A key rationale for the introduction of the proposed macro-prudential measures is to reduce the levels of unsecured lending to households as a means of reducing the risk of their overall indebtedness.

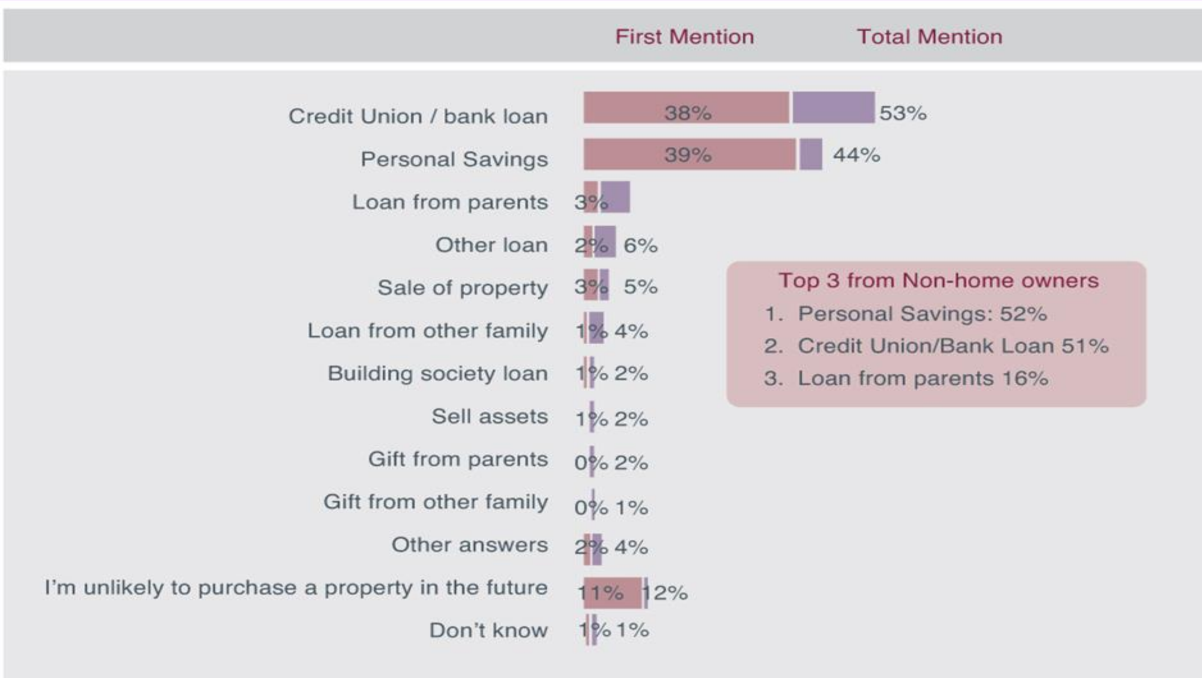
There is a risk, however, that if the LTV restrictions are too stringent, prospective purchasers will be forced to borrow funds from other unsecured sources.

One of the key findings of the RED C Poll commissioned by the SCSI was to ask where the 20% deposit would be sourced from.

Worryingly, 53% said they would get it from a credit union or bank loan.

Given that the intention of the macro-prudential policies is to reduce the level of unsecured lending, the 20% deposit requirement may actually have unintended consequences such as increasing the level of unsecured lending which could actually put households at a higher risk of default.

» Fig 8: Red C Poll – Likely Sources of Funding the 20% Deposit



- 1 in 2 said that they would source the deposit from a Credit Union or Bank Loans
- A similar number said they would source if from personal savings
- 10% said they would source it from parents

SCSI Recommendations

A key consideration for the Central Bank must be to weigh up the level of the LTV requirements with the associated risk of an increase in households sourcing the deposit from other unsecured sources.

(ii) Proposed Loan to Income (LTI) Restrictions

The Central Bank proposes to restrict lending for primary dwelling purchases above 3.5 times Loan to Income to no more than 20 per cent of that aggregate value.

The RED C Poll commissioned by SCSI asked people about the feasibility of various Loan to Income ratios to achieve a sufficient mortgage.

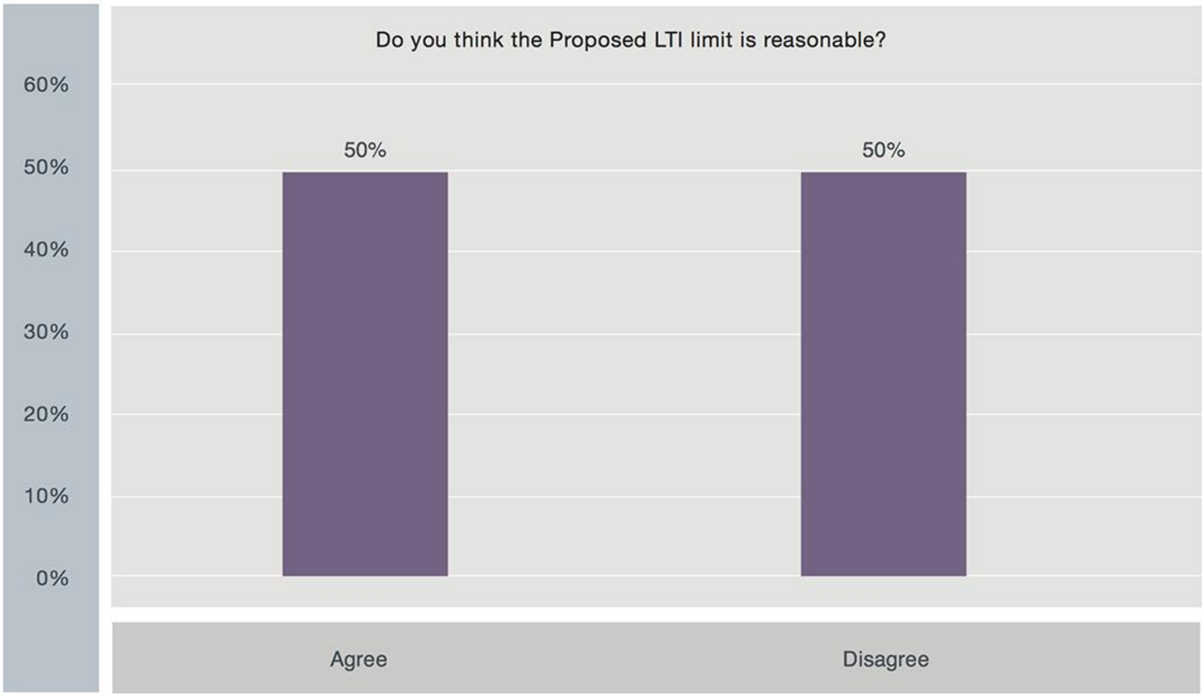
There was a not a wide variance in terms of responses to the various Loan to Income limits.

When asked about the different salary points, however, it is evident that only when 4 and a half times their salary is mentioned, this is the only point that can make a difference in likelihood to achieve a sufficient mortgage.

The SCSI also asked its members about their views on whether the proposed Central Bank LTI limits are reasonable.

There was a mixed response with roughly half agreeing and half disagreeing.

» Figure 9: SCSI Member Survey – Proposed LTV Limits



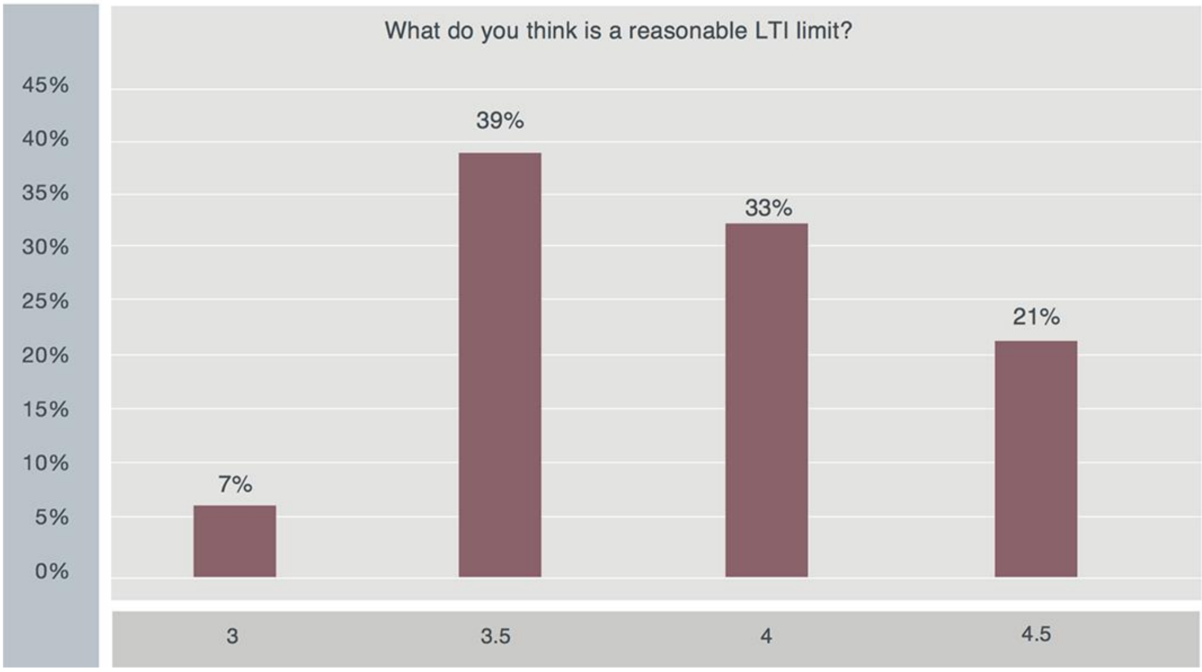
Further analysis of the survey would suggest that in principle having relatively strict LTI limits will support more prudent lending practices.

It would also suggest that the LTI limits aren't necessarily the key issue in terms of impacting the ability of prospective purchasers to buy a home and that the proposed 80% LTV limits will have a greater impact.

It was also acknowledged, anecdotally, that the financial institutions already have in recent years, put in place more stringent lending practices and stress tests on prospective purchasers which is to be welcomed.

SCSI also asked its members their views in relation to what, if introduced, the LTI levels should be.

» Figure 10: SCSI Member Survey – Proposed LTV Limits



The SCSI survey showed that

- 7% think that 3 times income limit is reasonable
- 40% believe that 3.5 times income limit is reasonable
- 33% believe that 4 times income limit is reasonable
- 21% believe that 4.5 times income limit is reasonable.

SCSI recommendation

There should be some flexibility in relation to the income limit somewhere between 3.5-4.5 income levels, depending on the location of the property.
It is recommended that people who have a strong credit history and track record of paying rent over a 2 year period should be taken into consideration

Mortgage Insurance Proposal

The Central Bank Macro Prudential Policy document also noted the possibility that lenders wishing to make loans at higher LTV ratios than the cap and who have obtained an adequate form of guarantee from a highly credit-worthy guarantor for the excess of the loan over the cap should be allowed to treat this guarantee as allowing an exemption from the LTV cap.

The SCSI would welcome in principle the possibility of a mortgage insurance scheme being introduced by the financial institutions

A recent Government strategy document indicated that consideration would be given to the concept of a mortgage insurance scheme which is awaiting details.

The SCSI believes that a Government-backed scheme could support prospective purchasers but that addressing the supply shortage is the key issue to stabilising property prices .

Unintended consequences

As previously outlined, the SCSI supports the principle of better regulations and more prudent lending to protect households against indebtedness.

Any proposals to be introduced, however, should also be considered from the perspective of ensuring that people who wish to buy a home and have the track record, repayment capacity and finance should not be discriminated against by limits that do not take into account the real dynamics of the property market. For example, it will be far more challenging for a prospective purchaser to meet the limits in Dublin where average property prices are higher than other areas. Similarly, the fact that rents have increased in Dublin at a faster rate than other areas, further limits the potential to purchase.

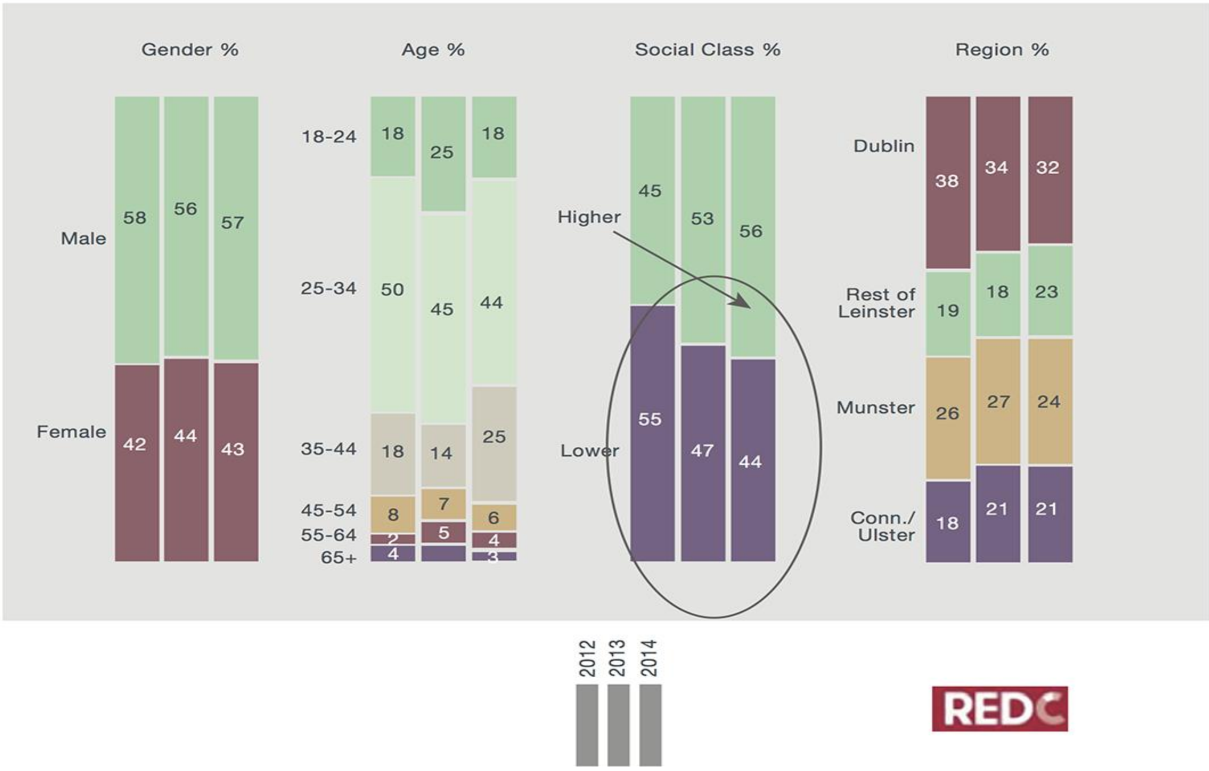
Any interventions in the market must be considered in terms of the current supply shortages and it is the SCSI's view that in order to achieve a more sustainable property market, and to protect against its inherent cyclicality as far as is possible, a coordinated approach to mortgage limits must be balanced out by meeting the supply shortage challenges and considering the financing requirements of developers.

The impact of these proposed limits on the private rented sector cannot be underestimated. Approximately one in five households are currently in private rented accommodation. A supply shortage in the housing market has already led to a shortage in the availability of private rented accommodation and increases in rents.

The proposed Central Bank LTV and LTI limits, if introduced in their current format, may put further pressure on the private rented sector and further rental price inflation.

If this happens, further pressure will also be put on the social housing sector. The Housing Agency has stated that over 89,000 people are in need of some form of social housing support.

» Fig 11: RED C Demographic Profile of Renters Overtime



The above chart shows the trend over the past 36 months of a larger percentage of people from a higher social class now comprising the private rented sector. The percentage of people from a lower social class has reduced from 55% (2012) to 47% (2013) to 44% (2014) over the past 3 years which would suggest that the supply issues in the sales market is pushing more people into the private rented sector at the expense of those from a lower social class.

Valuation Standards

In 2012, the Central Bank published *'Valuation Processes in the Banking Crisis – Lesson s Learned – Guiding the Future'* . The report highlighted that many professionals in the banking industry lacked the appreciation and significance of property valuations in the lending process. The report referred to the valuation standards and principles developed by the RICS/SCSI, in accordance with international valuation standards, also known as the Red Book.

The Red Book is a mandatory Practice Standard for all SCSI/RICS members carrying out mortgage valuations. It contains full procedures for preparing valuation reports including conflict of interest checks, terms of engagement, instructions and the provision of clear reasoning and use of relevant comparables.

Regulation of valuation services is overseen by the SCSI/RICS quality assurance scheme, known as the **RICS Valuer Registration Scheme (VRS)** since July 2012. While currently a voluntary scheme, this scheme will be made mandatory for all valuers who are SCSI/RICS members in 2015 in order to engender confidence in, and to provide assurance to, clients and recognised users alike, that a valuation provided by an SCSI/RICS qualified valuer will be undertaken to the highest professional standards overall.

An essential component of ensuring the integrity of the valuation process is the requirement that financial institutions *demand* that all residential mortgage valuations are undertaken in association with international standards, such as the Red Book that is in full compliance with the International Valuation Standards (IVS).

Conclusion

The SCSI welcomes the principle of the Central Bank Macro-Prudential proposals but has concerns about the inflexible nature of the proposed levels which do not fully take into account the multi-tiered nature of the property market and may in effect, create more of a 2-tier market and urban/regional divide.

It is also concerned about potential unintended consequences including further pressure on the private rented sector, a further impact on the viability of increasing much needed supply and further consequences for those in need of social housing which relies heavily on the private sector given the recent collapse in exchequer funding for social housing provision.

We also have concerns about how people will fund the 20% deposit and the results of the RED C poll which suggest that over half will source unsecured funding which may directly contravene the intention behind these proposals which is to reduce household indebtedness.

Finally, these proposals must be considered in the context of a more integrated approach to a developing a more sustainable sector. Prudence in lending is one factor but addressing the supply shortage is another crucial one and the impact of these proposals on construction viability must be fully considered.

The SCSI would welcome the opportunity for further engagement with the Central Bank of Ireland on this important issue.

About the SCSI

Dating back to 1895, the Society of Chartered Surveyors Ireland is the independent professional body for Chartered Surveyors working and practicing in Ireland.

Working in partnership with RICS, the pre-eminent Chartered professional body for the construction, land and property sectors around the world, the Society and RICS act in the public interest: setting and maintaining the highest standards of competence and integrity among the profession; and providing impartial, authoritative advice on key issues for business, society and governments worldwide.

Advancing standards in construction, land and property, the Chartered Surveyor professional qualification is the world's leading qualification when it comes to professional standards. In a world where more and more people, governments, banks and commercial organisations demand greater certainty of professional standards and ethics, attaining the Chartered Surveyor qualification is the recognized mark of property professionalism.

Members of the profession are typically employed in the construction, land and property markets through private practice, in central and local government, in state agencies, in academic institutions, in business organisations and in non-governmental organisations.

Members' services are diverse and can include offering strategic advice on the economics, valuation, law, technology, finance and management in all aspects of the construction, land and property industry.

All aspects of the profession, from education through to qualification and the continuing maintenance of the highest professional standards are regulated and overseen through the partnership of the Society of Chartered Surveyors Ireland and RICS, in the public interest.

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