# EBS DKM Affordability Index

## Buying your home is now much more affordable and potential buyers should start considering their options, writes **Dara Deering, Director, EBS Membership Business**

In the first six months of 2009 a number of factors have impacted affordability for first time buyers. Overall, the Irish economy has continued to contract and personal incomes have suffered due to the changes announced in the supplementary budget in April of this year. However, this should be balanced against the fact that house prices have continued to decline, interest rates have dropped to a record low (ECB is now at 1%) and as a result affordability has returned to the levels of the mid 1990s. The real cost of buying your first home has significantly reduced.

Over the last year, house prices have continued to decline as demand for housing in the market has slowed. According to recent figures issued by the ESRI/PTSB, average house prices have declined by 6.2% in the first five months of 2009 and prices for first time buyers have declined by 9.2%.

Consumer sentiment (as measured by the IIB Bank/ESRI Consumer Sentiment Index) has remained at low levels over the last year and with the exception of December, has been consistently below 50 points. Widespread job losses, lower after tax incomes and uncertainty about economic prospects have clearly influenced consumer sentiment. It is anticipated that sentiment levels will continue in a similar vein throughout 2009.

Mortgage interest rates, which directly impact affordability for new buyers, have reduced significantly in the past 12 months. The European Central Bank (ECB) decreased lending rates seven times by a total of 3.25% to 1%. Last July the average standard variable in Ireland was 5.86%. The average standard variable rate is now 3.00%. This equates to an average savings to mortgage holders of over €400 per month on a typical mortgage of €250,000 and the European central bank has indicated that interest rates are likely to remain at these lower levels throughout 2009.

While low levels of current consumer sentiment and confidence have been keeping some first time buyers away, there is no doubt that affordability has improved over the past six months. We have seen in the first half of this year an increased level of enquiries and applications for mortgages (source: IBF). Access to finance is more challenging today than it has been in the past, however this increased level of activity is an indication that first time buyers are now starting to consider dipping their toes in the water.

Furthermore, with many developers now offering much lower prices for new properties particularly in Dublin, this is also 'whetting the appetite' for many new buyers. Over the course of the year first time buyers should find it easier to get good value and take their first step onto the property ladder.

**The EBS DKM Housing Affordability Index** is a measure of the proportion of after tax income required to meet first year mortgage repayments for an 'average' first time buyer (FTB) working couple, each on average earnings. It takes into account changes in mortgage rates, changes in the level of mortgage interest relief, and is based on average earnings and new house prices in Dublin and across the national average.

## Key Highlights June 2009

- First time buyer working couples are paying 14.2% of their net income in mortgage repayments (18% in Dublin). These figures compare with 26.4% (32.5% in Dublin) at the end of 2006.
- Monthly mortgage repayments for the average first time buyer have reduced by up to 36.5% in the last 12 months.
- Over the past year, national house prices have dropped from an average of €275,200 to €245,300 - a decline of 10.9% (based on the permanent-tsb/ESRI data).
- Since July 2008 to date, the average standard variable rate has declined from 5.86% to 3.00%.
- Income reductions and levies, with increased unemployment, mean first time buyers are remaining cautious about buying their first home.

## Affordability is an essential ingredient in any housing market, but the key requirement is confidence, writes **Annette Hughes, Director DKM Economic Consultants**

### A major focus of housing policy in the past

The issue of housing affordability has been high on the policy agenda for the past fifteen years. The topic first came to prominence in the last housing boom, and as a result, in the late 1990s the housing policy focus was very much on increasing the overall supply of housing and improving affordability for persons who were unable to access home ownership due to escalating house price inflation. Within this, the focus was very much on the first-time buyer. Average house prices were rising at close to 30% per annum in 1998/99 with the result that first-time buyer working couples were faced with having to pay an average of almost 23% of their net income in mortgage repayments and close to 27% in Dublin at that time.

The affordability situation continued to get worse from 2000 as average house prices carried on rising, albeit at a slower rate, although falling interest rates over the period 2001 to 2005 helped offset some of the negative impacts. Housing became most unaffordable in December 2006, when average first-time buyer working couples across the State had to pay almost 26.5% of their net incomes in mortgage repayments and 32.5% in Dublin. Housing affordability has been improving ever since for a number of reasons which we explain below.

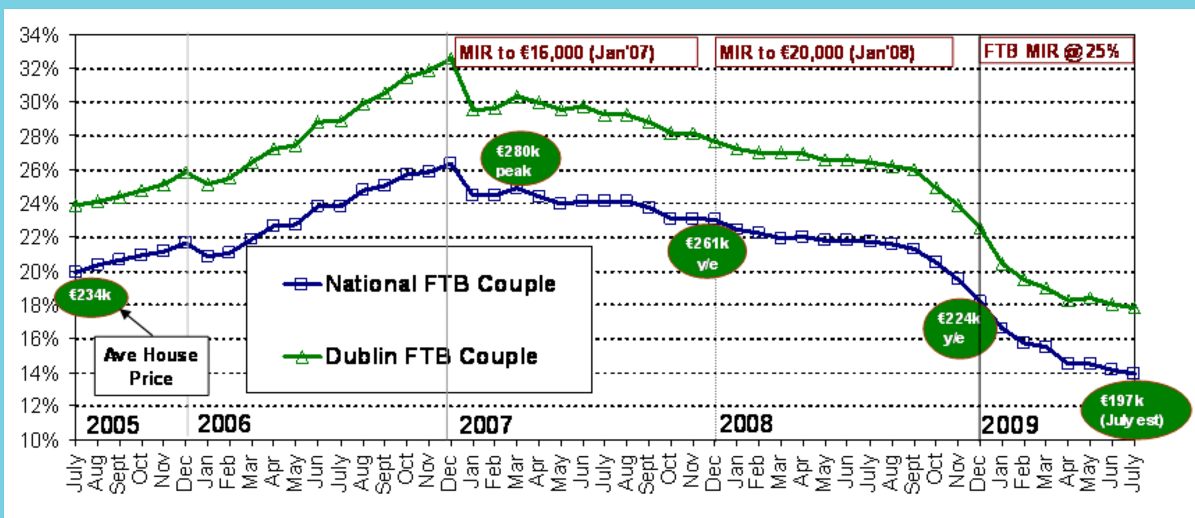
### Conditions in housing market damaged by weak confidence

The changed economic realities which have unfolded over the past twelve months together with the onset of economic recession have dramatically altered conditions in the housing market. The current conditions reflect very weak consumer sentiment as potential house buyers have been holding back due to concerns about their jobs and the general economic situation. Consumers perceive that is it not a good time to make major purchases despite the very favourable reductions in house prices and mortgage rates to date. Average first time buyer house prices have already fallen by almost 28% in real terms since their peak (March 2007).

Thus, although housing affordability has improved substantially, many potential purchasers expect further house price falls over the coming months. Housing transactions have also dropped sharply, reflecting a lack of confidence amongst buyers, which is reducing demand, as well as difficulties securing adequate mortgage funding for those in the market. The total number of mortgage loans paid out to first-time buyers declined by 34.5% to 19,946 in 2008 compared with 2007. In Q1 2009 alone, only 2,356 loans were paid out, 46% less than in Q1 2008.

Affordability is an essential ingredient in any housing market, allowing more potential house buyers to transact in the market when affordability improves. Potential house buyers are only likely to purchase a house if they can afford to do so and if they have confidence in the market at that time. The difficulty is that confidence in the market is very weak at the present time and while house prices are expected to fall further, there is no real urgency to buy.

### Housing affordability over four years with forecasts to July 2009




The proportion of net income for a FTB working couple required to meet net mortgage repayments on the 'average' house price based on a 90% loan to value ratio and a 25 year mortgage

### ..but there has been a substantial improvement in housing affordability

**The EBS DKM Housing Affordability Index** chart illustrates the significant improvement in housing affordability since early 2007. The latest estimate shows that a first-time buyer working couple is paying 14.2% of their net income in mortgage repayments and 18% in Dublin. These figures compare with 26.4% and 32.5% respectively at the end of 2006. Net monthly mortgage repayments for the average first-time buyer across the State are currently around €749 compared with €1,203 in July 2008 – a reduction of €454 or almost 38%. The corresponding repayments for a first-time buyer couple in Dublin are €1,015 compared with €1,552 last July 2008 – a reduction of €538 or 35%. The reduction in mortgage rates since the peak in August 2008 has led to a decline of €339 or 29% by June this year in the average monthly repayments on a €200,000 mortgage. In a situation in which incomes have remained the same over this period or have declined, this is a welcome development.

## Special Focus:
How do Budgets impact on the housing market?

### Improvement in affordability helped by measures in 2007 and 2008 Budget

There are many factors which explain the improvement in housing affordability over the past two and a half years, the main one being the reduction in house prices. However changes in mortgage interest relief were also responsible:

- The initial improvement around the peak (early 2007) commenced with a doubling in the value of mortgage interest relief (MIR) in the 2007 Budget from January 2007 to €8,000 for single persons and €16,000 for married persons who were first-time buyers or were in the first seven years of their mortgage.
- There was a further positive change in the 2008 Budget which increased the maximum value of MIR further to €10,000 for single persons and €20,000 for married persons.

The benefits of these increases however require the couple with a mortgage to be paying the maximum amount of interest on their mortgage (i.e. €20,000 for a married couple) in order to gain the maximum benefit in terms of interest relief (equivalent to €333.33 per month up to December 2008). That said both measures, along with price reductions, helped to improve housing affordability throughout 2007 and 2008 as the Chart demonstrates.

### But measures in the 2009 Budgets did not favour house buyers or home owners

However, more recent measures announced in the October 2008 and April 2009 Budgets are unlikely to stimulate housing demand anytime soon:

- Disposable incomes have been reduced as a result of the new income levy introduced in the October 2008 Budget which was doubled in the April 2009 Supplementary Budget. A further pension levy was also introduced for public sector workers last October. Our average first-time buyer working couple earning a gross income of €82,370 at the beginning of this year has already seen their income reduce by €275 in the first four months and by €2,875 per annum (or 4.3%) since December 2008 under the increased health and income levy provisions from May.
- Mortgage interest relief was abolished from the 1st May for all principal private residences after the first seven years of a mortgage. The current level of mortgage interest relief for a first-time buyer married couple is available at 25% in the first two years for interest paid up to a maximum of €20,000, compared with 20% previously. The rate of relief falls to 22.5% in years 3-5 and 20% in years 6-7. After 7 years the relief expires. This amounts to a total relief of €5,000 per annum or €417 per month in the first two years.
- Based on the April 2009 Budget statement, which referred to plans to broaden the tax base and stabilise the budget deficit by 2013, further tax measures are expected in the 2010 Budget, including the possibility of a residential property tax on all home owners.
- A new €200 tax on second homes was introduced in the October budget and is expected to hit an estimated 200,000 second homes across the State.
- In terms of the rented sector, the October 2008 Budget reduced the level of relief that investors are allowed to claim against interest paid on loans for residential property to 75% from 100%. Landlords are also affected by the increase in the capital gains tax to 25% from 22%.
- A further factor discouraging house purchase is the 16% reduction in private sector rents in the year to April 2009 (source: Daft.ie.).

All of the above will impact on a potential buyer's ability to raise a mortgage, notwithstanding the favourable reductions in house prices, mortgage interest rates and consumer prices to date.

### Trends in housing affordability for FTB working couple with forecasts to July 2009

| | Dec 05 | Dec 06 | Dec 07 | Dec 08 | Jan 09 | Mar 09 Actual | Jun 09 Forecast | Jul 09 Forecast |
|---|---|---|---|---|---|---|---|---|
| Average mortgage rate | 3.63% | 4.81% | 5.35% | 4.79% | 4.16% | 3.67% | 3.00% | 3.00% |
| **National first time buyer working couple** | | | | | | | | |
| Monthly repayments (€) | 1,018 | 1,323 | 1,228 | 1,007 | 912 | 850 | 749 | 737 |
| **As % of net income** | 21.6% | 26.4% | 23.0% | 18.2% | 16.6% | 15.5% | 14.2% | 13.9% |
| Ave house price (000s) | 249.5 | 279.0 | 260.8 | 224.2 | 222.4 | 215.4 | 200.0 | 196.8 |
| **Dublin first time buyer working couple** | | | | | | | | |
| Monthly repayments (€) | 1,295 | 1,741 | 1,573 | 1,325 | 1,193 | 1,110 | 1,015 | 1,002 |
| **As % of net income** | 25.8% | 32.5% | 27.7% | 22.5% | 20.4% | 19.0% | 18.0% | 17.8% |
| Ave house price (000s) | 309.6 | 359.0 | 333.9 | 294.9 | 290.9 | 281.3 | 271.0 | 267.5 |

**ASSUMPTIONS:**
**Monthly House Prices:** permanent-tsb/ESRI data; 90% loan to value ratio.
Latest data show average FTB prices down by 10.7% year to April; assume prices fall 1.6% per month May to July.
**ECB Rates:** down from peak of 4.25% on 14th Oct'08 to 1% on 13th May 2009 following 7 reductions since Oct'08.
**Average Mortgage Rates:** Latest 3% in June 2009.
**Maximum Mortgage Interest Relief:** €20,000 max available at 25% since Jan 2009 = €417 per month max.
**Average gross income** for FTB working couple of €80,978 in 2008, up 4.3% on 2007. Gross income unchanged at €82,370 since July 2008.
Income levy from January 2009. Incomes of Dublin buyers 10% higher than for buyers across the State as a whole.

## It's all about supply and demand. Demand for mortgages needs supply of mortgage credit, **concludes Dara Deering.**

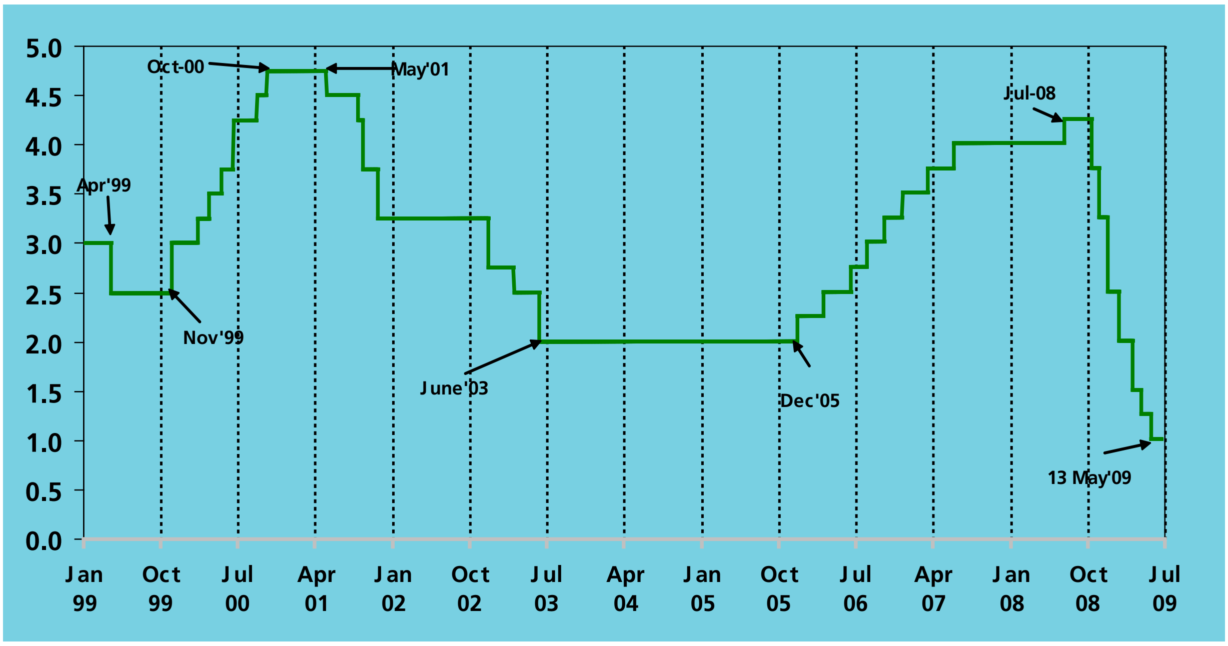
Irelands financial landscape has changed dramatically over the last year with the six banks now covered under the Government Guarantee Scheme, (one of these bank has been fully nationalised) and the National Asset Management Agency (NAMA) is in the process of being established. Furthermore the tightening of international money markets and the effective withdrawal from lending by foreign banks in Ireland has reduced the availability of funding in Ireland. This has and will continue to have an impact on first time buyers.

Overall market activity is down significantly due to the combination of demand and supply factors. Figures released by the Irish Banking Federation show that new lending in Q1 2009 was just under €2bn, a drop of 68% on the same period in 2008. For the market to recover we need demand and supply factors to be addressed. Demand is down due to the economic factors and supply is down due to an unwillingness of many banks to lend in this market.

Demand factors will be addressed through time as house prices continue to reduce. Over the past year developers have become more pragmatic in their approach to selling, and many have reduced pricing on developments, introduced "Rent to buy" schemes and other such innovations in order to encourage first time buyers into the market. Buyers are generally in a good position when it comes to negotiating price whether for new or existing properties. This coupled with improved affordability will impact confidence and early signs are encouraging; first time buyers are starting to get back into the market.

The supply of mortgage finance will only get addressed post recapitalisation of the Irish Banks and the effective establishment of the National Asset Management Agency. However we are unlikely to see a meaningful return to the mortgage market by foreign banks for some time. Once the flow of mortgage funding increases, access to finance will be easier for first time buyers who want to get onto the property ladder.

### ECB interest rate cycle over ten years to June 2009




Looking forward, **Annette Hughes** believes that house prices are likely to continue falling over the remainder of the year and into 2010. With mortgage rates at or close to their trough in the current cycle, the expectation is that housing affordability will continue to improve. There is the risk of further reductions in disposable incomes, (either as a result of pay cuts imposed by employers or further tax increases in the 2010 Budget), which would damage affordability prospects further. But the positive developments which have transpired to date have failed to act as the catalyst that they would otherwise be for the housing market due to the lack of confidence, the increase in unemployment and the economic recession.



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