Where Family Counts

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EBS DKM Affordability Index

November 2012

The EBS DKM Housing Affordability Index is a measure of the proportion of after tax income required to meet the first year's mortgage repayments for an 'average' first-time buyer (FTB) working couple, each on average earnings. It takes into account, not just property prices, but changes in mortgage rates, mortgage interest relief and disposable incomes for the average FTB working couple in Dublin and across the State.

House prices and interest rates continue to be main driver for affordability

writes **Owen Purcell, Head of Mortgages at EBS**

According to the latest CSO Residential Property Price Index, prices fell by 9.6% in the year to September 2012, compared to 14.3% in the year to September 2011. As always, there continues to be divided opinion on whether or not prices have reached the bottom. Importantly, property prices have been fairly flat over the last 7 months. If we consider the last year's decline of 9.6% in two halves, house prices declined nationally by only 0.5% in the last 6 months compared to a decline of 9.2% in the previous 6 months. Dublin has performed slightly better with prices up 1.2% in the last 6 months. There is some consensus building amongst commentators that if we are not there, we are nearly there.

According to the Department of the Environment, Community & Local Government the number of house completions continues to decrease, with just over 5,300 new dwellings connected for electricity (proxy for housebuilding) in the first eight months of the year, 23% less than the same period last year.

While the mortgage market also remains subdued, the mortgage market profile statistics confirmed a year on year increase in the home purchase segments, i.e. First Time Buyers and Next Time Buyer sectors, the first year on year increase since the Quarter 1 of 2006. 2,858 mortgages were advanced to First Time Buyers in the first half of this year, accounting for 49% of all new mortgages issued.

Consumer sentiment (as per the KBC Bank Ireland/ESRI Consumer Sentiment Index) had shown steady improvement since the start of the year but remains fragile, dipping back in September to March 2012 levels. The average level so far this year has been at 62, an increase from December 2011 when it was 49.2. This suggests that confidence has been somewhat revived amongst consumers, albeit, easily undermined.

One major factor which may affect consumer confidence will be the upcoming budget. It is likely that measures will impact disposable income in Irish households, in addition households will have to cope with the proposed property tax. Any additional unanticipated measures introduced in the budget could further impact consumer confidence and dampen demand.

Another important aspect in the movements of affordability is the interest rate at which customers can borrow. There has been a general increase in new business rates towards the end of Quarter 3 as lenders have looked to price mortgages taking into account the cost of accessing finance.

In summary, some stability is evident in the mortgage market as new lending for home purchases is up year on year. House prices are down 9.6% year on year but have been broadly flat for the last seven months. As a result of this, there is great value to be had for consumers and with interest rates relatively low by historical norms, affordability remains a key driver for those thinking of purchasing property for 2012.

Key Highlights November 2012

- Residential property prices nationally are down 50% since their peak and 9.6% in the last year but have been broadly flat for the last 7 months.
- First Time Buyers continue to be the strongest segment, with 51.1% of new lending in Quarter 2, 2012.
- Consumer sentiment index measured 60.2 in September 2012, up from a lower position 49.2 in December 2011.
- The average first time buyer working couple is spending 11.7% of their joint income to fund a mortgage, compared with 26.4% in December 2006.

Housing affordability showing signs of stabilisation as year-end approaches

writes **Annette Hughes, Director DKM Economic Consultants**

Annual rate of decline in property prices reaches its lowest rate in four years

According to the CSO's Residential Property Price Index (RPPI), prices nationally in September were down 50% from the peak (September 2007). On an annual basis prices were down 9.6%, the first single digit decline in year-on-year terms since October 2008. However, the rate of change on a monthly basis has been positive since July, with the rate of increase accelerating modestly in each of the last three months from 0.2% in July to 0.5% in August and 0.9% in September. Whether these trends signal a bottoming out in average property prices across the State remains to be seen. Following the sharp decline in consumer sentiment in September, which revealed a very fragile consumer concerned about another tough Budget in December, the extent of uncertainty around disposable incomes in 2013 suggests that we may have to wait to see if this trend in property prices continues in the opening months of 2013 before any sense that prices have stabilised can be confirmed.

In Dublin average prices in September were down by 56.4% from the peak (February 2007). The monthly rate of change turned negative in each of the three months to August, despite having been positive in each of the previous three months March to May 2012. However average prices recorded their strongest monthly increase in September (+2.4%) since August 2006. Given the scale and diversity of the Dublin market, this may indicate that some locations may be witnessing a relatively strong recovery in property prices, a trend which is evident both anecdotally and from other indices of transactions prices. As with the national trend, the annual rate of decline reached its lowest since August 2008, at just below 10% in September.

Based on the trends to date, the average first-time buyer (FTB) property price nationally was estimated at €134,100 in September or 3.75 times average earnings. The corresponding estimate for Dublin was €168,700 or 4.3 times average earnings for Dublin FTBs.

Average FTB property prices in Dublin are currently estimated to be almost 26% higher than average FTB prices across the State as a whole compared with 32% at the beginning of 2009.

Housing affordability nationally showing signs of stabilisation

The recent trends in property prices have led to some stability in the housing affordability measure. The proportion of net income required to fund a mortgage for the average FTB working couple in the State is currently estimated at 11.7% (October 2012) and has been at or around this level since February this year. This stability reflects the fact that net repayments and disposable incomes have fallen at around the same rate (c. 1%) over the past eight months. The current affordability estimate compares with 12.8% in October 2011.

Conversely in Dublin, housing affordability reached a low point in February this year at 13.5% of net income. An increase in average prices in Dublin since (+1.3%) combined with a reduction in disposable incomes (c. 1%) has seen the measure of affordability increase to 13.9% in September. Estimates are, however, still below the corresponding percentage recorded twelve months earlier of 15.6%.

The projections for housing affordability assume that property prices continue to fall at a rate of 0.7% per month both nationally and in Dublin until December 2012. They also use the average standard variable mortgage rate, based on approximately eight mortgage lenders which report to the Central Bank and Financial Services Authority of Ireland. The most recent average figure published is 4.25% for August. Gross earnings are assumed to remain unchanged between 2011 and 2012. The Affordability Table contains projections up to December 2012 and predicts a continued stabilisation in affordability nationally, reflecting further falls in property prices but an increase in the average variable mortgage rate to 4.35% in November. National FTB working couples are expected to be paying 11.6% of their disposable incomes in December compared with an average of 11.7% for the year as a whole.

For Dublin FTBs, the proportion of net income required to fund a mortgage is expected to remain at 13.8% in each of the three months October to December compared with an average of 13.7% for the year as a whole. If average house prices were to continue increasing at the same rate as in September (+2.4% per month) from October through to December, there would be a significant deterioration in affordability with Dublin FTBs paying 15.1% of their net incomes to fund a new mortgage by December.

Single FTBs nationwide are expected to be paying 23.2% of their net incomes in mortgage repayments by December this year compared with 24.4% at the end of 2011.

The lack of consumer confidence remains a substantial barrier to transactions

Despite the substantial improvement in housing affordability there are few transactions, due to 1) a lack of consumer confidence, as potential buyers remain concerned about their household finances in the next twelve months, including further possible reductions in their disposable incomes in the forthcoming Budget and a property tax from mid-2013; and 2) difficulties accessing mortgage credit. However the most recent data on mortgage transactions from the Irish Banking Federation for Q2 2012 is encouraging and shows an increase in the number of FTB drawdowns of almost 10% year-on-year or 7% for all mortgages involving a property transaction. There have also been increases, albeit more modest, in the first half of 2012, equivalent to 1.9% (for FTBs) and 1.7% respectively. In regard to the overall market the Property Price Register (PPR) shows that there were approximately 9,400 transactions in the first six months compared to 5,050 transactions involving a mortgage drawdown. By the 12th October this year, the PPR had reported almost 15,700 transactions, which is equivalent to around 20,000 for the full year.

Negative equity is also a factor for many who purchased their first home in the past decade

Falling house prices also create negative equity problems for existing households who end up in a situation in which they owe more when their mortgage debt outstanding is greater than the current value of their properties. Estimates of the numbers of households in negative equity vary widely from over 30% to around 50% of mortgaged properties.

Research undertaken by the Central Bank (Kennedy and McIndoe Calder, 2011) on the residential mortgage books of the four main credit institutions only estimated the number of households in negative equity at 31% of mortgaged properties, representing over 47% of the outstanding mortgage loan balances at the end of 2010. These proportions represented 145,400 properties or 175,000 loans, the vast majority of which were taken out between 2004 and 2008. The same research reported that if house prices were to fall by another 20% from their official Q4 2010 level, the total number of mortgages in negative equity would increase to 236,600. The actual rate of decline in average property prices nationally since Q4 2010 has been almost 22%.

Taking an example of a FTB working couple who purchased a property in June 2005 (the date our monthly index commenced) at the average FTB house price nationally of €230,688 with a 90% loan to value ratio and at the standard variable mortgage rate, that couple today would have negative equity of €37,536. This figure represents the difference between the value of the property today (€130,000) and the outstanding balance on their mortgage (€167,536).

Should this couple avail of the new negative equity mortgage products in the market, some of which have a maximum LTV ratio of 175%, they could trade up to a property worth say, €200,000. Adding the negative equity of €37,500 to the new mortgage, the LTV would be 109%, assuming a 90% LTV for the new property. Thus the value of the loan would be 109% of the value of the new house. Their corresponding monthly mortgage repayments would be €1,204 (assuming mortgage interest relief would not be available for the second purchase) compared with €976 per month under their original mortgage. In the second example in the Table if the couple were to trade up to a property worth €250,000, the LTV would be lower at 105% but their mortgage repayments would increase to €1,453.

First Example of Negative Equity Mortgage for FTB Working Couple who paid average FTB property price in June 2005

		Purchase A	Purchase B
Original average house price June'05 (25 year term)	€230,688		
Mortgage June '05 (90% LTV over 25 years)	€207, 619,		
Capital outstanding September'12	€167,536		
House Price September'12	€130,000	€200,000	€250,000
Negative Equity	€37,536		
New Mortgage (90%)		€180,000	€225,000
Plus Negative Equity		€217,536	€262,536
New LTV Ratio (including negative equity)		109%	105%
Previous Monthly Mortgage Repayments	€976		
Revised Monthly Repayments @4.35%*		€1,204	€1,453
* Assuming no Mortgage Interest Relief on second purchase			

Assume that the FTB couple originally paid €500,000 for their property back in June 2005. In this case availing of the new negative equity mortgage product and purchasing a property today for €300,000, the value of the new loan would be 128% of the value of the new property. Their corresponding monthly mortgage repayments would be €2,120 (assuming mortgage interest relief would not be available for the second purchase) compared with €2,116 per month under their original mortgage. In the second example in the Table if the couple were to trade up to a property worth €350,000, the LTV would be lower at 122% but their mortgage repayments would increase to €2,369.

Second Example of Negative Equity Mortgage for FTB Working Couple who paid €500,000 for a property in June 2005

		Purchase A	Purchase B
Original average house price June'05 (25 year term)	€500,000		
Mortgage June '05 (90% LTV over 25 years)	€450,000		
Capital outstanding September'12	€363,122		
House Price September'12	€250,000	€300,000	€350,000
Negative Equity	€113,122		
New Mortgage (90%)		€270,000	€315,000
Plus Negative Equity		€383,122	€428,122
New LTV Ratio (including negative equity)		128%	122%
Previous Monthly Mortgage Repayments	€2,116		
Revised Monthly Repayments @4.35%*		€2,120	€2,369
* Assuming no Mortgage Interest Relief on second purchase			

The new negative equity mortgage products allow persons to trade up to more suitable properties by adding their negative equity to their new mortgage. These products are likely to suit a certain sector of the mortgage market as not all households are prepared to take on additional debt in the current era of austerity, with concerns about the prospects for disposable incomes after the forthcoming budget and an imminent property tax in 2013. There are other charges expected in 2014, notably water charges, plus the termination of Mortgage Interest Relief for mortgages taken out by all new FTBs after December 2012.

Housing Affordability Trends for a FTB Couple and Single Person December 2006 – September 2012 with Projections to December 2012

	Dec 06	Dec 07	Dec 08	Dec 09	Dec 10	Dec 11	Sept 12	Nov12 Estimate	Dec12 Estimate
Average mortgage rate	4.81%	5.37%	4.80%	3.32%	4.02%	4.24%	4.25%	4.35%	4.35%
National first time buyer working couple - both working on average earnings									
Monthly repayments (€)	1,323	1,230	1,008	722	683	579	554	551	547
As % of net income	**26.4%**	**24.1%**	**19.4%**	**14.5%**	**13.9%**	**12.2%**	**11.7%**	**11.7%**	**11.6%**
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	140.3	134.1	132.3	131.4
National single first time buyer - on average earnings									
Monthly repayments (€)	1,390	1,306	1,008	722	683	579	554	551	547
As % of net income	**55.4%**	**51.1%**	**38.7%**	**29.0%**	**27.8%**	**24.4%**	**23.5%**	**23.4%**	**23.2%**
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	140.3	134.1	132.3	131.4
Dublin first time buyer working couple									
Monthly repayments (€)	1,741	1,577	1,326	929	877	720	697	693	688
As % of net income	**32.5%**	**29.0%**	**24.0%**	**17.6%**	**16.9%**	**14.3%**	**13.9%**	**13.8%**	**13.8%**
Ave house price (000s)	359.0	333.9	294.9	241.9	216.1	174.4	168.7	166.3	165.1

ASSUMPTIONS:
Monthly FTB Property Prices: permanent-tsb/ESRI FTB up to July 2009. Data from August 2009 derived by assuming that FTB prices fall in line with the CSO's Residential Property Price Index up to September 2012. Post September 2012, assume average FTB property prices decline nationally and in Dublin by 0.7% per month until December 2012. This % reduction represents the average monthly fall in the first nine months of 2012. The average Dublin FTB property price is assumed to be equal to 84% of the average Dublin price, based on the permanent-tsb/ESRI dataset.
Loan to value ratio: 90% **Mortgage term:** 25 years.
Average Variable Mortgage Rate: is an average of the standard variable mortgage rates for Mortgage Lenders reporting to the Central Bank & Financial Services Authority of Ireland (CSO/CB data). Latest published figure is 4.25% for August 2012. Average rates are assumed to increase to 4.35% in November and remain at that level in December 2012.
Maximum Mortgage Interest Relief for FTBs: €20,000 max MIR available for married couples at 25% since Jan 2009 = max of €417 per month and held at this level for FTBs in 2012.
Average Gross Earnings: Gross income figures represent average earnings according to the CSO's Earnings, Hours and Employment Costs Survey. The FTB working couple started out earning €70,000 in June 2005. Average earnings increased to €38,380 in Q2 2007 and fell back to €35,673 in Q1 2010, 3.3% below the corresponding figure in Q1 2009. Latest CSO data show earnings at €35,768 in Q2 2012, unchanged from Q2 2011. Average earnings of €35,857 projected in 2012, almost unchanged from the average figure for 2011 (€35,880).
Incomes of Dublin buyers are assumed to be 10% higher than for buyers across the State as a whole. Income and health levies replaced by the new Universal Social Charge from January 2011.
Disposable Incomes: derived by adjusting gross incomes for tax bands and credits, PRSI and USC rates announced in successive budgets.

NOTE: Information in this report was compiled on 1st November and reflects the latest data available at this date.

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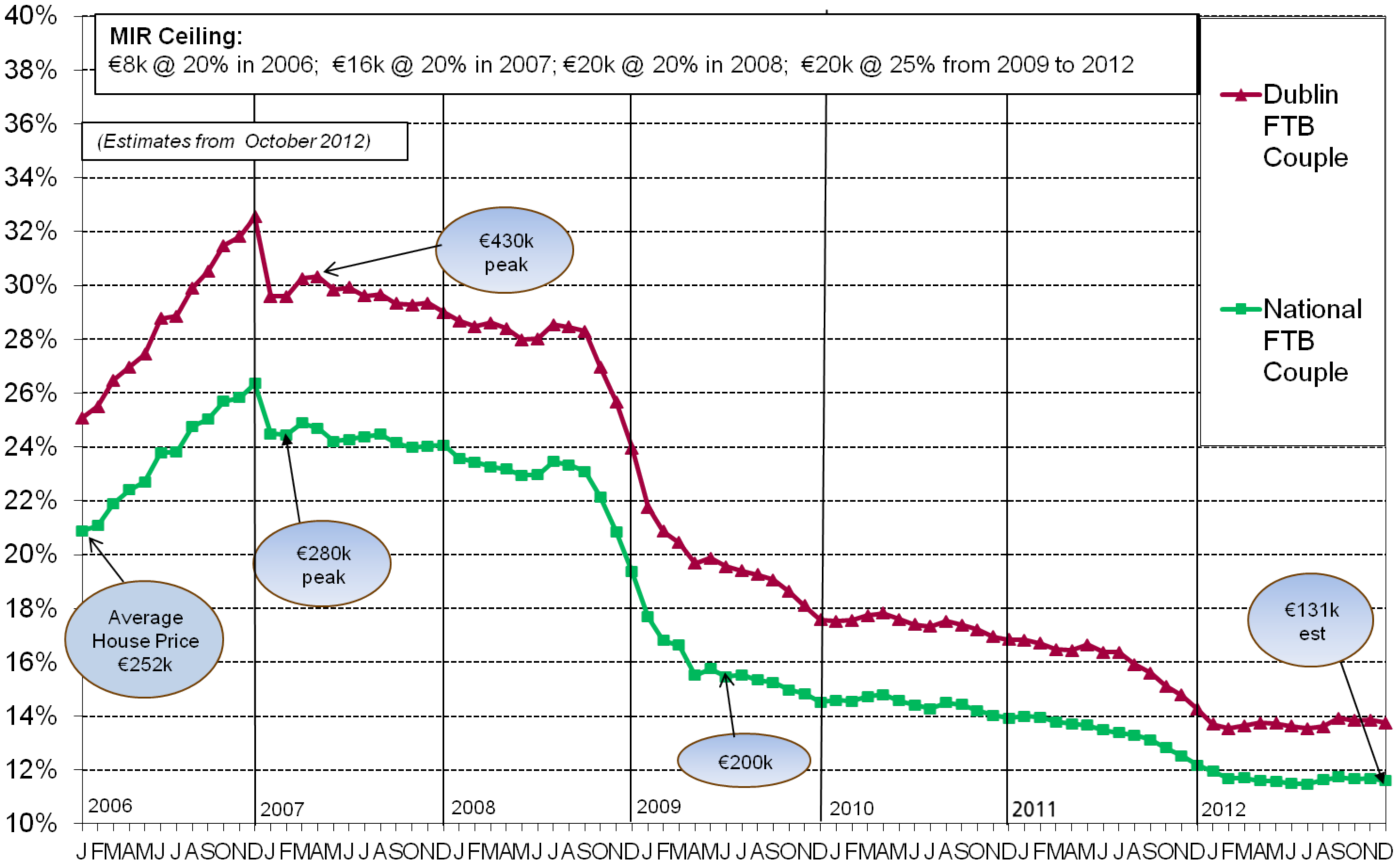
Figure 1: EBS-DKM Housing Affordability Index: The proportion of net income for a FTB working couple required to meet net mortgage repayments on the 'average' FTB house price based on a 90% loan to value ratio and a 25 year mortgage



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