

EBS DKM Affordability Index

June 2011

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 FTB house prices in Dublin and across the State as a whole.





Confidence remains key to recovery of mortgage market and affordability trends provide good starting point

writes **Dara Deering, Director, EBS Retail Business**

So far in 2011 housing trends have continued to decline in line with the levels of reduction seen last year. This decline is not unexpected. House prices have continued to contract, new mortgage lending remains low and one-off house builds are the only form of domestic building taking place around the country. Low levels of consumer confidence underpins the market.

House prices in the last 12 months have contracted by 12.2% according to the latest residential property price index from the Central Statistics Office (CSO) and are now down 41% from the peak. The rating agency Standard and Poor's recently stated that while house prices may have bottomed, there has as yet been no evidence of a recovery.

Completion levels are forecast at c.10k for 2011 with development activity estimated to account for only 20% of all completions. Single-unit builds have become a more dominant part of this market and are likely to account for a large portion of completions in the short to medium term. This is likely to result in a low number of new developments coming on to the market, which in turn over time will lead to a weakening of supply in the market.

New Lending has also continued to contract. The combined factors of low levels of demand, low supply of new stock to the market and reduced appetite for lending by financial institutions, has resulted in c.€576m of new lending in the first quarter of this year. This is down 53% from last year and 95% from the peak according to figures released by the Irish Banking Federation in May.

While the level of new housing supply is shrinking and house prices are reaching a point where there is real value for some properties in certain locations in Ireland, consumer confidence will continue to be the key factor that will see the recovery of the mortgage market. This will be impacted by the steps the new Government has taken and continues to take to restore public finances, sort out the banking crisis and return the country to a period of economic growth.

Confidence levels dropped to below 70 points at the end of 2007 and have not risen above this since; in fact, it has now been below this level for 44 consecutive months. Until such time as consumer confidence recovers, we are unlikely to see much change in the levels of new mortgage lending.

However, in contrast to the dip in consumer confidence, affordability levels have, over the past three years, seen much improvement. This positive change in affordability has a real influence on the cost of maintaining a mortgage and will provide that strong foundation required for the market when consumer confidence returns.

Key Highlights June 2011

- House prices have contracted by 12.2% in the 12 months to May.
- Average first time buyer working couple nationally in June 2011 paying 13% of their net income to fund a mortgage. This is down from 26.4% at peak (Dec 2006).
- Improvements in affordability continues to be more pronounced for Dublin buyers - average Dublin first time buyer working couple paying 15.8% in June 2011, down from 32.5% at peak (Dec 2006).
- Affordability expected to continue to improve representing the most affordable house purchase proposition in the past 25 years.

CSO Index - an important new source for residential property prices in Ireland

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



As previous issues of the EBS DKM Affordability Index have highlighted, the continued reductions in residential property prices since they peaked at end 2006/early 2007 have led to a sustained improvement in housing affordability in recent years.

The index is a measure of the proportion of after tax income required to meet first year mortgage repayments for an 'average' first-time buyer working couple, each on average earnings. It thus 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 country.

A new residential property price index

In the past, the index drew on residential property prices estimated from permanent tsb/ESRI data. However, in July 2009, permanent tsb/ESRI stopped producing estimates of property prices for First Time Buyers (FTB's) and from May 2011, ceased production of its index altogether. This is largely due to the fact that the CSO has now begun to publish its own Residential Property Price Index (RPPI). This index is based on transactions in the housing market which are funded by residential mortgages and is designed to measure the change in the average level of prices paid for residential properties sold in Ireland.

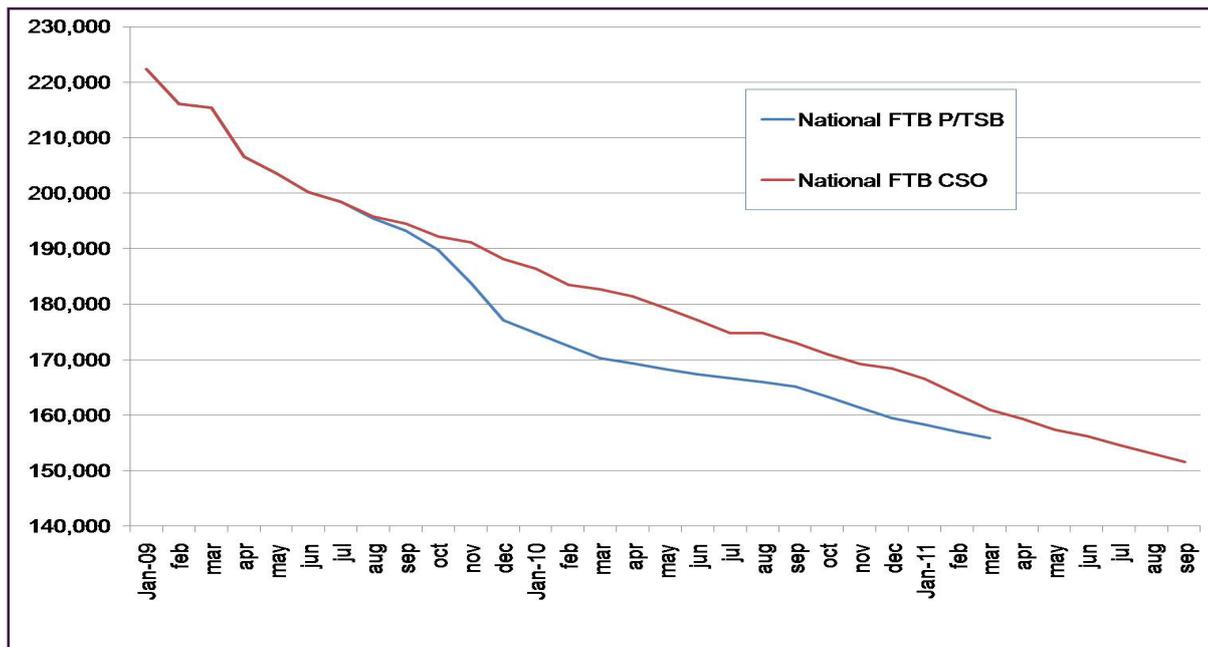
The CSO index also provides details on the characteristics of properties bought as well as the price paid (albeit in index form only) and is more broadly based than the permanent tsb/ESRI series as it is compiled using data on mortgage draw-downs provided on a monthly basis by eight of the main mortgage lending institutions as opposed to just the permanent tsb dataset. It is also adjusted to allow for the fact that different types of properties are sold in different periods and is transactions based, so that prices are recorded only when a sale actually occurs.

However, the new CSO index only captures residential property sales which are funded by a mortgage. Although the CSO's analysis suggests that their data captures in excess of 75% of the market as measured by Stamp Duty returns, it is also clear from anecdotal evidence that cash purchases are playing an increasingly important role in the current market place with the increase in distressed sales and the emergence of special auctions of distressed property. It is also important to note that the CSO analysis does not provide actual property prices.

The CSO index is, nevertheless, an important step forward in the provision of a consistent and comprehensive source of information on residential property prices in Ireland. For the purposes of the EBS DKM Affordability Index therefore, the existing series on average FTB property prices has been updated using the new CSO series from August 2009.

The impact of this change is illustrated in Chart 1 overleaf. This chart shows estimates of FTB property prices since July 2009 (the last date specific estimates were published) adjusted for monthly changes from August 2009, using both the CSO and permanent tsb/ESRI indices. The new, more broadly based, CSO index suggests that FTB prices are slightly higher than under the permanent tsb/ESRI series – over the period, the difference equates to just €8,000 on average. The impact on the EBS DKM Affordability Index is therefore relatively modest.

Chart 1: Comparison of FTB property prices: the permanent tsb versus the CSO Residential Property Price Index



Note: Using the % rate of change as per the CSO index from August 2009.

Chart 2, on the following page, shows trends in the percentages of net income required to fund a mortgage for a working FTB couple and a single person at the end of December each year over the period 2006 to 2010 with projections to September 2011.

Housing affordability continues to improve

The proportion of net income required to fund a mortgage for the average FTB working couple in the State was 13% in June 2011 down from 13.4% at the end of December and down from a peak of 26.4% at the end of 2006. The sustained improvement in affordability is due to the continued decline in property prices over the period – according to the CSO’s new RPPI, property prices fell by 12.2% in May (latest available) compared with the previous year’s level and were 11.5% down in the first five months of the year, on the same period in 2010. Falling prices help offset the impact of rising mortgage interest rates which increased from an average of 4% at the end of December to 4.25% in June.

For the corresponding Dublin FTB working couple, the percentage of net income required to fund a mortgage was 15.8% in June 2011, down from 16.2% in December 2010. Residential property prices in Dublin registered a marginal increase of 0.4% in the month of May but declined by 11.5% in May 2011 on the same month last year and were down by 12% in the first five months of 2011. Whether the recent monthly increase is an early indication of a bottoming out of prices in Dublin or just a temporary blip remains to be seen. But it is the case that the improvement in affordability to date has been more pronounced for Dublin buyers.

Single buyers spending around 26% of their net incomes

The Table also shows that single persons purchasing in today’s market are spending around 26% of their net incomes to fund a mortgage, down from around 55% at the peak (Dec 2006).

House price to income ratios continue to move into more affordable territory

The improved affordability is also reflected in the average house price to income ratio, which is down to around 4 times gross income for a single person and around twice joint income for an average FTB working couple.

Most affordable house purchase proposition in the past twenty five years

While property prices have fallen severely in recent years, it is widely believed that there is some more reduction in store before the floor is reached. Macroeconomic factors such as unemployment and ongoing fiscal retrenchment reinforce this view. However the recent increase in ECB interest rates of 0.25% may reverse the improvement in affordability generated from lower prices.

For the period to September 2011 it is assumed that property prices continue to decline by an average of 1% per month. On the other hand, income levels are expected to remain broadly flat. The 0.25% increase in the ECB Base Rate announced on 7th July has been included in the projections, with mortgage rates assumed to remain at 4.5% until September. As a result affordability remains around 13% until September when a further reduction in house prices leads to a slight improvement, with the proportion of net income required to fund a mortgage for the average FTB working couple in the State forecast to fall to 12.9% by September 2011 and to 15.6% for FTB couples in Dublin. This continues to represent the most affordable house purchase proposition in the past twenty-five years.

Chart 2 - Trends in housing affordability for FTB working couple and single person to June 2011 with forecasts to September 2011

	Dec 06	Dec 07	Dec 08	Dec 09	Dec 10	June 11 Estimate	Sept 11 Projected
Average mortgage rate	4.81%	5.35%	4.80%	3.32%	4.00%	4.25%	4.50%
National first time buyer working couple							
Monthly repayments (€)	1,323	1,228	1,008	722	682	644	637
As % of net income	26.4%	23.0%	18.6%	13.9%	13.4%	13.0%	12.9%
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	155.8	151.2
Dublin first time buyer working couple							
Monthly repayments (€)	1,741	1,573	1,326	929	875	832	823
As % of net income	32.5%	27.7%	23.0%	16.9%	16.2%	15.8%	15.6%
Ave house price (000s)	359.0	333.9	294.9	241.9	216.1	201.4	195.4
National single first time buyer							
Monthly repayments (€)	1,390	1,304	1,008	722	682	644	637
As % of net income	55.4%	48.9%	36.4%	27.3%	26.9%	26.0%	25.7%
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	155.8	151.2

ASSUMPTIONS:

Monthly FTB House Prices: permanent tsb/ESRI FTB prices available up to July 2009. Data from August 2009 derived by assuming that FTB prices fall in line with national average house prices up to May 2011. Post May 2011, assume average FTB property prices decline by 1% per month until September. The average Dublin FTB house price is assumed to be equal to 84% of the average Dublin house price, based on the permanent tsb/ESRI dataset.

Loan to Value Ratio: 90%

Average Mortgage Rates: down from peak of 5.87% in August '08 to trough of 3.16% in June'09. Increased thereafter to 4.25% by May 2011 and increased in July to reflect the 0.25% increases in ECB Base Rate on 7th July.

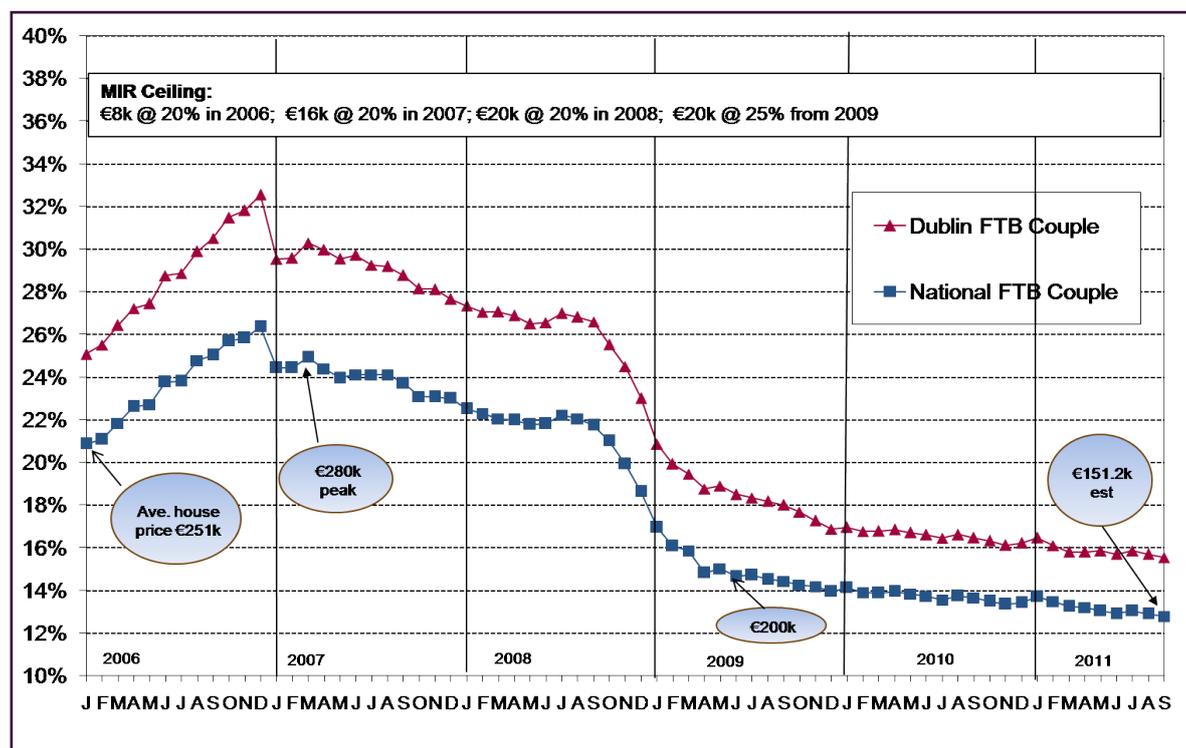
Maximum Mortgage Interest Relief: €20,000 max available at 25% since Jan 2009 = €417 per month max. MIR to remain for homeowners in negative equity until 2017 (Budget 2010).

Average gross income for FTB working couple of €79,585 in 2009, unchanged from 2008. In 2010 gross income reduced in line with CSO figures, implying a reduction of 3% to €77,197. The FTB couple started out earning €70,000 in June 2005, implying gross income up by 10.3% in 5½ years. For 2011, gross income assumed to remain flat (though ESRI Spring QEC predicting a 0.75% increase in wage rates). Income and health levies replaced by the new Universal Social Charge from January 2011.

Incomes of single person set at €35,000 in June 2005 and by 2010 was €38,600 (+10.3% over 5½ years). Average incomes are assumed to be flat in 2011 compared with 2010.

Incomes of Dublin buyers are assumed to be 10% higher than for buyers across the State as a whole.

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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