Where Family Counts

EBS DKM Affordability Index

November 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.

Affordability Continues to Improve Despite Falling Incomes

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

In the final quarter of 2011, house prices in Ireland have continued to decline at a similar pace as seen in 2010. According to the latest residential property price Index from the CSO, house prices have fallen 12% year to date and are down 44.2% since the peak. Dublin continues to see the strongest contraction and from peak is now down by 51.6%. In terms of house type, apartments have seen the strongest contraction and are down by 57.1%, with Dublin apartments again seeing the strongest contraction down by 58.5%.

Consumer sentiment rose noticeably in October to 63.7, the highest level since July 2010. For the first nine months of the year consumer sentiment averaged at 55 and this low level impacted the volume of mortgage applications to financial institutions. Given the continuing economic crisis it is difficult to see if the uplift seen in October will be maintained. Low levels of demand and reduced appetite for lending by financial institutions resulted in €1.8bn of new lending in the first three quarters of this year. While First Time Buyers are the most resilient segment of the market, new mortgages to FTB fell by 49% in Q3 when compared to the same period last year.

Housing supply remains challenging on two levels. Firstly the number of completions remains very low with almost 8,000 to the end of September 2011, with 10,000-11,000 completions forecasted for the full year. Secondly the level of unfinished dwellings varies greatly depending on location. According to the Department of Environment there are over 2,000 unfinished estates in Ireland and 90% of these show low levels of building activity. However, Limerick, Galway and Waterford in particular have a low level of vacant units (running at 5 vacant units per 1,000 households), whilst the levels of vacancies in Cavan, Longford and Leitrim are 7-8 times higher.

Over time, locations in Ireland where the overhang of new stock has been eroded are likely to experience a faster recovery with demand for good properties in these areas increasing.

Notwithstanding the fact that the housing market still remains challenged, affordability remains at its lowest levels in years, which is positive for First Time Buyers. However, the budget due to be announced in the coming weeks and the likely changes to personal disposable income for First Time Buyers may affect this trend.

But while personal disposable incomes are reducing, after the latest announcement by the ECB to reduce rates and the continued significant reduction in house prices, new homes are likely to remain very affordable in the medium term.

Key Highlights November 2011

- Residential property prices nationally are down 44.2% since their peak and 14.3% in the last year.
- Average first time buyer working couple nationally paying 12.4% of their net income to fund a mortgage in October 2011. This is down from 26.4% at the peak (Dec 2006).
- Dublin first-time buyers paying 14.4% of their combined net income in mortgage repayments.
- The average property price was €178,400 nationally in September and €148,000 for first-time buyers.
- As 2011 comes to a close, the market is approaching the end of its fifth year of consistent property price declines.
- A number of changes in the December Budget are expected to adversely impact on housing affordability in 2012.

Continued Reductions in Property Prices Led to a Sustained Improvement in Housing Affordability

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. 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 State.

The sustained improvement in affordability is due to the continued decline in prices over the period - according to the CSO's Residential Property Price Index (RPPI), prices nationally fell by 14.3% in September compared with the previous year's level and were 12.3% down in the first nine months of the year on the same period in 2010. Falling prices have helped to offset the impact of rising mortgage interest rates in the first ten months of the year, when they increased from an average of 3.96% in January to 4.29% in August through to October.

Good news on the interest rate front

The unexpected reduction of 0.25 of a percentage point to 1.25% in ECB interest rates on 3rd November will provide some welcome relief for existing homeowners on tracker mortgages. For the remainder the hope is that mortgage lending institutions pass on the rate reduction. A reduction of 0.25 of a percentage point is equivalent to €14 per month for a mortgage of €100,000. The affordability calculations below have assumed that the average mortgage rate declines from 4.29% in October to 4.04% in December and remains at that level until March 2012.

Thus the proportion of net income required to fund a mortgage for the average FTB working couple in the State was 12.4% in October 2011 down from 13.4% at the end of December 2010, around half the peak level recorded at the end of 2006 (26.4%). The lower mortgage rates from November combined with further likely reductions in property prices - an estimated 1% per month - suggest that housing affordability will improve further for potential FTB's by the year-end. Thus the proportion of net income required to fund mortgage repayments continues to reduce, from 12.4% in October to an estimated 12.1% at the year-end.

For Dublin buyers, the proportion of net income falls to 14.4% for a working couple by December, down from 16.9% in December 2010.

These calculations are based on the CSO's RPPI, which suggests an average first time buyer property price of €148,000 in September as against an average national price of €178,400. The corresponding average price in Dublin was €222,600. The gross average earnings of the working couple in September were €76,425, based on average weekly earnings published by the CSO. Research completed by the Central Bank suggests that purchasers typically tend to have incomes which are above the national average.

A single person on average earnings is currently paying around 24% of his/her disposable income towards monthly mortgage repayments. Their average price to income ratio was down to 3.8 in November compared with 7.4 at the peak in December 2006.

Adverse changes in the pipeline may affect affordability in 2012

There are a number of changes in the pipeline which are likely to impact on affordability in January 2012. These will include:

- The likelihood that disposable incomes will decline further in 2012 resulting from a combination of higher income taxes in the December Budget and the introduction of the €100 property tax for principal residences.

- Changes to mortgage interest relief (MIR) which according to current legislation, states that mortgages taken out by first-time buyers between 1 January 2012 and 31 December 2012 will attract mortgage interest relief at the lower rate of 15% (25% previously) on interest paid up to a maximum amount of €3,000 for an individual (€10,000 previously) or €6,000 for a married couple (€20,000 previously).

- Stricter Central Bank criteria around mortgage lending, which were introduced in October, are likely to result in new lending stress tests with the possibility of smaller loan amounts for those whose applications succeed.

The changes to MIR are significant and for the average working couple will mean a reduction in the maximum MIR from €416.67 per month (€20,000 per annum multiplied by 25%) to €75 per month (€6,000 per annum multiplied by 15%). Thus the mortgage repayments for a first-time buyer working couple borrowing €200,000 at 4% would be €900 per month in December, after MIR. Their corresponding monthly repayments, should they not buy until January 2012, will be €992, i.e. an increase of €92 or around 10%. This increase is over three times the relief generated by the improvement from lower mortgage rates, estimated at €28 per month for the married couple in question.

The affordability table does contain indicative projections for the January to March 2012 period which take into account the MIR changes, but the calculations are on the basis of unchanged incomes, taxation and mortgage rates. The first issue of the *EBS-DKM Affordability Index* in the New Year will reflect the full impact of the 2012 Budget changes. At this stage the projections indicate that the sustained improvement in housing affordability to date will reverse in January, due to the MIR changes expected. The impact is somewhat alleviated in February and March as property prices are assumed to continue falling in the early months of the year. However it is hoped that the forthcoming Budget will bring more clarity with respect to MIR changes for FTB's.

Potential buyers likely to tread carefully despite the 'blip' in October sentiment

Thus as 2011 comes to a close, the market is approaching the end of its fifth year of consistent property price declines. Over that period, average national property prices declined from the peak to date by 44%. The corresponding reduction in real terms (i.e. adjusted for inflation) was almost 47% nationally. This period followed an extraordinary long period of residential property price inflation from August 1994, during which average prices nationally increased almost fourfold in nominal terms or by 231% in real terms over the period. Thus the trough to peak during the upturn lasted 12.5 years while the peak to date has lasted 5 years. It remains to be seen whether property prices will reach their floor in 2012.

Notwithstanding the good news on interest rates and house prices for those considering entering the property market, potential buyers are likely to tread carefully over the coming months. The surprising upturn in the KBC/ESRI consumer sentiment index in the month of October does not appear to have reflected any concerns about the fragile economic situation abroad (which has gathered momentum in recent weeks). Also consumers' perceptions about the outlook for the domestic economy, their household finances and unemployment shouldn't have changed that much. For those purchasers keen to transact in the market, they are likely to face more onerous lending criteria in an already constrained environment. Key elements influencing how the market develops during 2012 will be progress on measures to restore a supply of mortgage credit as well as developments in the wider economy in regard to unemployment and incomes.

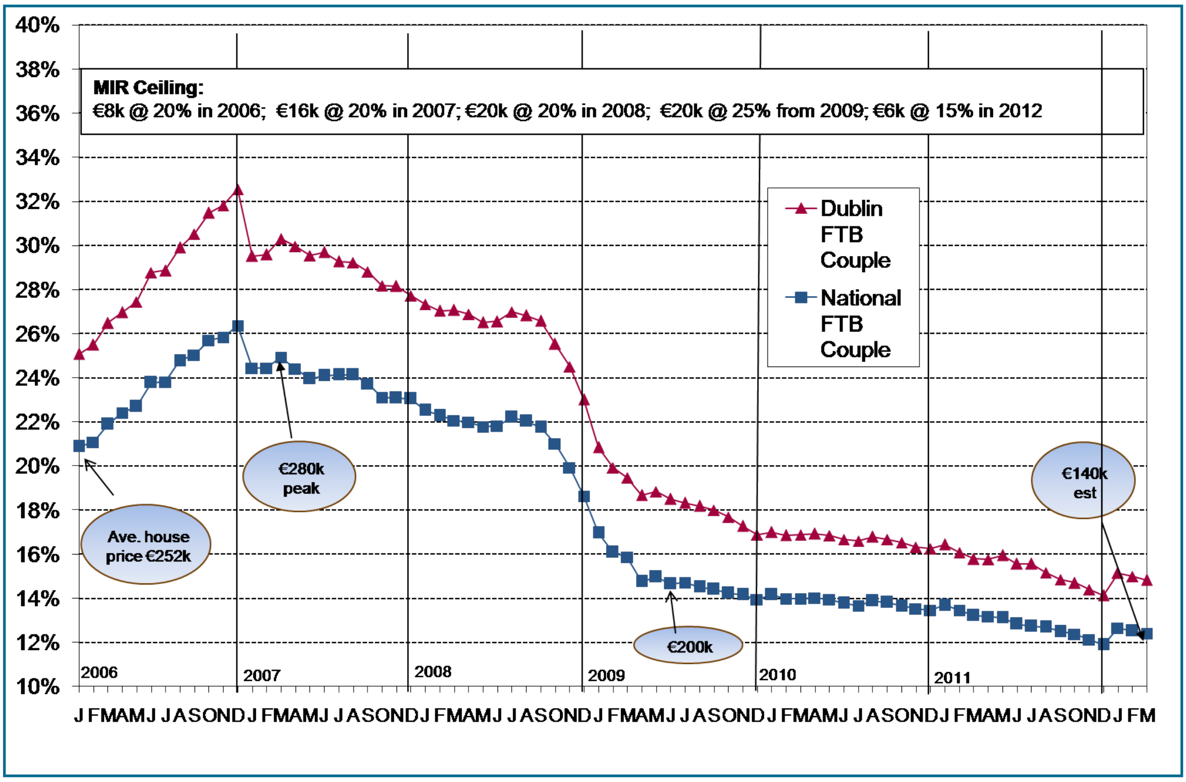
The accompanying Table and Chart show trends in the percentages of net income required to fund a mortgage for a working FTB couple and a single person at the end of December each year over the period 2006 to October 2011 with projections to March 2012.

Trends in housing affordability for FTB working couple and single person December 2006 - October 2011 with projections to March 2012.

	Dec 06	Dec 07	Dec 08	Dec 09	Dec 10	Oct 11	Dec 11 Estimate	Mar 12 Forecast
Average mortgage rate	4.81%	5.37%	4.80%	3.32%	4.02%	4.29%	4.04%	4.04%
National first time buyer working couple								
Monthly repayments (€)	1,323	1,230	1,008	722	683	608	584	609
As % of net income	**26.4%**	**23.0%**	**18.6%**	**13.9%**	**13.4%**	**12.4%**	**12.1%**	**12.4%**
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	146.7	143.8	139.5
Dublin first time buyer working couple								
Monthly repayments (€)	1,741	1,577	1,326	929	877	767	751	774
As % of net income	**32.5%**	**27.7%**	**23.0%**	**16.9%**	**16.3%**	**14.7%**	**14.4%**	**14.8%**
Ave house price (000s)	359.0	333.9	294.9	241.9	216.1	185.1	181.4	176.0
National single first time buyer								
Monthly repayments (€)	1,390	1,306	1,008	722	683	608	584	635
As % of net income	**55.4%**	**49.0%**	**36.4%**	**27.3%**	**26.9%**	**24.8%**	**23.8%**	**25.9%**
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	146.7	143.8	139.5

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 September 2011. Post September 2011, assume average FTB property prices decline by 1% per month until March 2012. 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%. **Mortgage Term**: 25 years.
Average Mortgage Rates: down from peak of 5.87% in August '08 to trough of 3.16% in June'09. Increased thereafter to 4.29% by August 2011. Rates reduced to 4.15% in November and 4.05% in December, following the reduction in ECB rates on 3/11/2011. Rates remain at 4.04% until March 2012.
Maximum Mortgage Interest Relief: €20,000 max available at 25% since Jan 2009 = €417 per month max. MIR reduced to €6,000 at 15% from January 2012, equivalent to €75 per month.
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. For 2011, gross income is reduced by a further 1% to an estimated €76,425, in line with CSO trends in H1 2011. The FTB couple started out earning €70,000 in June 2005, implying gross income up by 9.2% in 6½ years.
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 2011 was €38,213 (+9.2% over 6½ years).
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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ECONOMIC CONSULTANTS

EBS, EBS Building
2 Burlington Road, Dublin 4, Ireland.
Telephone: +353 1 6659000;
Email: info@mail.ebs.ie; Website: www.ebs.ie.

DKM Economic Consultants Ltd.,
6 Grand Canal Wharf, South Dock Road, Ringsend, Dublin 4, Ireland.
Telephone: +353 1 6670372;
Email: info@dkm.ie; Website: www.dkm.ie