

House prices, credit & supply: Lessons from Ireland's recent past

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TCD Policy Institute event, June 10th 2014

Is all analysis of Irish housing doomed?

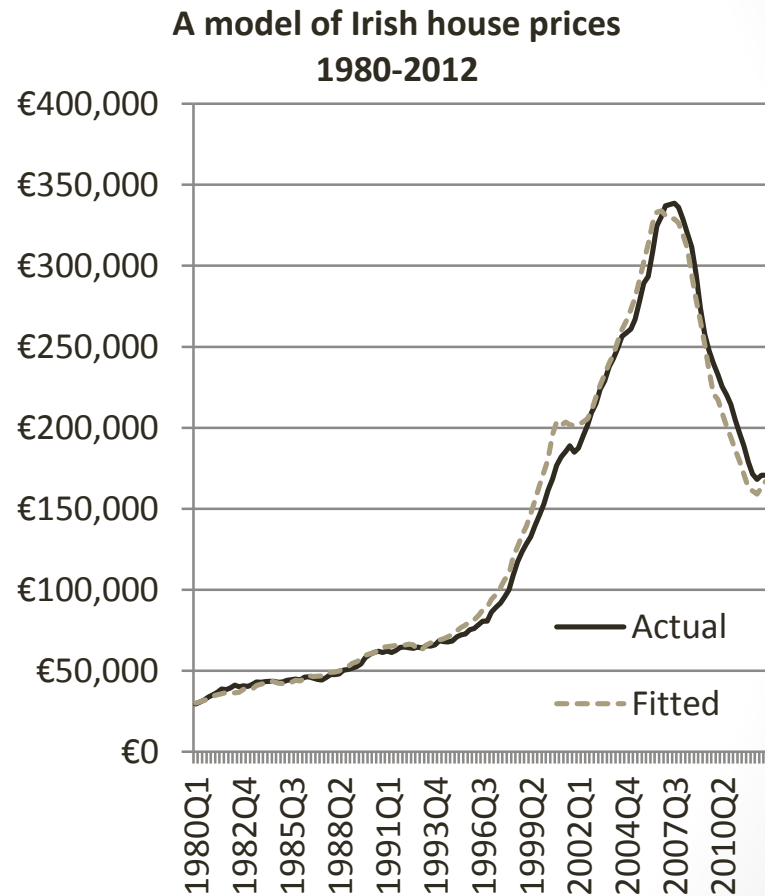


David McWilliams, *A sneaking sense of déjà vu*, May 19, 2014

“The housing market in Ireland is driven by deep psychological urges on the part of most Irish people, which renders the old-fashioned laws of supply and demand not just obsolete, but dangerously inaccurate.”

David is both wrong and right

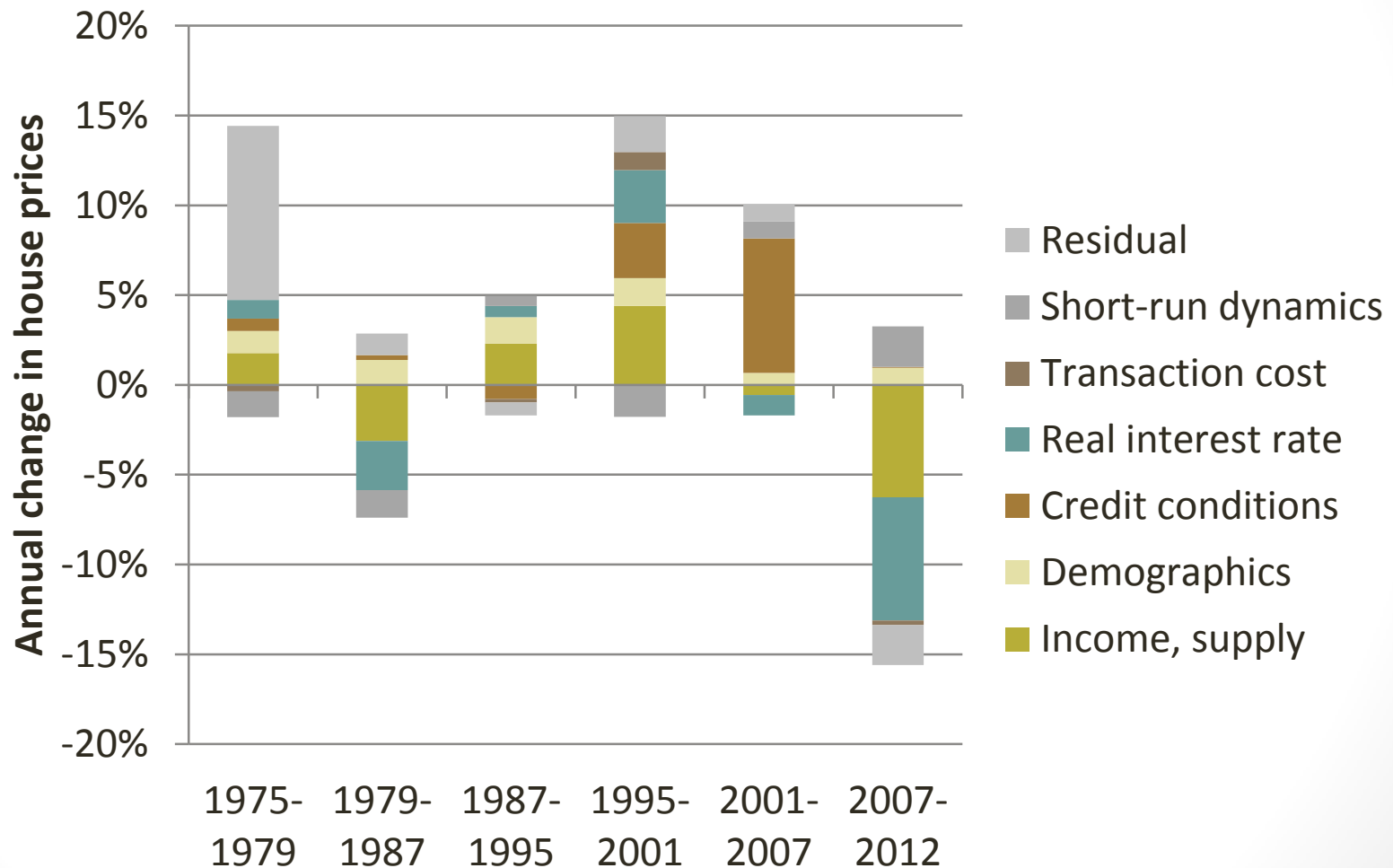
- He's wrong: we can actually analyse the housing market
- He's right: we need to incorporate human factors, in particular expectations
- In other words, we need the right definitions of supply and demand



What determines Irish house prices?

- Two sets of factors that affect Irish house prices
- Fundamentals
 - **Income** per household – captures wages, unemployment
 - **Supply** – measured in value (per HH), not volume
 - **Demographics** – number of people per household
- Asset considerations
 - **User cost**, “real interest rate” – expectations about future changes in prices [$\pm 20\%$] drown out nominal interest rates
 - **Credit conditions** – ease of getting a mortgage, e.g. typical loan-to-value for first-time buyers

Understanding the Irish bubble and crash



Separate legacy issues

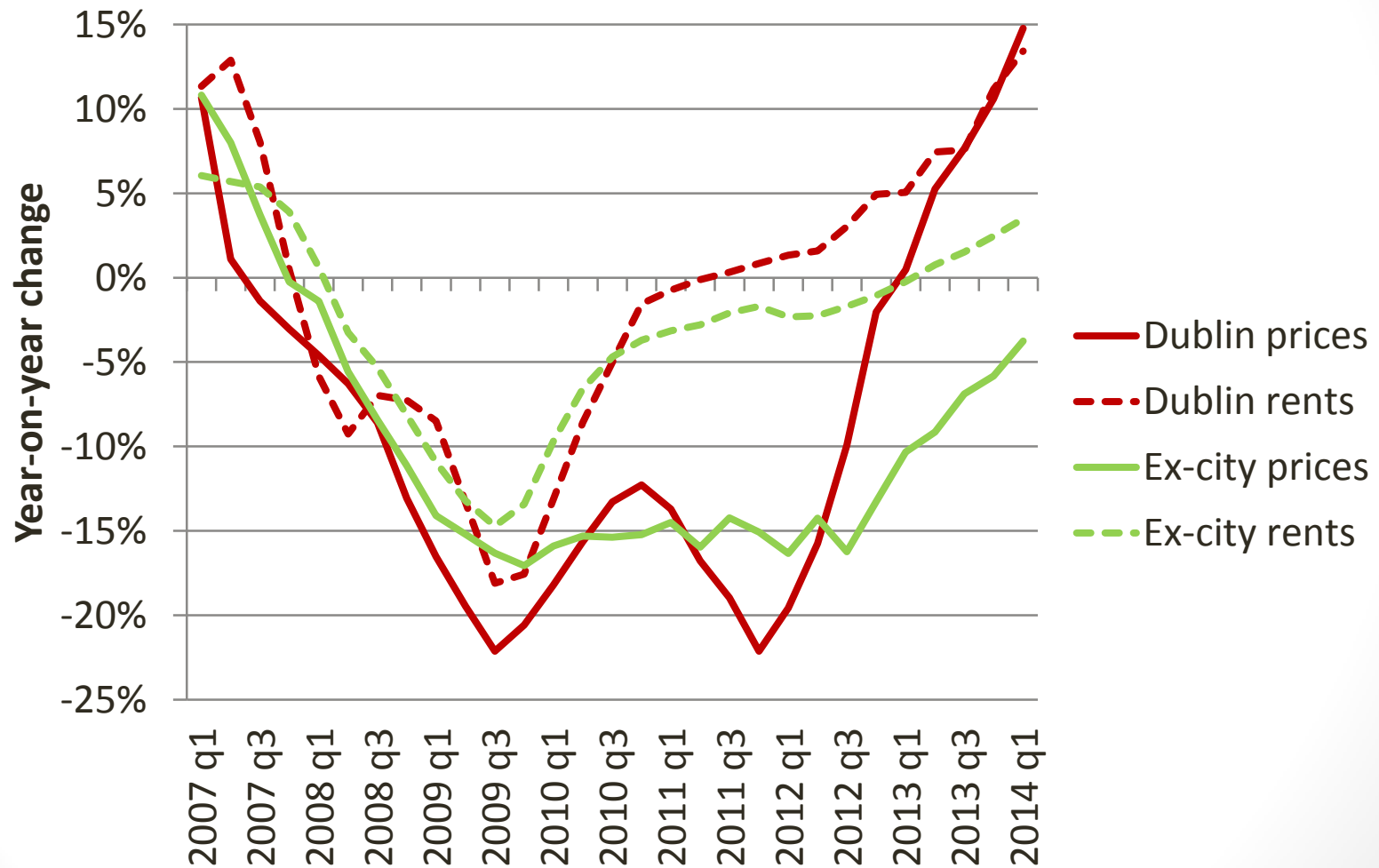
Negative equity, arrears: Excess supply of credit (nationally)



Ghost estates: Excess supply of housing (in 'wrong' areas)



Current trends in prices and rents

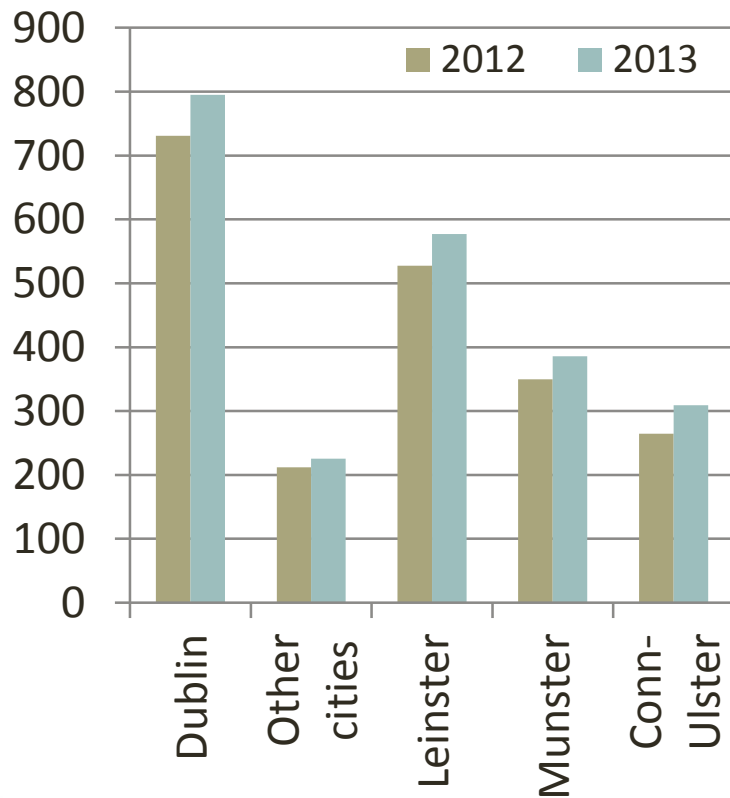


Why are prices rising now?

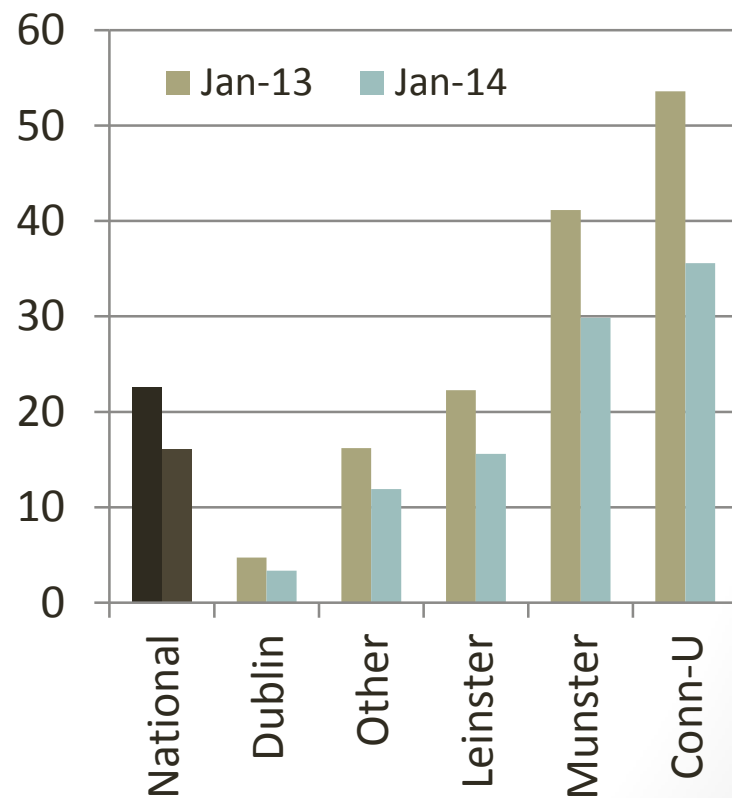
- Three main explanations of why house prices can rise
- A house price boom
 - **Incomes rising** – are incomes rising 10% yr/yr in Dublin?
- A house price bubble
 - **Looser credit conditions** – are banks lending at higher LTVs to first-time buyers in Dublin only?
- A house price “spike”
 - **Lack of supply** – are there not enough properties for people to buy?
- Whatever is explaining it, it must vary significantly by region to account for geographic differences

3m supply in Dublin vs. 3y in Connacht

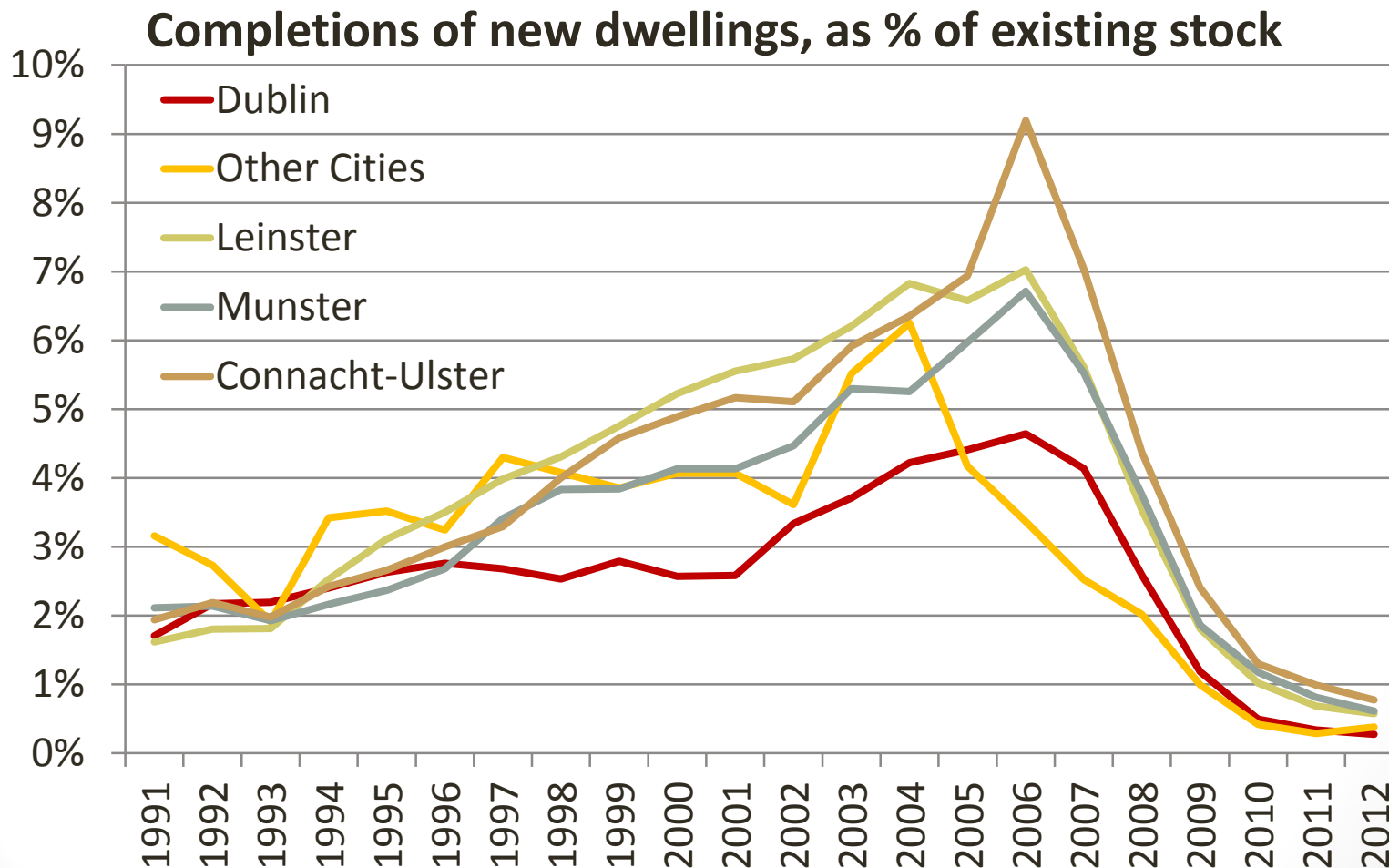
Average number of transactions per month, 2012-2013



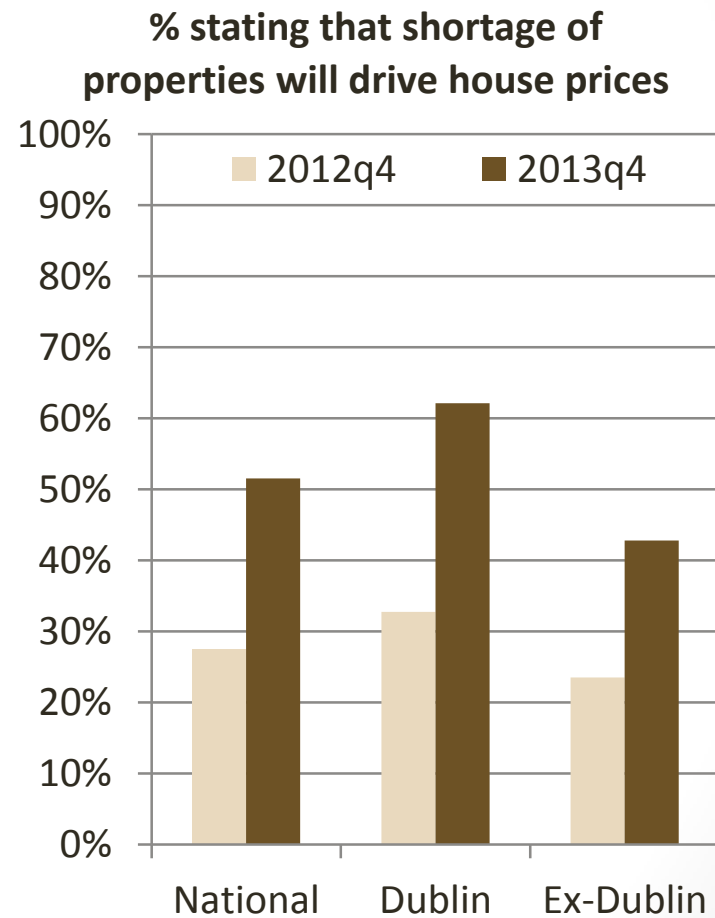
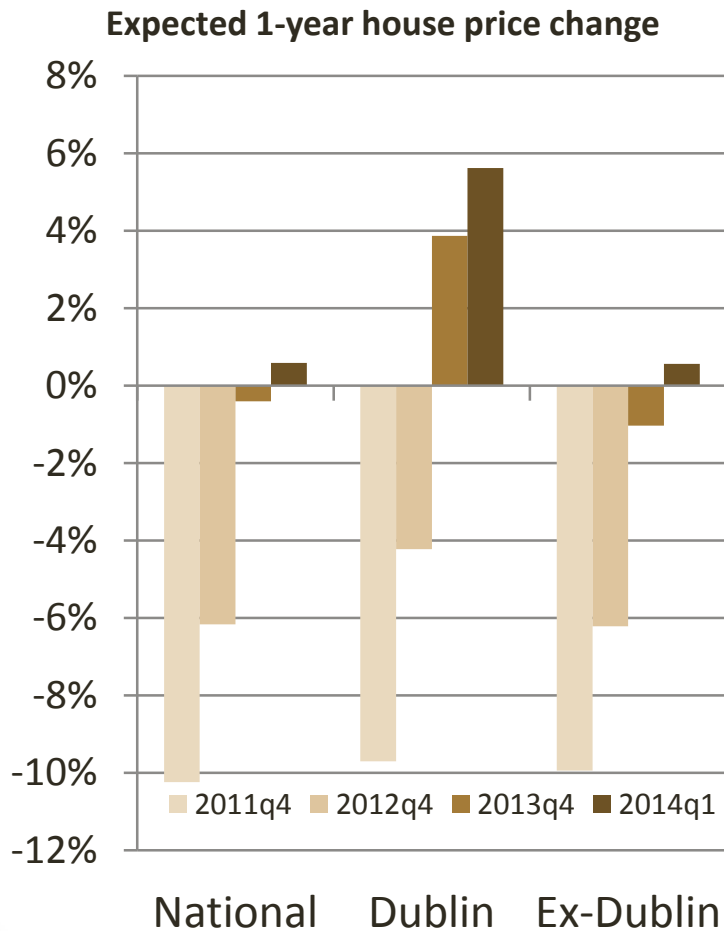
months supply on the market, Jan 1 2013/2014



Dublin completions $\sim 1/10^{\text{th}}$ last recession



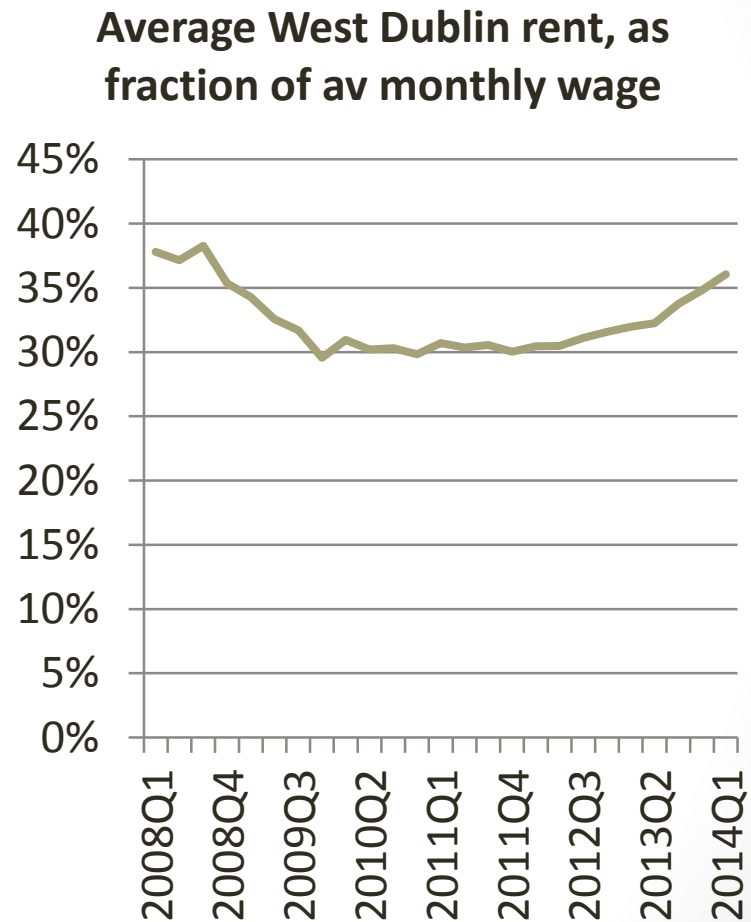
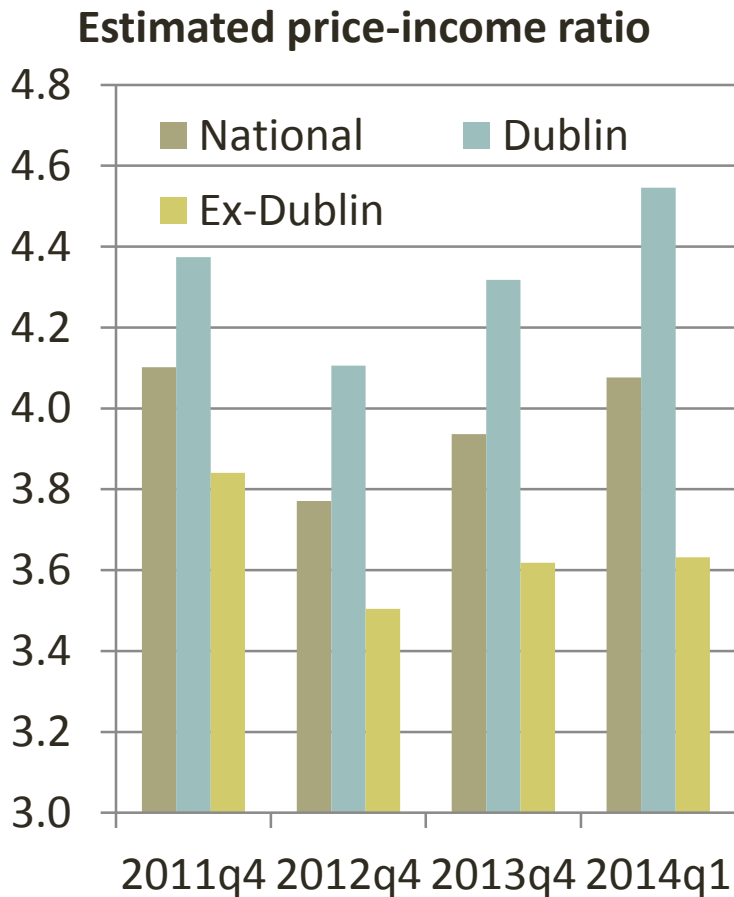
Not a bubble... yet



Supply is about revenue and costs

- So, house price increases are neither a bubble (credit) nor a boom (income) but instead due to lack of supply
- But why is supply of new homes so low?
- Ultimately, the construction industry is about profit, i.e. revenues less costs
- Revenues are about prices and rents
 - Are these too low?
- Costs are about wages, profits, materials, land costs and regulation
 - Which of these are contributing to the lack of supply?

Market is at limits of affordability



Answer must lie on cost side

Materials

- Largely world prices
- Small scope for savings

Capital

- The residual factor
- Flows in if numbers stack up

Labour

- Concerns about wage levels
- Large enough to matter?

Space

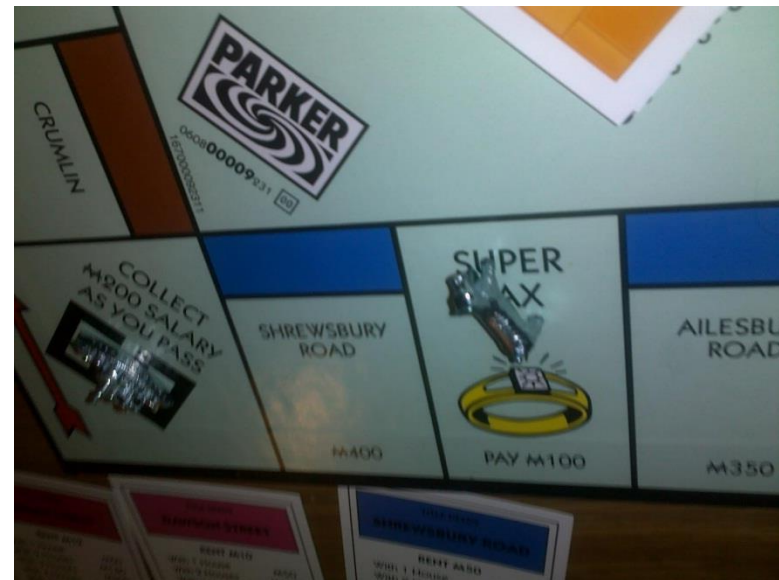
- Cost of land and of permission to build
- E.g. of €60k per unit where value is ~€215k

Permit costs and efficiency of stock

- First issue is level and transparency of permit costs
- Developers say that to build near new Luas would cost €60k per unit in various charges
 - A two-bed apartment in Stepside is currently worth €215k
 - Why should only new residents pay for Luas?
- Greater transparency needed on per-unit permit costs
 - As the “greatest small nation in which to do business”, Ireland needs to target efficient regulatory burden
- Second issue is use of existing stock, “empty nesters”
 - As Housing Agency research shows, no shortage of family homes – many occupants are not families though
 - Carrot & stick: can get them to consider move... but where?

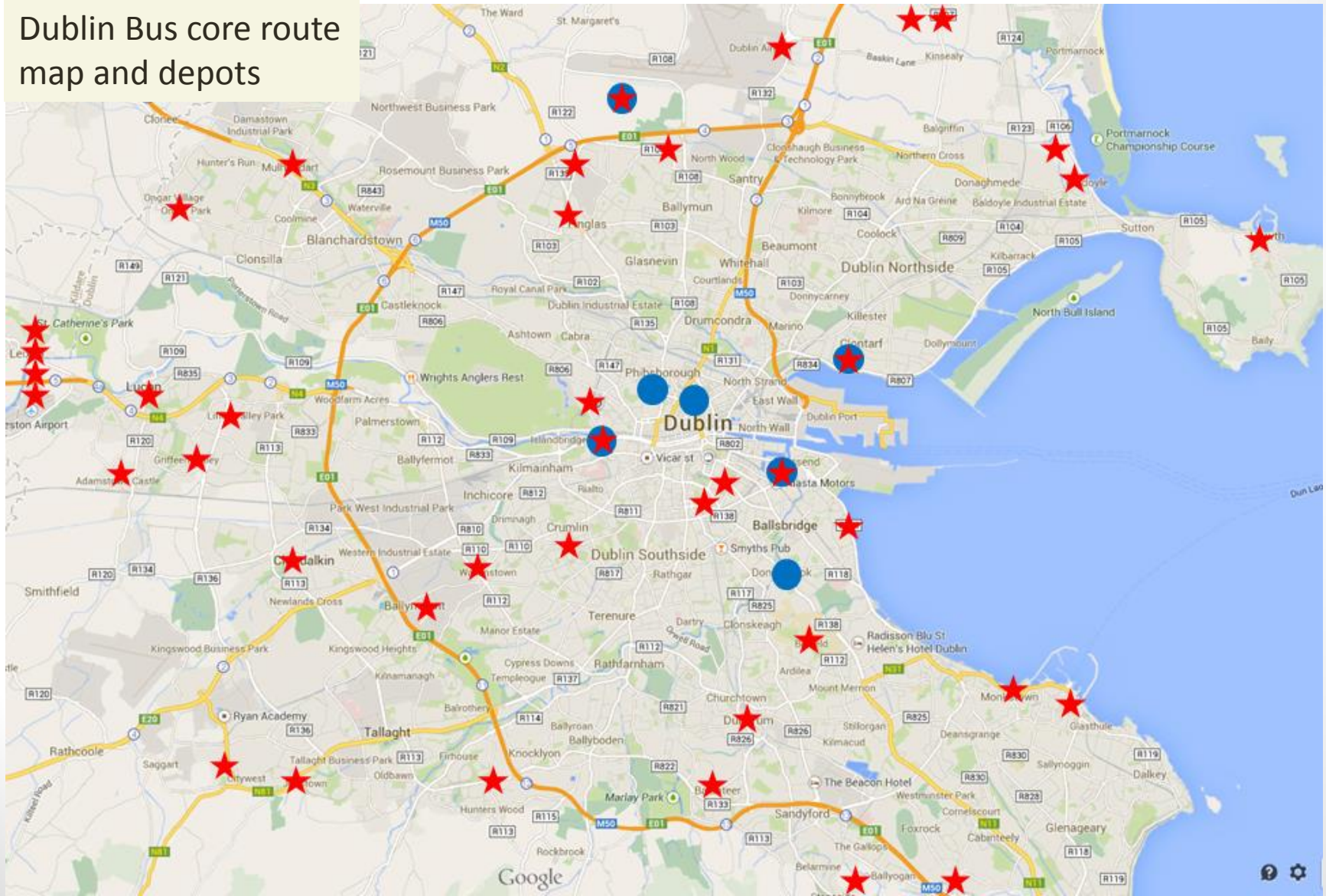
Not just greenfield – need ‘best-use’ policy

- Third issue is lack of brownfield redevelopment
- Ireland’s “most expensive Monopoly areas” comprise about 400 acres
- Why do Dublin Bus and RTE own 40 acres of some of Ireland’s most valuable residential land?
 - Elm Park golf course has another 90 acres!



Currently “last use” not “best use”

Dublin Bus core route map and depots



Incentives & need for joined up taxation



Fractured policy system

- Responsibility for housing policy is currently shared across a number of Government organisations
 - Departments of Environment, Finance, Central Bank, Justice/PRSA, Taoiseach, plus Housing Agency, An Bord Pleanala, local authorities, etc...
- Unsurprisingly, a large number of policies, policy statements, strategies, plans
- “Housing Czar”, rather than a “Super-Junior Minister”?
- Principal policy target should be reducing cost of building a new home 25% by certain date (e.g. June 2015)
 - The World Bank *Doing Business* style of doing business

Fractured taxation system

- Also unsurprisingly, given number of parties involved, large number of taxes, levies, charges, contributions, fees, etc...
- Time to connect up fiscal and planning systems
 - Could replace stamp duty, rates, LPT, development contributions, windfall tax, etc., with single unified land tax
 - After all, society creates the value – why not claim some of it back?
- Striking the right balance between planning (top-down preferences) and the market (bottom-up preferences)

Thank you

- I look forward to comments and discussion