

EBS DKM Affordability Index

March
2012

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.





2012 provides further improvement in affordability for First Time Buyers

writes **Aidan Power, Head of Marketing and Communications at EBS**

The rate of contraction of the Irish mortgage market through 2011 and for the first quarter of 2012 is very much in line with expectations set at the start of last year. Similar predictions have been made for 2012, albeit with the rate of decline predicted to reduce. So far this year we have seen that property prices continue to decrease on a national basis, which represents a fall of 48% since the peak of the market in 2006. According to the latest CSO Residential Property Price Index, prices fell by 16.7% in the year to December 2011, and this declining trend is predicted to continue to the end of 2012, but this decline is likely to be at a considerably lower rate of approximately 10%.

The level of building activity continues to slow with just over 10,000 new house completions last year, down 28% on 2010 volumes, with similar volumes expected in 2012. The majority of these were single unit builds around the country with less activity in the area of new developments. The lack of movement in this area will allow current stock of unsold properties work through the system resulting in supply eventually meeting demand and bringing us back to a more normalised market.

Lending institutions continue to test rigorously prior to approving new mortgages, to ensure that successful mortgage applications have the ability to sustain mortgage repayments over the life of the loan. Looking at the New Lending statistics for the full year 2011, First Time Buyers continue to be the strongest segment. 6,381 mortgages were advanced to First Time Buyers last year accounting for 45% of all new mortgages issued. The total number of new mortgages increased in three successive quarters last year suggesting some stability may be returning to the market.

Consumer sentiment, measured by KBC Bank and the ESRI, has been fluctuating since September 2011 with some impressive rises and disappointing falls. Confidence levels measured at 56.6 in January 2012 which was up from 49.2 in December 2011 however down on November's result of 60.1. The volatile movement does suggest real uncertainty still amongst consumers.

Shining further light on the dynamics of the mortgage market is the low interest rate environment in which we are currently operating. ECB remains at 1% with some predicting a further cut of 0.25% before the summer. Those on variable and tracker rate mortgages are certainly benefiting from the current situation and for those taking out new mortgages, variable rate mortgages seem to be the order of the day.

In summary, some stability is evident in the mortgage market with volumes of new mortgages steadily increasing each quarter in 2011, and house prices continue to fall albeit at a lower rate than was previously the case. As a result of the drop in house prices there is great value to be had for consumers and with interest rates remaining low, affordability remains a key driver for those thinking of purchasing property in 2012.

Key Highlights March 2012

- Residential property prices nationally are down 48% since their peak and 16.7% in the last year.
- First Time Buyers continue to be the strongest segment, with 6,381 mortgage advances in 2011.
- Consumer sentiment levels measured 56.6 in January 2012, up from 49.2 in December 2011.
- ECB remains at 1% with some predicting a further cut of 25 basis points before Summer 2012.
- Affordability continuing to improve with the average first time buyer working couple spending 11.9% of their joint income to fund a mortgage, compared with 26.4% in 2006.

This first index for 2012 continues to portray the substantial improvement in housing affordability which has been taking place since the market peaked at the end of 2006.

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



The sustained improvement in affordability is due to the continued decline in property prices since the peak. According to the CSO's Residential Property Price Index (RPPI), prices nationally last January were down 48% from the peak. Despite this substantial downward adjustment, the monthly rate of decline in property prices accelerated for the third month in a row in January to 1.9%. As a result, the average first time buyer property price nationally was estimated at €137,653 or 3.9 times average earnings. The annual rate of decline was 17.4% in January, the highest annual rate of decline since January 2010.

In Dublin, where average prices are down by 56.7% from the peak, the monthly rate of decline in January also accelerated sharply for the third month in a row to 4%, the highest rate of decline since March/April 2009 (-3.9%). Average property prices in Dublin in January were estimated at €167,386, which corresponded to 4.3 time average earnings for Dublin FTBs. The annual rate of decline was considerable at 21.1%, the highest rate in two years.

Falling property prices have helped to offset the impact of rising variable mortgage interest rates since mid-2009, although rates started falling again at the end of 2011. With ECB lending rates unchanged since December, average variable mortgage rates have been at 4.22% since December (CSO data) and are assumed to remain at that level over the next three months to June. Although further ECB reductions are expected in the coming months, it is not clear that any cuts will be fully passed on in lower mortgage rates.

As a result of these developments, the proportion of net income required to fund a mortgage for the average FTB working couple in the State fell to 12.1% in January 2012 from 14% twelve months previously. The more substantial reduction in Dublin property prices has seen the proportion of net income required to fund mortgage repayments also reduce for Dublin FTBs from 16.9% in January 2011 to 13.8% last January and to an estimated 13.7% this month. Average FTB property prices in Dublin are currently estimated at just 21% higher than average prices across the State as a whole compared with 35% at the beginning of 2009.

The Affordability Table contains projections up to June 2012 which continue to predict further improvements in affordability, in response to further falls in property prices and unchanged mortgage rates. National FTB couples purchasing in today's property market are expected to be paying 11.5% of their disposable income in June. The corresponding proportion for Dublin FTBs is projected at 13.1%. This further improvement is expected despite a further modest reduction in average earnings this year (annual rate of -0.7%).

Single FTBs nationwide are expected to be paying 23% of their net incomes in mortgage repayments by June this year compared with 24.5% at the end of 2011.

Mortgage Interest Relief unchanged for FTBs in 2012 Budget

The 2012 Budget was favourable for FTBs in that it maintained the Mortgage Interest Relief (MIR) ceiling at €10,000 for single FTBs (€20,000 for FTB married couples) and the rate of relief at 25% for the first two years of a mortgage. The amount of relief reduces to 22.5% in tax years 3, 4 and 5 and to 20% until 2017. However as the maximum ceiling of €20,000 is over four times the average annual interest bill for national FTBs purchasing in today's market, buyers are not getting the benefit of the full relief. At current house prices, for example, a married couple paying the average house price of €135,000 and borrowing at a 90% LTV at 4.22% would receive MIR of around €1,300 in the first year, compared with a maximum amount available of €5,000.

Tax bands and tax credits for married couples favour working couples

Table 1 and Figure 2 contain affordability measures for a range of FTBs. The purpose is to illustrate the impact of the different tax credits and tax bands for potential buyers in the following cases:

- A married couple, both working, each on average earnings - requires 11.9% of net income;
- A married couple where one is working on twice average earnings - requires 13.8% of net income;
- A married couple where one is working on average earnings - requires 22.2% of net income; and
- A single person on average earnings - requires 23.9% of net income.

The tax system clearly favours a married couple, when both are working, as due to their higher tax credits and bands, the couple require 11.9% of their income to fund mortgage repayments in the first year. This compares with 13.8% when the household has the same income but only one person is working. For persons on average earnings, the tax system is more favourable for a married couple, where one person is working (22.2% of net income), compared with a single person (23.9% of net income).

Lack of access to credit remains an issue despite the substantial improvement in affordability

The relatively low cost of funds and easy access to credit were key factors driving housing demand and house prices during the boom years. The current market stagnation reflects a number of factors but most notably a lack of consumer confidence as potential buyers are not willing to transact in the market at present due to the belief that prices have not yet reached their floor and concerns about reductions in income due to job losses, pay cuts or tax increases, and difficulties accessing mortgage credit.

The tightening of credit coupled with an unwillingness amongst households to seek funding at this time, have contributed to the significant decline in housing transactions. While government is taking measures to stabilise the banking system and restore a supply of credit, the credit availability situation remains a barrier to transactions. However there are a number of other factors which need to be factored into any potential house purchase decision, given the current challenging economic environment.

These include concerns about job security and the prospects for gross income levels but also expectations of further reductions in disposable incomes in the current era of austerity. Thus there is the likelihood that a full property tax will be introduced in 2013 to replace the current €100 residential property charge. The Budget made provisions for increases in VAT, Motor Tax and Carbon Tax which combined with recent increases in the cost of transport fuels, will adversely impact on disposable incomes. Other charges, notably water charges, are expected in the medium-term while the remaining steps to restore the public finances to a sustainable position will necessitate additional fiscal consolidation measures in forthcoming budgets. All are likely to increase the risk of a further softening in average residential property prices over the coming months.

Table 1: Trends in housing affordability for FTB working couple and single person December 2006 - January 2012 with projections to June 2012.

	Dec 06	Dec 07	Dec 08	Dec 09	Dec 10	Dec 11	Jan 12	Mar 12 Forecast	Jun 12 Forecast
Average mortgage rate	4.81%	5.37%	4.80%	3.32%	4.02%	4.22%	4.22%	4.22%	4.22%
National first time buyer working couple - both working on average earnings									
Monthly repayments (€)	1,323	1,230	1,008	722	683	578	567	556	540
As % of net income	26.4%	23.0%	18.6%	13.9%	13.4%	12.2%	12.1%	11.9%	11.5%
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	140.3	137.7	134.9	130.9
National first time buyer working couple - one working on twice average earnings									
Monthly repayments (€)	1,323	1,230	1,008	722	683	578	567	556	540
As % of net income	29.1%	26.8%	21.7%	16.7%	16.1%	14.1%	13.9%	13.8%	13.3%
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	140.3	137.7	134.9	130.9
National first time buyer working couple - one working on average earnings									
Monthly repayments (€)	1,323	1,230	1,008	722	683	578	567	556	540
As % of net income	48.1%	44.6%	36.1%	27.2%	26.3%	22.7%	22.4%	22.2%	21.3%
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	140.3	137.7	134.9	130.9
National single first time buyer - on average earnings									
Monthly repayments (€)	1,390	1,306	1,008	722	683	578	567	556	540
As % of net income	55.4%	49.0%	36.4%	27.3%	26.9%	24.5%	24.1%	23.9%	23.0%
Ave house price (000s)	279.0	260.8	224.2	188.1	168.4	140.3	137.7	134.9	130.9
Dublin first time buyer working couple									
Monthly repayments (€)	1,741	1,577	1,326	929	877	719	690	674	651
As % of net income	32.5%	27.7%	23.0%	16.9%	16.3%	14.3%	13.8%	13.7%	13.1%
Ave house price (000s)	359.0	333.9	294.9	241.9	216.1	174.4	167.4	136.5	157.9

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 January 2012. Post January 2012, assume average FTB property prices decline nationally by 1% per month (1.2% in Dublin) until June 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 data). Latest published figure is 4.22% for January 2012. Rates remain unchanged until June 2012.

Maximum Mortgage Interest Relief for FTBs: €20,000 max MIR available for married couples at 25% since Jan 2009 = €417 per and held at this level for FTBs in 2012.

Average Gross Earnings: Gross income figures have been revised back to January 2007 and 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 €35,856 in Q4 2011, 1.5% below the corresponding figure at end of 2010. Average earnings are projected to fall by 0.7% in 2012.

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: The information in this report was compiled on 8th March and reflects the latest data available at this date.

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

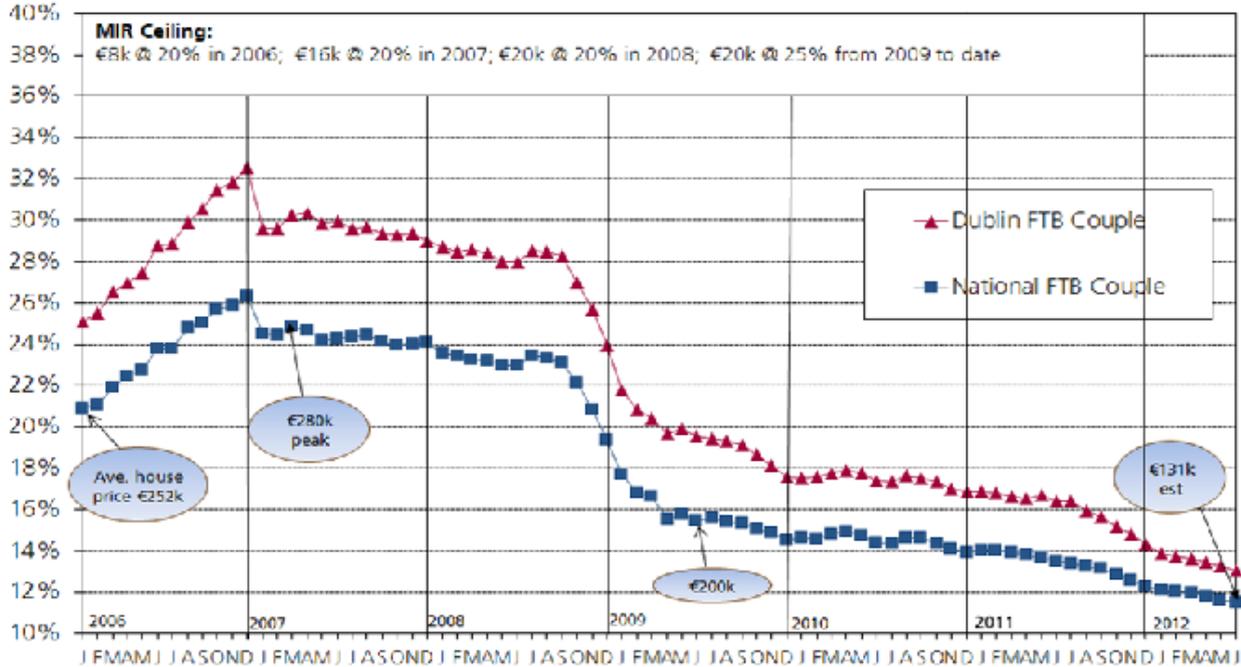
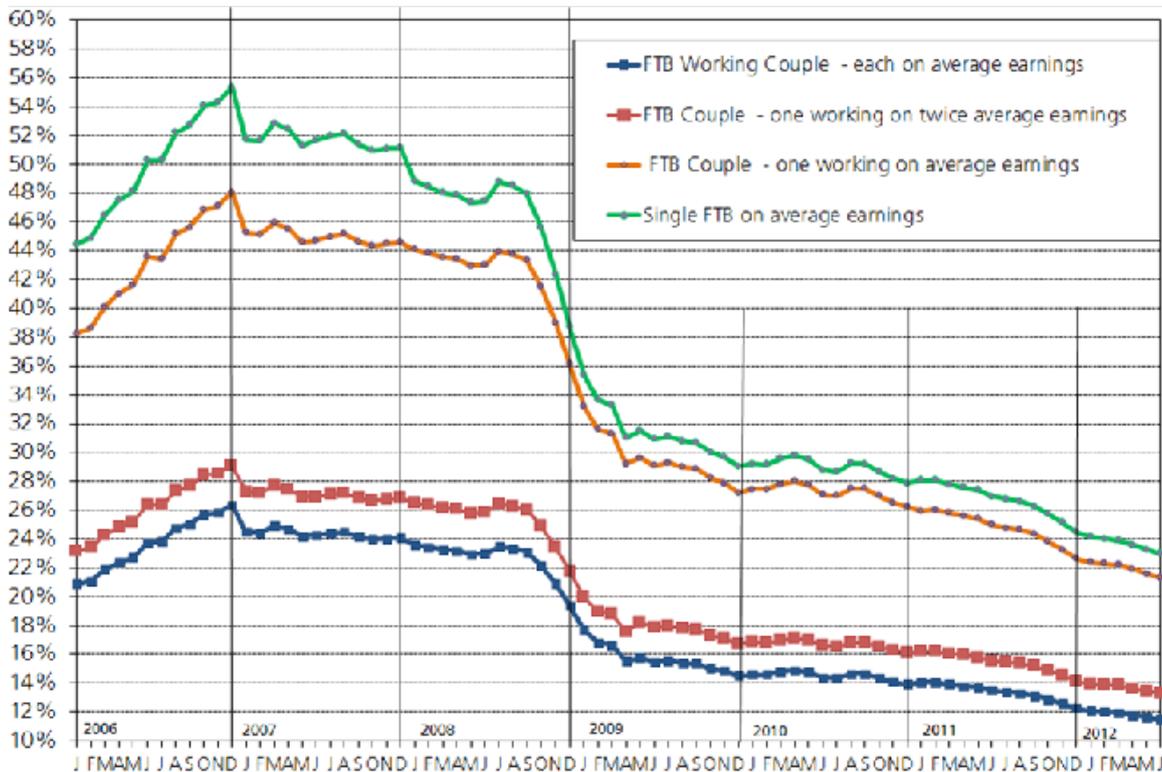


Figure 2: Housing Affordability for National First Time Buyers



This publication is for information purposes only. Any expression of opinion is subject to change without notice. EBS and DKM accepts no liability whatsoever for the outcome of any actions taken arising from the use of information contained in this report. Figures quoted represent the latest available figures from each source at the time of going to press. EBS Limited is regulated by the Central Bank of Ireland.