

EBS DKM Affordability Index

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.



January 2010



The market for First Time Buyers is becoming increasingly attractive, writes **Dara Deering, Director, EBS Membership Business**

Over the past three years, property prices have decreased by almost 27%. This equates to €83,000 for properties nationally and €137,000 for properties in Dublin. First time buyers considering entering the market over the coming 12 months should expect to see this contraction continue, albeit at a slower rate than last year. Some commentators are predicting that we may be approaching a turning point in the market, although there still continues to be enough conflicting views on the subject that it makes decision making challenging for those who are still waiting to get into the market.

It seems, however, that some first time buyers feel that conditions have improved enough to warrant purchase in the past year, with the first time buyers outperforming all other sectors in 2009. From Q2 they began to engage with the market: 9,173 mortgages were issued to first time buyers in the first nine months of last year according to Irish Banking Federation figures, and there was limited growth in Q3 over and above Q2.

Indeed this reflects our own experience in EBS - application levels in Q4 were 47% higher than in Q1 demonstrating that First Time Buyers are starting to see value in the market and are choosing to look around to establish what they can afford. A further sign of growing interest from First Time Buyers was the fact that over 1,000 First Time Buyers attended EBS hosted nationwide seminars on House Purchase and Finance in the second half of 2009.

New house builds in 2010 are also expected to continue to contract and are estimated to be at between 12,000 and 15,000 units. This compares to an annual completion rate of 93,000 units at the peak in 2006. It is likely that the low level of new builds will continue until supply levels in the market come down.

Registration levels, a key indicator of new house builds, are only 6% of 2006. Given the low level of new builds we are likely to see the majority of sales for new houses coming from existing stock of completed or nearly completed units.

Dublin has experienced a sharper contraction than the rest of the country. If the Irish mortgage market follows international patterns of recovery it is also likely to be the first county to show signs of recovery.

Consumer sentiment, a key driver of activity for First Time Buyers, coupled with rising unemployment will continue to influence demand in the market for the course of this year. Over the past few months the unemployment level has stabilised at 12.5% and is expected to peak at 14% in 2010. If consumer sentiment begins to rise and the economy shows signs of recovery, it is likely that many consumers in stable jobs that have been saving over the past 2 years will feel more confident about taking their first step on the ladder.

Now is an ideal time for First Time Buyers to start to look at the market and to explore what they might be able to buy as choice and affordability has never been better. While we don't yet know when the bottom will hit in terms of prices, what we do know is that they have fallen significantly and potential buyers will have the luxury of investigating the market and finding a possible home without the pressure of other buyers competing for the same property.

In summary, house prices will continue to contract this year albeit at a slower rate. Some areas that have experienced sharper contractions will present some genuine opportunities to First Time Buyers over the course of the year however, consumer sentiment remains at low levels and this will influence when potential First Time Buyers enter the Market.

We have already seen higher application levels in the final quarter of 2009 than existed in the first quarter. We are cautiously optimistic that the new year will continue as last year ended. If this turns out to be the case we will see more First Time Buyers engaging in the market this year than last year.

Key Highlights January 2010

- Forecast March 2010: First Time Buyer working couples will pay 13.1% of their net income in mortgage repayments, (15.9% in Dublin). These figures compare to 23% (27.7%) at the end of 2007.
- The average First Time Buyer house price at around €180,000 had decreased by around 35% from the peak (January 2007).

How do current affordability levels compare with history?

It is interesting to look back at trends in housing affordability to establish whether housing is more affordable today compared with previous decades. Two data points were selected: Q4, 1985 and Q1, 1995. Based on estimating housing affordability in those years, the average working couple paid around 17% of their net income to service a mortgage on the average house price in Q4, 1985; the corresponding proportion in Q1 1995 was around 15%. Both proportions compare with around 13% today and 26% at the recent peak.

	Average House Price €	Mortgage @ 90% €	Mortgage Interest Rate	Annual Net Repayments €	Gross Income (couple) €	Net Repayments as % of Disposable Income
Q4 1985	49,889	44,900	9.75%	2,750	27,716	17.0%
Q1 1995	77,747	69,972	7.30%	3,984	40,469	15.3%
June 2005	230,688	207,619	3.46%	11,106	70,000	20.0%
December 2006	279,003	251,103	4.81%	15,879	75,750	26.4%
January 2010	182,868	164,581	3.00%	8,217	77,693	13.4%

The table illustrates how the mix of house prices and mortgage rates can influence housing affordability. On the face of it, it appears that potential house buyers today are currently facing a better proposition in terms of affordability than buyers over the last two decades. However, the availability of credit and the ability to repay are not factored into the above measures, both of which are constraining the housing market at present. Moreover, with confidence at a low level and house prices expected to continue falling, some further improvement in affordability is likely by the end of the year.

December 2009 Budget changes

Following changes to the level of Mortgage Interest Relief (MIR) in the April 2009 Supplementary Budget (which restricted the availability of MIR to seven years at a declining rate of relief), the December Budget extended MIR for homeowners in negative equity until 2017 for those for whom the relief would have expired in 2010 or after. Thus buyers who purchased in 2003 or later will receive MIR for another seven years, provided they are in negative equity. MIR is currently available up to a maximum of €10,000 in annual interest payments for a single FTB and €20,000 for a married couple FTB. The maximum rate of relief for FTBs is 25% in the first two years, 22.5% in years 3 to 5 and 20% in years 6 to 7. MIR is to be abolished for all at the end of 2017. We consider the case below of a single person who bought her first home in June 2005 and who will now benefit from the extension of MIR by saving almost €5,000 in repayments up to 2017.

The other significant change in the December Budget was the reductions in public sector take-home pay. There is limited data on pay reduction in the private sector but the latest data from the CSO suggests that average weekly earnings for private sector workers were down by 3.1% year-on-year in Q2 2009. We suspect that further reductions materialised over the past six months. In conclusion, while the MIR changes will provide some relief beyond 2012 for existing owners in negative equity, the continuing risks of pay cuts and unemployment remain for both existing owners and potential buyers in the current difficult economic climate.

Trends in housing affordability for FTB working couple with forecasts to March 2010

	Dec 05	Dec 06	Dec 07	Dec 08	June 09	Dec 09 Actual	Jan 10 Estimate	Mar 10 Forecast
Average mortgage rate	3.63%	4.81%	5.35%	4.79%	3.29%	3.00%	3.00%	3.00%
National first time buyer working couple								
Monthly repayments (€)	1,018	1,323	1,228	1,007	767	693	685	668
As % of net income	21.6%	26.4%	23.0%	18.2%	14.5%	13.1%	13.4%	13.1%
Ave house price (000s)	249.5	279.0	260.8	224.2	200.2	185.1	182.9	178.5
Dublin first time buyer working couple								
Monthly repayments (€)	1,295	1,741	1,573	1,325	1,029	879	886	863
As % of net income	25.8%	32.5%	27.7%	22.5%	18.3%	15.9%	16.4%	15.9%
Ave house price (000s)	309.6	359.0	333.9	294.9	268.6	239.6	236.6	230.6

ASSUMPTIONS:

Monthly House Prices: permanent-tsb/ESRI data up to July 2009; July to October 2009 assume same % reduction as for national average; post October 2009 assume average monthly % reduction since the peak (-1.2%).

Loan to Value Ratio: 90%

Average Mortgage Rates: Down from peak of 5.87% in August 2008 to 3% in December 2009. .

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); was previously to expire in 2010.

Average gross income for FTB working couple of €82,370 in 2009, up 1.7% on 2008. Gross income reduced in line with the Budget 2010 reductions, implying average gross income for couple reduced by 5.7% from Jan'10 to €77,693. The FTB couple started out earning €70,000 in June 2005, implying gross income up by 11% in 4½ years. Income levy remains in 2010.

Income of Dublin buyers 10% higher than for buyers across the State as a whole.

CASE STUDY 1: Impact of Mortgage Interest Relief Extension

Ciara bought her first home in June 2005 at the average price of €230,000, with a 10% deposit (leaving Ciara with a €207,000 mortgage). In June 2006 her variable mortgage interest rate was 3.46%. In January 2010, the house value is estimated to have fallen to €180,000. Up to December 2009, based on a variable interest rate, Ciara had made €23,074 in capital repayments, leaving her with an outstanding mortgage of €183,926. This is greater than the current value of the house, which means Ciara is in negative equity, albeit in the amount of only around €4,000. Had she bought a house in Dublin back in June 2005, at the average price of €300,000, she would have negative equity today of around €5,000.

She currently pays interest at a variable rate of 3% p.a., which makes her annual repayments €12,058 (including €5,518 interest). She qualifies for mortgage interest relief at a rate of 22.5% (up to an interest ceiling of €10,000). This reduces her annual repayments to €10,817. The relief will drop to 20% in June 2010, and was due to end in June 2012. However, the changes announced in the Budget will extend this relief until December 2017 because Ciara is in negative equity.

Ciara continues to meet her monthly repayments until 2017. If interest rates remained at 3%, Ciara will save almost €5,000 through the extension of MIR until 2017 at 20%. By Dec 2017, her MIR is worth €63 per month. Post 2017, MIR is abolished entirely for everyone. Assuming mortgage interest rates were to increase to 4% in January 2011 and 4.5% in January 2012, her total savings over the period until 2017 would be €6,871. The table illustrates the corresponding savings for Ciara had she bought a house in Dublin in June 2005: €6,429 from the extension of MIR and a total of €9,858 should mortgage interest rates also increase.

	National Buyer	Dublin Buyer
House purchase price (Dec'05)	€230,000	€300,000
Mortgage (90%, over 25 years)	€207,000	€270,000
Mortgage Rate (Dec'05)	3.46%	3.46%
Payments made to Dec'09	€23,074	€30,096
Outstanding mortgage @ Dec'09	€183,926	€239,904
Current house value (Jan'10)	€180,000	€235,000
Negative equity amount	-€3,926	-€4,904
Total savings in mortgage repayments 2010-2017*:		
1) From extension of MIR until Dec 2017	4,929	6,429
2) Increase in mortgage rates: 4% Jan'11 and 4.5% Jan'12	6,871	9,858

* Both scenarios are compared with the situation before the extension of MIR until 2017.

Thus the savings of almost €5,000 for Ciara are worth €714 per annum over the period 2010 to 2017, although all of this benefit will arise over the five years 2012-2017. This will help her housing affordability over this period, by which time house prices should have started to increase again and Ciara should have built up some equity in her house.

CASE STUDY 2: Impact of Lost Earnings

Mike and Emily buy a house together in January 2010. Both of them are first time buyers on incomes of €35,000 p.a. each and they have budgeted to buy a house at the average FTB price of €180,000, with a 10% deposit. They expect to spend 14.5% of their joint disposable income on mortgage repayments.

Scenario 1: In March 2010, Mike unexpectedly loses his job. The repayments must now be made out of Emily's income and Mike's Jobseekers Benefit (which he receives at a rate of €196 per week, or €10,200 p.a.). Their gross income falls to €45,200. Repayments now make up 20.8% of the couple's disposable income, i.e. back to mid-2008 affordability levels.

Scenario 2: In April 2010, Mike and Emily are both employed but Emily receives a pay cut of 20%. This reduces Mike and Emily's combined income to €63,000 p.a. Mortgage repayments now make up 15.8% of the couple's disposable income. In a situation where Mike becomes unemployed and their gross income is reduced to €38,200, their mortgage now represents 23.8% of their joint disposable income, i.e. back to mid-2007 affordability levels.

Mike & Emily	At Purchase (Jan 2010)	Scenario 1 March 2010 - Mike becomes unemployed	Scenario 2 Emily takes a 20% pay cut
Combined Incomes	€70,000	€45,200	€63,000
House Price	€180,000		
Mortgage	€162,000		
Interest Rate	3.3%		
Net Annual Repayments	€8,217		
As a % of Disposable Income	14.5%	20.8%	15.8%

The sensitivity of mortgage repayments to pay cuts and unemployment for a working couple is illustrated by the above case study. Such concerns, while they persist, are likely to delay any recovery in housing transactions.

EBS Strengthens its leadership position in the First Time Buyer and Affordable Housing markets, concludes Dara Deering.

In a year that was defined by continued financial uncertainty and declining consumer confidence EBS Building Society continued to grow its share of the First Time Buyer mortgage market. The market conditions dictated that the overall market was declining; however, EBS as a result of its commitment to remain open for business had a very strong performance.

The Society increased its share both of the retail mortgage market and of the overall market according to the market data issued by the Irish Banking Federation in November last year. EBS has grown its share of the retail mortgage market to 21.7%. Its share of the overall market has grown to a significant 17.8% - a 6.4% increase over this time last year.

The pace of growth in market share by the Building Society can be attributed to its continuing commitment to provide accessible and competitive mortgage products to all those wishing to buy a new home. While many other financial institutions have not been actively lending in the market EBS has continued to offer choice and value to those who are actively looking in the market while maintaining competitive rates and consistency on LTV ratios.

According to the figures from the Irish Banking Federation EBS's share in the first time buyer segment has grown to 38.4% in the retail mortgage market and to 24.7% in the market overall. This is an increase in share of 4.2% in the overall market since this time last year.

In addition to growing share in the FTB market, EBS has also been the primary lender in the Affordable Housing segment. EBS Building Society delivered in excess of €150m of funding through its 2009 Affordable Housing Fund. The Fund was developed and launched by the Building Society in January last year to ensure that finance is accessible and available for buyers seeking to purchase their first homes through the Affordable Housing Scheme. EBS committed €150m to the Fund and has lent in excess of that to borrowers over the past 12 months.

As a result of the dedicated commitment to this segment the Building Society has grown its market share to 46% of the Affordable Housing Market, up from 40% at the start of the year.

EBS has a strong track record of supporting the Affordable Housing Scheme having provided the majority of home loans that have been advanced to borrowers since that Scheme was first established. In 2009 this equated to 1,100 loans provided to first time buyers participating in the Affordable Housing Scheme.

The Society is building on its commitment for the year ahead by again setting aside a portion of its available funding for the affordable housing sector.

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