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Housing Affordability in Ireland

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European Commission
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By Maria Jose Doval Tedin and Violaine Faubert

Abstract

This Economic Brief analyses the main drivers of housing prices in recent years and examines policy options to improve housing affordability. A decade of under-investment following a property crash in 2008 led to a decrease in the housing stock per capita in Ireland. Its composition also became inadequate to meet the increased demand for urban apartments. As a result of persistent housing shortages, house prices grew faster than household income and home affordability worsened, especially for low-income tenants and homebuyers living in and around Dublin. Macroprudential measures have helped curb house price inflation in the owner-occupied sector since 2018. By contrast, prices in the rental sector continued growing to levels well above those prior the 2008 crisis.

The evolution of house prices after the COVID-19 pandemic will depend on the speed of the economic recovery. Lower house prices and uncertainty may reduce housing construction and worsen affordability.

Increasing housing supply by scaling-up the construction of social housing, reducing the restrictiveness of rent legislation and the relatively high delivery cost of housing could improve affordability. The latter might entail curbing land price inflation, increasing the relatively low productivity of the construction sector and addressing skills shortages. In case of a sluggish recovery following the COVID-19 pandemic, this may be combined with a temporary use of housing subsidies so as to help stabilise house prices and avoid risks in the financial markets.

Keywords: housing prices, Ireland, rental market, housing affordability, macro-prudential policy.

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Introduction

In the early 2000s, Ireland experienced a construction boom accompanied by surging bank credit to property-related activities, strong wage growth and rapid house prices increases. When demand for housing collapsed in the wake of the 2008 crisis, nominal house prices corrected abruptly and decreased by 50% from their 2007 peak to their 2013 trough.

From 2013 to 2019, house prices picked up as the economy recovered. Contrary to the early 2000s construction boom, the recovery in house prices did not seem to be driven by rapid credit growth, but rather by a shortage of housing supply following a decade of under-investment. Improved labour market conditions, the low interest rate environment and relatively strong population growth also contributed to upward pressure on house prices. While property prices remained below the high pre-financial crisis levels and their growth receded since April 2018, tight supply conditions in the main cities pushed rents well above these levels. Against this background, home affordability has worsened both for tenants and homebuyers.

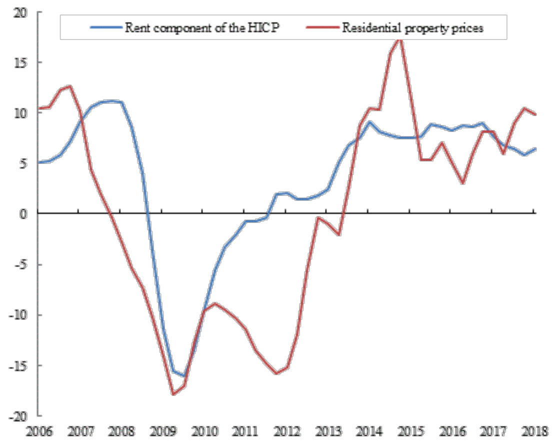
This Economic Brief analyses the main drivers of housing prices in recent years and examines policy options to improve housing affordability. While the bulk of the analysis was made before the coronavirus outbreak, some considerations on its possible impact on housing demand and supply have been factored in.

Housing prices sharply increased in recent years

House prices have increased since their 2013 trough, but remain well below the pre-financial crisis high levels. Between 2013 and 2019, the average annual increase in house prices, as measured by the national Residential Property Price Index, was 9.7%. Since April 2018, house price increases have slowed down as a result of the decline in house inflation at the top end of the market (European Commission, 2019). Falling prices have even been reported in 2019 in the most expensive areas of Dublin and Mid-East regions. The moderation of house price increases possibly reflects the increase in housing supply, which is higher in more expensive markets, and the dampening impact of the Central Bank's macroprudential rules (1) on housing demand. Overall, property prices remain around 20% below their pre-crisis peak, even in the most expensive markets such as Dublin. Following the COVID-19 outbreak, the worsened economic outlook is expected to dampen the demand for housing and hence, to reduce housing prices in 2020-2021. The magnitude of the decline in prices will depend of the speed of the economic recovery. While in case of a V-shaped recovery, house prices could decline by around 3.5% between the first quarter of 2019 and the fourth quarter of 2021, the drop could be more severe (around -15%) in case of a sluggish recovery (Allen-Coghlan and McQuinn, 2020).

Rental prices have sharply increased amid a recovery of the labour market and are well above their pre-crisis peak. During the economic downturn, the adjustment in rents was far more limited than that of property prices (Graph 1). After falling by 19% between 2008 and 2010, rents stabilised as early as in 2011 and recovered sooner than house prices. National rental prices, as measured by the rental component of the harmonised index of consumer prices (HICP), increased by 6.3% on average each year between 2013 and 2019. In January 2020, rents were 32% above their pre-crisis level. Rental inflation was higher in urban areas, with major cities (Dublin, Cork and Galway) witnessing the strongest increases in rents.

Graph 1: **Residential property prices and rents (year-on-year percentage changes, quarterly data)**



Source: CSO, Eurostat.

Robust economic growth and population growth supported housing demand in recent years

Favourable macroeconomic conditions fuelled housing demand. Until early 2020, the Irish economy has experienced a sustained expansion phase. Population growth accelerated on the back of a strong labour market. Driven by positive net inward migration from 2015 onwards, average annual population growth reached 1.2% in 2016-2018, compared with 0.6% in 2009-2015. Population growth was concentrated in urban areas [2] where the shortage of housing was most acute.

The decline of the average household size increases housing demand. Population ageing and increasing net inward migration [3] led to a decline of the average household size in Ireland from 2.7 in 2016 to 2.6 in 2018. In Dublin, the average household size dropped by 0.1pp to 2.6 in 2018. This trend may reverse, as it happened after the 2008 financial crisis, if unemployment rises as a result of the covid-19 pandemic and people remain in the family home and delay the formation of independent households.

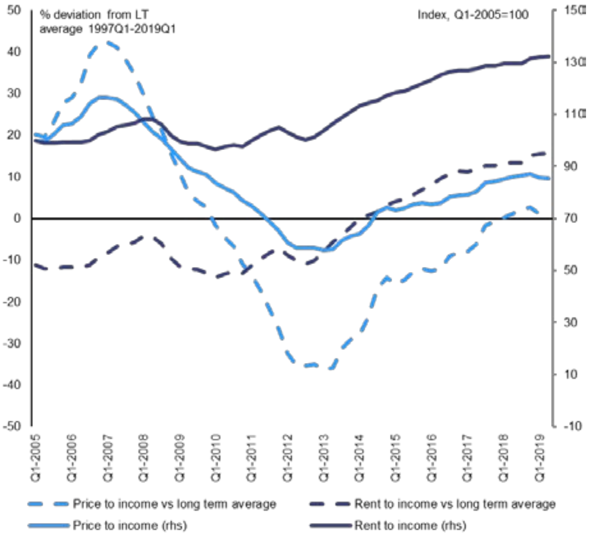
Strong labour market performance and dynamic earnings sustained household disposable income and the demand for housing. In particular, job creation by multinational enterprises, which significantly contributed to the post-financial crisis recovery, exerted significant upward pressure on rents and house prices. Multinational firms (MNEs) directly accounted for 16.8% of total employment in Ireland in 2018, with 38.2% of these jobs located in Dublin. The number of jobs linked to multinationals significantly increased between 2013 and 2018 (+24%) (CSO, 2020). Agnew and Lyons (2018) estimate that per 1,000 extra multinational-linked jobs being created, monthly rents increased by 0.5% to 1% and house prices by 2% in nearby properties after one or two years. The estimated impact was stronger for high-skilled workers, with employment in information and communication technology (ICT) firms and financial services exerting the largest impact on both rents and prices. Given that the multinational-dominated ICT and pharmaceutical sectors are expected to be less affected by the COVID-19 crisis and even benefit from increased demand (Department of Finance, 2020), this effect may persist unless de-globalisation effects prevailed. [4]

Increased uncertainty and lower income may reduce the demand for housing following the COVID-19 crisis. As uncertainty regarding the economic outlook increases, households may postpone their investment decisions. According to Beirne et al. (2019), temporary employment income support approved by the government during the COVID-19 lockdown is expected to largely neutralise or even reverse the losses of those households in the two lowest quintiles of disposable income. Those in the higher quintiles will suffer losses that are expected to be larger for higher income families. However, the situation might change for low-income households once this temporary support is over, especially if employment does not rapidly recover. The loss of income could dampen the demand for housing and make it harder to meet the down payments requirements.

Home affordability is a particular concern for tenants

Home affordability has worsened both for tenants and homebuyers since 2013. Property and rental prices have increased faster than household disposable income since 2013 (Graph 2). While the affordability index for buyers, measured by the housing price to income ratio, still remained 27% below its pre-crisis peak, the affordability index for tenants, measured by the rental price to income ratio, was 22% above its pre-crisis level by mid-2019. The rent to income index has been above its long-term average since 2014. Home affordability slightly improved in 2019, as a result of the sharp slowdown in house price inflation and the continued growth in disposable income.

Graph 2: **Affordability indicators**



Source: Eurostat, OECD, ECB, BIS and Commission services calculations.

Note: An increase in the index suggests that affordability is worsening. Long term averages are computed over 1997Q1-2019Q1.

Affordability constraints are particularly acute for low-income households. In 2016, housing costs exceeded one-third of income for more than 75% of the households in the bottom income quartile. Monthly mortgage instalments and rental payments represented, respectively, 55% and 40% of the net income of these households (Corrigan et al., 2018). [5] In contrast to their wealthier peers, households in the bottom income quartile were affected by a severe increase of the loan-to-income ratio between the onset of the financial crisis in 2008 and 2016 (Corrigan et al., 2018). This may reflect the major expansion of mortgages to low-income households at very loose credit conditions before the financial crisis (Lydon and McCann, 2017).

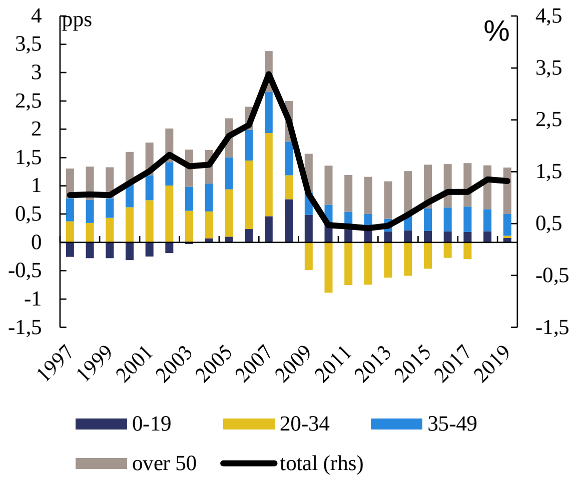
The relative cost of housing is generally higher for tenants than for owners, except for the poorest households. In 2016, the average monthly mortgage instalments for households in the second, third and fourth income quartiles, respectively, accounted for 25%, 20% and 15% of their net income, while for tenants in these quartiles rental payments represented respectively 30%, 22% and 17% of net income. In the two years to 2016, the rent-to-income ratio increased significantly for the bottom and second income quartiles and for individuals over 46. This age cohort faces the highest affordability constraints in the rental sector (Corrigan et al., 2018), probably because those with high income are likely to have already moved to the owner-occupied sector at this age. [6]

Affordability constraints are more pronounced in Dublin and surrounding commuting regions. For owners, affordability constraints are higher in the Mid-East region, where 23% of households spent more than 30% of their net disposable income on housing over 2013-2016. Dublin follows closely, with housing costs exceeding one-third of income for 19% of households. Regarding the private rental sector, affordability constraints are higher in urban regions. Among them, Dublin and the Mid-East regions have the highest share of households (respectively 39% and 37%) facing housing cost-to-income levels above 30% (Corrigan et al., 2018).

The increasing share of tenants may reflect affordability pressures for prospective home buyers. According to EU-SILC data, the share of tenants in the population has increased since the onset of the financial crisis, from 22% in 2006 to 31% in 2016. This does not reflect a population composition effect. Indeed, the age group that contributes most to household formation (i.e., those aged 20 to 49 years old) has remained broadly stable since 2006. The contribution to population growth of the age group most likely to rent a house (i.e. people aged 20 to 34 years old) was even negative between 2009 and 2018 (Graph 3). The income shocks suffered during the financial crisis and the down-payments constraints introduced by the macroprudential rules since 2015 may have driven the increase in the share of tenants in Ireland.

High rental costs may extend the time needed by a potential first-time buyer to accumulate down-payments via savings. According to Kelly and McCann (2016), the number of years needed for a first-time buyer to save the required down-payment to purchase an average house in Dublin increased by between one and two years between mid-2014 and mid-2016, and by between three and six months in the rest of the country. The combined cost of paying rents while also saving in order to build the required down-payment may postpone homeownership (National Competitiveness Council, 2016). As a result, the age at which homeownerships becomes the majority tenure category is on the rise. While the age that marked the changeover between renting and home ownership was broadly stable between 1991 and 2006 (27 years on average), it increased from 28 years in 2006 to 35 years in 2016.

Graph 3: **Contribution to population growth**

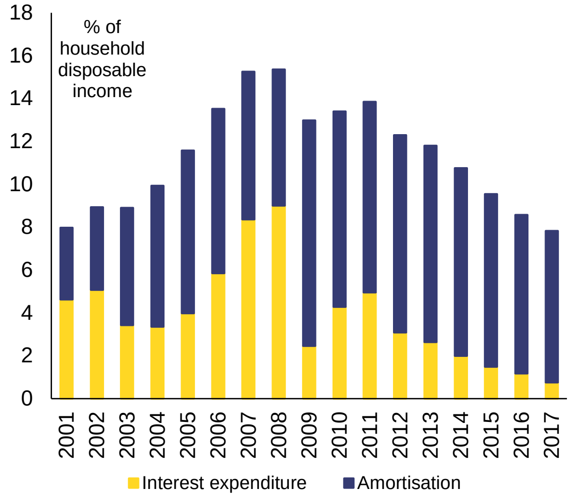


Source: CSO, European Commission calculations.

House price inflation has not been driven by excessive credit growth

Contrary to the 2000s construction boom, low interest rates have not fuelled housing demand in recent years. Irish households underwent a period of prolonged deleveraging after the bust of the housing bubble. As a result, the debt-to-income ratio declined to 133% in 2018, its lowest level since 2004, although it remains one of the highest in the EU. Interest rates on new loans have halved since 2008, from 6% to 3% in mid-2019, but new mortgage lending has increased only moderately since 2014. It remains well below the levels seen in the 2005-2007 period, while the share of residential property transactions financed by cash remains substantial (50% on average between 2015 and 2018). Interest expenditure fell from 9% of disposable income in 2008 to 1% in 2018 and the debt-servicing ratio of households declined from 16% of disposable income in 2008 to 6.5% in 2018 (Graph 4). According to Keenand and O'Brien (2018), the level of new mortgage lending activity is in line with its structural determinants, such as long-term interest rates and demographics.

Graph 4: **Households' debt servicing ratio**



Source: Eurostat.

In contrast to the run-up to the 2008 crisis, investment in buy-to-let properties plays a minor role in mortgage credit growth. Prior to the crisis, considerable new lending was allocated for buy-to-let (BTL) investment, which was supported by low lending standards (Rae and van den Noord, 2006). By contrast, lending for primary dwelling house (PDH) purposes accounted for almost 90% of all outstanding mortgage lending in the second quarter of 2019. The overall stock of mortgage credit has begun to rise only recently, sustained by PDH mortgage, which have been persistently growing since mid-2016, whereas the outstanding amount of BTL mortgages continues to contract. The lack of BTL investment contributes to the tight supply conditions in the rental market.

Lending practices have become more prudent after the 2008 crisis. In 2015, the Central Bank of Ireland introduced macroprudential measures aimed at preventing excessive credit growth and leverage. Since then, loan-to-value (LTV) and loan-to-income (LTI) restrictions limit the size of mortgages that consumers can borrow. Against this background, the moderation of house prices observed since 2018 could reflect both the increase in housing supply and the dampening impact of the Central Bank's macroprudential rules on housing demand.

Credit conditions are becoming more binding but are not leading to a general deterioration in lending standards. The proportion of borrowers taking up more than 90% of maximum credit granted by their banks has increased by 17pps to 46% since macroprudential measures were introduced in 2015. At 68%, this proportion is even higher in Dublin (Kelly et al., 2019). The share of lending around the macroprudential limits continued increasing in the first half of 2019, compared with the same period in 2018. However, since 2015 the mean and median LTVs have remained stable and slightly increased in case of the LTIs. This seems to indicate that lending standards have only slightly deteriorated (CBI, 2019).

Credit standards may tighten following the COVID-19 outbreak. Confinement measures put in place by the government have resulted in a sharp decline in mortgage market activity between March and May 2020. While the government has put in place measures to sustain households and companies, there is still a high risk that the number of non-performing loans increases in 2020 and 2021. As a result, credit institutions may reduce the number and size of mortgages they issue**.** The removal of the counter cyclical capital buffer by the Central Bank in March 2020 may help free up some credit. However, it may be insufficient to completely offset the tightening of credit standards. (Allen-Coghlan and McQuinn, 2020).

Macroprudential policies might impact house prices

Over the long-term, macroprudential measures could reduce house prices and construction levels. Simulations with the European Commission's QUEST model [(7)] (European Commission, 2020), calibrated for Ireland, show that a 10% tightening of the loan-to-value (LTV) ratio on mortgages granted to credit-constrained households could help curb land and house price inflation and improve affordability for home buyers. The 2019 slowdown in house price inflation in Ireland's high-end of the market, where macroprudential rules are more binding, and the resultant improvement in home affordability, seem to confirm this finding. Disregarding potential second-round effects from increased financial stability, such as lower mortgage rates, simulations also suggest that stricter LTV limits reduce aggregate housing investment and the housing stock, which may in turn reduce affordability in the rental sector. These results are consistent with findings in Duffy et al. (2016) and CBI (2019).

There is mixed evidence as regards how macroprudential measures affect rental prices. Tightened down-payment requirements may lead potential borrowers to stay longer on the rental market, thus sustaining rental demand. Yet, using data at the national level, Kennedy et al. (2016) find that the recovery in rents preceded the introduction of macroprudential regulations. McCann (2016), focussing on regional data, presents similar findings for Ireland's most expensive rental markets (Dublin and its bordering counties), where rents were already increasing above predicted values in late-2013, well in advance of the introduction of the macroprudential regulations in 2015. However, in the South-West,

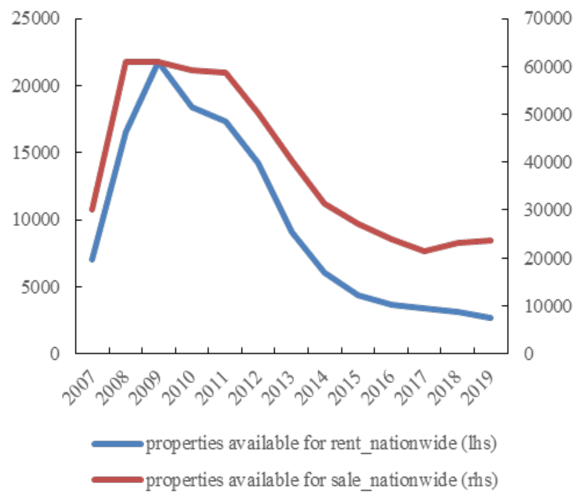
West and Midland regions, rents moved above predicted levels at the same time as the introduction of the regulations.

The existing stock of housing is insufficient and inadequate to meet demand

The housing stock per capita has decreased after a decade of under-investment following the housing bust. According to the Central Statistics Office (CSO) data, between the first quarter of 2011 and the same period in 2019, the housing stock per capita decreased by 4%, as the moderate increase in the housing stock (3% over that period) was outpaced by population growth (7%). The drop in the housing stock per capita was most acute in the Dublin and Mid-East regions (around -5%).

The number of second-hand properties available for sale and rent has shrunk since 2012, reflecting limited supply. According to Daft, a property search website (8), the stock of second-hand properties available for sale remains well below the peak-levels observed in 2009-2011 (Graph 5), although it has increased somewhat since its 2017 low. Similarly, the stock of properties available for rent has decreased sharply in most areas since 2009, especially in Dublin, and remains relatively close to the levels recorded in 2007.

Graph 5: **Stock of properties available nationwide**



Source: DAFT.ie, CSO. Preliminary data for 2019.

The composition of the existing stock of housing is inadequate to meet the increased demand for urban apartments. The economic recovery saw a pick-up in wages, as well as significant inflows of workers into urban areas around the country, many of which are likely renters due to their young age (McCann, 2016). However, the housing stock is mostly made up of detached houses (42%), whereas apartments accounted for only 12% of the total stock in 2016. According to Eurostat data, the population density in Dublin is also very low compared with other European capitals and one-third that of Belfast's.

Mobilising the stock of vacant housing is unlikely to alleviate the housing supply shortage. According to GeoDirectory (9) data, in the second quarter of 2019, the average vacancy rate in Ireland was relatively low, at 4.8%, with rates ranging from 1.2% in Dublin to 15.2% in Leitrim. The vacancy rate was low where demand for housing was most acute, such as in the greater Dublin area (10), while high vacancy rates were registered in rural counties with low housing demand. The reutilisation of long-term vacant properties in counties such as Cork or Galway (with vacancy rates of respectively 4.1% and 6.6%), where housing demand is increasing, may mitigate the supply shortage. However, it is unlikely to alleviate the supply shortage in the greater Dublin area.

Despite the recent pickup in construction, housing shortages could persist

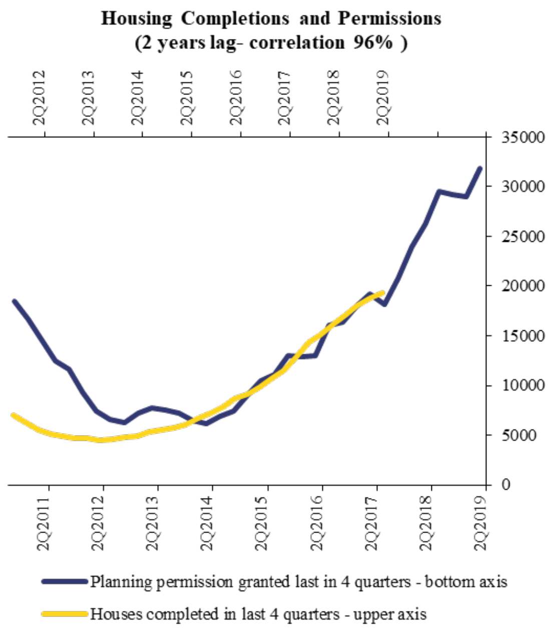
Residential construction ramped up in recent years from very low levels. In 2015, the annual level of housing completions amounted to just some 7,200 dwellings. Between 2016 and the third quarter of 2019, around 57,000 units were completed in Ireland, 36% of them in the year to the third quarter of 2019 (11).

Construction was mainly concentrated in urban areas where demand is higher. Around 76% of the dwellings completed since the beginning of 2016 were built in urban areas. The majority of completions was concentrated in Dublin (37%) and surrounding counties (Meath, Kildare and Wicklow), which accounted for 21%.

The apartment share in total completions increased to 46% in 2019 on the back of less restrictive construction rules. Apartment completions represented only 14% of total completions in the three years to 2018. The lack of viability of urban residential apartment schemes (DHPLG, 2018) might explain this low level (AIB, 2019). The approval in 2018 of new apartment guidelines and less stringent rules for building height and density have coincided with an increase in planning permissions for apartments, from 5,336 in 2017 to 20,582 in 2019. The apartments share in total permissions has increased from 26% in 2017 to 51% in 2019.

Despite the pickup in residential construction, housing shortages were significant in 2019. Before the COVID-19 outbreak, real housing demand [12] in Ireland was estimated to range between 32,000 (Duffy et al., 2016b and Ibec, 2019) and 50,000 units per year (Lyons, 2018). Five cities and their suburbs (Dublin, Cork, Limerick, Galway and Waterford) accounted for 55% of the total real demand in urban settlements [13] estimated for the period 2016-2020. [14] Dublin city and its suburbs [15] accounted for 74% of the estimated demand of these five cities, with the building of 7,466 units required per year (Housing Agency, 2017). These estimates did not consider possible pent-up demand from delayed household formation due to high housing prices. Moreover, lower estimates were based on net inward migration levels (20,000 per year) one third lower than those seen before the COVID-19 outbreak (around 30,000 per year). In 2019, housing completions amounted to 21,138 and 6,944 respectively in Ireland and County Dublin, i.e. well below the level of real demand estimated before the coronavirus outbreak. The real demand could decline if net migration inflows declined or the average household size increased following the pandemic.

Graph 6: **New dwelling completions and planning permissions**

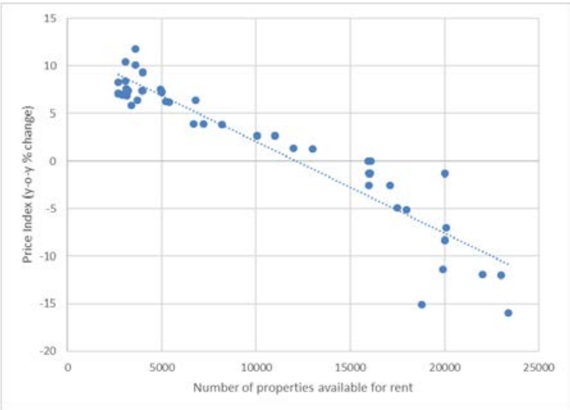


Source: CSO and European Commission calculations.

Completions are expected to collapse in 2020 following the COVID-19 outbreak. Construction permissions, a leading indicator of housing completions, were granted for 40,252 dwellings in Ireland in 2019. Given the approximately two-year lag correlation observed between housing permissions and completions (Graph 6), housing completions were not expected to reach this level until the end of 2021 before the COVID-19 epidemic broke out. The administrative closedown implemented to contain the COVID-19 pandemic is expected to slowdown housing completions in 2020 by at least 25% to around 16,000 units (CBI, 2020). [16] The recovery in housing completions in 2021 will depend on the speed of recovery in economic activity.

A marked increase in rental supply could stabilise rental prices. Changes in rents seem to have been chiefly determined by the stock of properties available to rent relative to potential demand and, to a lesser extent, by income and employment. Rental inflation is inversely correlated with the number of properties available for rent (Graph 7). A supply of 12,000 units per quarter, i.e. four times the supply reported in the first quarter of 2019, might halt the increase in prices of new and renewed tenancies. Rental supply sharply increased by 40% to around 3,800 in the second quarter of 2020. Part of this increase has been triggered by Airbnb landlords' moving from short to long-term rental as a result of the COVID-19 hit on tourism. Which part of this shift will be permanent remains to be seen.

Graph 7: **Number of properties available for rent (quarterly data) and annual rent inflation**



Source: Daft data and European Commission calculations.

The build-to-rent sector is expected to contribute to the rental stock in Dublin in the coming years. In the second quarter of 2020, around 47,000 build-to-rent rental homes (BTRs) were being planned or under construction in Dublin. In addition to other private developments, this might increase the Dublin stock of rental houses by 36% in the period 2019-2025. (Daft, 2019 and 2020) The uncertainty as regards the duration and impact of COVID-19 may lead to postpone some of the BTRs which are still in a pre-planning (20,000 units) or planning-application (7,000) phase.

High delivery cost of housing reduce affordability

Dublin is the third most expensive place in Europe to build. Average construction cost for residential buildings in Dublin [17] stood at around €2,240 per m^2 in the last quarter of 2018, the highest level after London and Zurich (Turner & Townsend, 2019). Labour costs do not seem to explain the higher construction costs in Dublin, as 11 European regional markets, including London and Zurich, reported higher labour costs.

At the national level, construction costs are similar to those in other EU countries. In 2018, Irish residential construction costs were on average comparable to those in Germany, France and the UK, but above those in the Netherlands (Housing Agency, 2018).

New energy requirements and the withdrawal of the UK from the EU might increase the cost of construction further. The Nearly Zero Energy Building Regulation, which came into force in November 2019, is expected to increase average constructions costs of new dwellings by 1.9% while lowering energy bills by around 70%. [18] In addition, Ireland is highly dependent on the UK for the supply of certain construction materials. The withdrawal of the UK from the EU could create further inflationary pressures and delays in accessing materials (House of the Oireachtas, 2019a). [19]

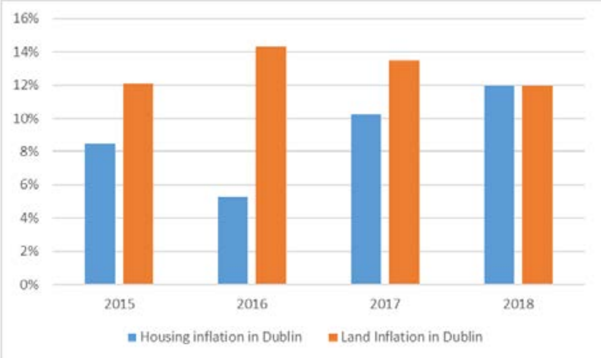
Skills and labour shortages in the construction sector may increase construction costs and limit the supply of housing. Despite 11% annual average growth of employment in the construction sector since 2013, it still represents a modest part of total employment (6% in 2018, against 11% in 2007). The construction industry has reported skill shortages across most construction trades and professions (DHLPG, 2018; DIT, 2018; DKM, 2017 and SCSI/PWC, 2019). Job vacancy rates in the construction and real estate sectors have increased since 2016. Two factors explain the shortfall in appropriately skilled construction workers: Most of the construction workers who lost their jobs during the crisis have likely emigrated (Conefrey and McIndoe-Calder, 2018). The number of individuals entering construction-related education has also been subdued since the construction bust. The shortage of skilled construction workers may persist after the COVID-19 crisis, unless reduced inward migration and lower disposable income significantly depressed the demand and supply of housing.

The relatively low productivity of the construction sector in Ireland contribute to relatively high construction costs. In 2017, the gross value added (corrected by using the construction sector purchasing power parity index) per hour worked by Irish construction workers was 5% below the EU average. This seems to indicate that construction in Ireland was more labour-intense than in other countries and consequently more sensitive to labour cost inflation. [20]

Most of the delivery costs for housing are not associated to construction costs. Construction costs represented only 45% of the costs associated with delivering a 3-bedroom semi-detached home in Ireland in 2016. The remainder consisted of taxes, levies and fees (18%), finance and marketing costs (8%), land costs (17%) and margins (11%). The share of land cost in some Dublin suburbs might be considerably higher – around 25 to 30% of total costs (SCSI, 2016).

The surge in house prices in recent years seems to have been mainly driven by increases in land prices and construction margins. Market reports (SCSI, 2016-2019) suggest a significant growth in residential land values since 2015, particularly in Dublin, also pointing out to insufficient land supply. Land Price inflation in Dublin, while slightly declining since 2016, still records two-digit values, well exceeding housing price inflation from 2015 to 2017 (Graph 8). However, land price inflation alone cannot explain high house price inflation since land prices only represent between 17% and 30% of house prices. Neither can construction cost inflation, which has been relatively low in recent years. In particular, in the three years to mid-2019, the annual average rate of inflation of the wholesale price of building and constructions materials and of weekly construction labour costs has been, respectively, 2% and 0.9% in Ireland. Taxes, levies and fees and finance and marketing costs have not surged. Therefore, high inflation values may be partly explained by an increase in margins, which may indicate insufficient competition.

Graph 8: **Housing and land inflation**



Source: Society of Chartered Surveyors Ireland and Eurostat.

Concentration in the land market could damage housing affordability. While before the crisis, land-buyers used to be family business house-builders, they are now very often investment companies, such us real estate investment trusts, public limited companies or other investment type mechanisms, a number of which are foreign investors (DHPLG, 2018). This change may reflect the fact that high land prices represent a barrier to entry for small builders. The concentration of land by a limited number of promoters could reduce competition and may fuel inflation in the price of land.

Overall, market concentration in the rental market remains low. According to the Central Statistical Office (CSO), 6.4% of housing transactions were concluded between households and investment type vehicles in 2017, against 1.8% in 2010. The rise was more pronounced for apartments, from 4.2% in 2010 to 11.9% in 2017 (SCSI/CBI, 2018). The higher number of landlords managing between 10 and 20 properties in 2017 indicates that more large-scale professional landlords are entering into the rental sector (RTB, 2017), which might contribute to increasing the housing supply (European Commission, 2019). While market concentration in the rental sector remains low nationwide, with 85% of landlords renting no more than one or two properties in 2017, the concentration could be higher in local markets such as Dublin, for which no such data are available.

A combination of supply and demand measures might increase affordability

Supply side measures

A well- administered vacant site tax could increase land availability and reduce land inflation. In January 2019, sites registered as vacant in January 2018 have become subject to a 3% levy on their market value unless works were activated in the interim. This levy will increase to 7% in subsequent years. In April 2019, 360 vacant sites were registered, 162 of them in Dublin. (Houses of Oireachtas, 2019b). Around 10% of the sites identified had already come off the register and started construction, which might indicate that the levy has the potential to incentivate housing supply. Local authorities have expressed concerns due to the resources involved in administering the levy and reported difficulties in interpreting the law and identifying vacant sites and their ownership. Partly due to these constraints, the implementation of the levy has been uneven, with only 17 out of 31 local authorities having active registers by end-2019. A more centralised approach could be considered to address part of these concerns (PBO, 2020).

Reforming the property tax might reduce housing under-occupation. House price valuations serving as a base for property taxes have not been revised since 2013, which may lead to sub-optimal resource allocation and housing under-occupation (European Commission, 2012a). A regular updating of house price valuations combined with special arrangements for low income owners and illiquid assets may improve resource allocation, while increasing the progressivity and fairness of the tax system (European Commission, 2012b). The update may have inflationary effects in the rental market, as landlords could pass property tax increases on to tenants in a context of rental supply shortages. In addition, it could discourage landlords to renovate their dwellings. Therefore, special arrangements for the long-term rental sector may also be required.

Using publicly-owned land for residential construction may improve housing affordability. In 2018, publicly-owned land was estimated to have capacity for the development of over 50,000 housing units. This land could be used to provide social or affordable housing. (NESC, 2018) [21]

Providing adequate and timely supply of serviced land might help improve affordability in the long-term. The Land Development Agency [22] is expected to assemble strategic land banks from a mix of public and private lands, making them available for housing. Part of this land — in 2019 in Dublin, land with capacity for more than 50,000 housing units— might require significant investments to be developed. (DHPLG, 2019)

Attracting foreign producers and skilled workers and increasing productivity may reduce construction cost and bolster housing supply. While the COVID-19 pandemic could temporarily reduce the demand for housing, high housing development costs, if not addressed, risk squeezing margins, reducing housing supply and creating housing shortages when the economy recovers. Removing barriers to entry and attracting foreign skilled labour may increase competition and reduce construction cost. Boosting productivity in the construction sector might be achieved by incentivising — inter-alia through public procurement — the use of rigorous planning processes and modular and prefabricated solutions as well as investments in digital technology and advance automation. (McKinsey Global Institute, 2017)

Reducing the complexity and restrictiveness of rent legislation may increase the number of buy-to-let properties coming onto the market. According to the Residential Property Price Survey (SCSI/CBI, 2018) [23], one-third of respondents identified the complexity and restrictiveness of rent legislation as a primary factor hampering buy-to-let investments in 2018.

Demand side measures

Housing subsidies might help moderate the drop in house prices in case of a sluggish recovery. Housing subsidies pass through to higher land and housing prices when land-use and planning restrictions limit housing supply (Salvi del Pero et al., 2016). House prices are expected to decline as a result of the COVID-19 pandemic. While the decline in prices may be mild in case of a V-shaped recovery, it could be more severe if high rates of unemployment were persistent and a slow-pace recovery materialised. In the latter case, the temporary use of housing subsidies (such as the Rebuilding Ireland Home Loan and Help-to-Buy schemes in the owner-occupied sector and the Housing Assistance Payment and Rental Accommodation scheme in the rental sector) may support housing demand and moderate the decline in house prices. Tapering these subsidies once house prices stabilise will limit the risk of excessive housing price increases building-up.

Macroprudential rules may increase affordability in the owner-occupied sector in the medium-term. Prudent lending practices are paramount to foster financial stability and avoid a credit-led boom. In the short term, macroprudential rules may reduce affordability (especially in main cities where housing prices grow faster than income). However, in the medium-term, macroprudential rules might curb house price inflation and help correct the misalignment between housing price and income (see page 7-8).

Conclusion

Housing affordability has worsened both for tenants and home-buyers in recent years, on the back of increasing property prices. Contrary to the early 2000s construction boom, the recovery in house prices after the financial crisis has not translated into rapid credit growth, as the introduction of macro-prudential policies has fostered more prudent lending practices. The increase in house prices has been mainly driven by insufficient housing supply.

Transient containment and social measures taken to address COVID-19 are expected to impact both the demand and supply of housing in 2020. The temporary bans on rent increases and evictions combined with generous welfare payments, could lead to a temporary decline in rental prices and improved affordability for those households with lower incomes. Confinement and social-distancing measures are expected to curtail sales and construction while restrictions to migration flows, increased uncertainty and the economic slowdown may curb housing demand. Given the supply shortages Ireland faced before the COVID-19 outbreak, the collapse in housing completions in the first half of 2020 may put additional upward pressure on house prices when the economy recovers, exacerbating the affordability issues that existed before the pandemic.

Supporting housing supply, including by stepping up investment in social housing, will be paramount to improve housing affordability after the COVID-19 pandemic. A raise in unemployment or a tightening in credit conditions following the COVID-19 crisis could reduce housing demand and prices. However, they would also reduce disposable income and the access to credit, therefore, they are not likely to improve housing affordability unless they are accompanied by a reduction of net migration inflows (24). On the contrary, in the absence of measures supporting housing supply, lower house prices and uncertainty may reduce housing construction and make housing prices decline at a slower pace than disposable income. In addition, once the economy recovers, housing shortages will create inflationary pressures and further exacerbate affordability issues. Affordability constraints in the housing market could have major economic implications. These are likely to limit the ability of firms to attract skilled workers and may exert upward pressures on wages and hamper the competitiveness of the Irish economy. Policies supporting the reduction of construction and land costs, combined with prudent macroprudential policy, and the development of social housing and an affordable rental market might limit the materialisation of such risks. In case of a sluggish recovery, the temporary use of housing subsidies could support affordability and help housing prices stabilise.

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(1) Since 2015, the Irish Central Bank has enacted macro-prudential policies aimed at preventing excessive credit growth and leverage. Loan-to-value (LTV) and loan-to-income (LTI) restrictions limit the mortgage amounts that consumers can borrow.

(2) Population in urban areas represented 63% of the total population in Ireland in 2016. Dublin region concentrates 44% of the population in urban areas (Source: Census 2016, CSO)

(3) In 2018, net inward migration accounted for 53% of demographic growth, against 31% in 2016. Household size of non-Irish people is typically lower (2.3 versus 2.7 for Irish households).

(4) In May 2020, following the COVID-19 outbreak, the US president Donald Trump vowed to bring global pharmaceutical production back to the United States

(5) In Ireland, 45% of households owned their property outright in 2016. These households are excluded from the ratio calculations. The costs of utilities (water, electricity, gas and heating) resulting from the actual use of the accommodation are not included.

(6) Only 27% of individuals with an equivalised income above 60% of the median were tenants in 2018. Less than 25% of households whose main representative is over 46 years were in the rental sector in 2017 compared with more than 40% below that age (European Central Bank, 2020).

(7) Simulations compare a baseline scenario with no measures to an alternative scenario with a 10% tightening of the LTV. The LTV applies only to credit-constrained households, who represent 50% of total households. This is an approximation to reality: 1) the LTV for first time buyers is 90% but for second and subsequent buyers is higher (80%) and 2) banks are allowed to grant part of the mortgages (20% for second and subsequent buyers and 5% for first time buyers above these limits.(further details in European Commission (2020), box 3.1)

(8) Daft.ie is a property search website which collects data on the Irish property market aimed at monitoring trends in both rental and sales markets. It provides the longest time series of rental prices at a regional level in Ireland. Rents reported by Daft.ie are advertised asking prices for rental properties, which could understate the actually agreed rents on new leases during periods of excess demand (given that in a tight market rents may be bid above the asking price) and similarly overstate the actual rental price in periods of weak demand, where owners may have to accept rents below those being advertised. Price statistics are based on properties advertised online for a given period and are computed using hedonic price regressions.

(9) Two sources are available on vacancy rates: CSO data based on the Census and the GeoDirectory database. The two sources suggest different vacancy levels, reflecting different methodologies and definitions of vacancies. CSO figures include all vacant properties, whereas the GeoDirectory database excludes dwellings which are available for sale or rent and dwellings currently undergoing renovations. The GeoDirectory data could better reflect long-term, structural vacancies, while CSO data also encompasses the units which are vacant on a short-term basis, due to frictions on the housing and rental markets.

(10) The Greater Dublin Area covers the counties of Dublin, Meath, Kildare and Wicklow.

(11) Data source: New Dwelling Completions (NDC) from the Central Statistics Office (CSO)

(12) *Real* housing demand refers to the demand created by population growth and changes in household size. *Actual* housing demand might be different due to financial, macroeconomic or policy factors.

(13) Urban settlements are defined as those with more than 500 habitants.

(14) Demand estimates over the period 2016-2020 do not consider the possible pent-up demand accumulated before 2016.

(15) Dublin city and suburbs incorporates Dún Laoghaire and parts of South Dublin and Fingal. This area represents 94% of the housing supply needs in County Dublin.

(16) Construction Information Services (CIS) reported in mid-May 2020 that €17.9bn in project work had been halted in Ireland due to the COVID–19 industry shutdown. https://constructionnews.ie/cis-covid19/

(17) Cost including factor prices (labour, materials and plan), productivity and profit margin but excluding taxes, levies, fees, finance, marketing and land costs.

(18) Heating and hot water costs of a 3-bedroom semi-detached house might be reduced by between 66 to 75%.

(19) According to Economic and Social Research Institute (ESRI), nearly 50% of imported plumbing and electrical fittings and prefabricated buildings and around 30% of wood products used in the Irish construction sector are imported from UK.

(20) Traditional building heights in most urban areas in Ireland vary somewhat within a limited and generally low number (two to four) of stories (Government of Ireland, 2018). According to (United Nations, 1965), labour productivity in the construction of multi-story buildings with identical floors increases with each additional floor up to a certain height ranging from eight (Poland and Germany) to ten floors (Israel). New rules introduced in Ireland in December 2018 facilitating taller buildings may therefore help increase the labour productivity of the construction sector. While in general terms taller buildings increase productivity, other aspects impacting labour productivity need to be considered such as country-specific regulatory factors (e.g. in Ireland additional fire-safety requirements apply to buildings above 6-storeys and 18 metres in height) or land factors (e.g. bad soil qualities may require lengthy and costly processes for the reinforcement of the building foundations above certain heights).

(21) The National Economic and Social Council (NESC, 2018) recommends master-planning this land before engaging with private promoters. This may allow public authorities benefitting from its increased value and compensating the costs of serving it with the appropriate infrastructures. It would be important that the sale or leasing of the land to private promoters is conditional to its immediate development to avoid land hoarding.

(22) The Land Development Agency is a statutory body recently created by the government with responsibility for developing State lands as well as working with public and private sector land owners to increase land supply while stabilising prices

(23) The CBI/SCSI Residential Property Price Survey is a quarterly sentiment survey of estate agents, auctioneers and surveyors, as well as those with a more indirect interest in the industry such as economists, market analysts and academics. The survey is commissioned by the Central Bank of Ireland and the Society of Chartered Surveyors Ireland.

(24) According to Philiponnet and Turrini (2017), the elasticity of house prices with respect to disposable income is 0.94, i.e. a decline in disposable income will lead to a slightly lower decline in house prices leading to slight worsening of affordability. If the decline in disposable income is accompanied by falling net migration inflows, affordability may improve. However, unlike in the post-2008 crisis period, migration outflows of low skill workers would be less likely to occur due to the global economic impact of the pandemic. In Ireland, 82% of net migration inflows correspond to people with third level studies. Sectors requiring these skills are expected to be relatively resilient to the COVID-19 crisis. However, an acceleration of deglobalisation trends could not be excluded.

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