

Affordability

COMMENT

Current housing market movements are good news for first-time buyers, writes **Dara Deering**

AFFORDABILITY, which measures, in this case, a first-time buyers ability to purchase a new home and make their monthly mortgage repayment, has improved once again this quarter.

This improvement is due to continued decreases in house prices and follows the introduction of the new mortgage interest relief bands in Budget 2008.

The PTSB/ESRI House Price Index has shown that house prices fell by a further 0.7 per cent in January this year, bringing the average house price for first-time buyers to €257,222, compared to €279,399 in January last year, a decrease of €22,177 in the last twelve months. Although the rate of decline in house prices will slow throughout the year, it is expected that by December, house prices may have declined by as much as 5-10 per cent. This decline will bring the average price for a first-time buyer's home to the region of €232,000 to €244,000, once again improving affordability further for first-time buyers.

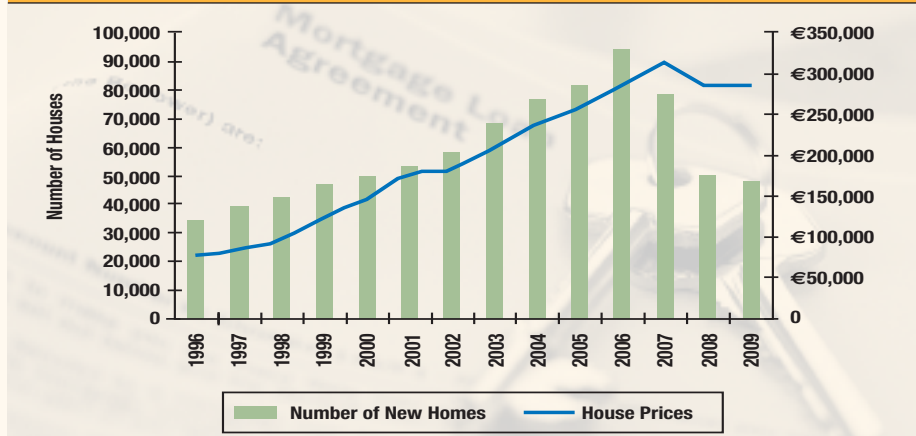


DARA DEERING:
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House prices have decreased over the last year as demand for housing in the market has slowed. This is due to two key factors.

Firstly, increased levels of supply of housing. Over 80,000 new homes were completed in 2006 and 78,000 in 2007. With strong levels of supply,

NUMBER OF NEW HOUSES & AVERAGE HOUSE PRICES 1996-2009 (f)



house prices started to slow as the market reached a state of equilibrium as shown in the chart above.

We estimate that between 45,000 to 50,000 houses will be completed in 2008, as supply continues to decrease in response to falling demand, and that in the years to come completion figures will average around this level.

Secondly, many first-time buyers (and other buyers) decided to step out of the market before the election as they waited for promised changes to stamp duty.

With both of these factors causing house prices to decrease, affordability for first-time buyers has seen a strong improvement.

During 2007 we saw another factor come into play. Average rents increased by just over 11 per cent, this was mainly due to increases in demand as purchasers rented while they waited before purchasing their first home.

Central Statistic Office figures for February 2008 have shown that although rents continue to increase, they are doing so at a lower level than before, which would suggest that some buyers may already be returning to the market.

Finally mortgage interest rates also impact

affordability for new buyers.

During the period from December 2005 to June 2007, the European Central Bank (ECB) increased lending rates eight times by 2.00 per cent in total. When ECB rates increase, so too do standard variable rates and tracker variable rates in Ireland. At the last increase in June the average standard variable in Ireland was 5.33 per cent. The average standard variable rate is now 5.39 per cent due to the impact of the credit crunch on the cost of money. We expect that during 2008 (more likely in the latter half of the year) that the European Central Bank will reduce rates by possibly 0.50 per cent. Should this happen, it is likely that it would be with two decreases of 0.25 per cent. Both of these decreases would further improve affordability for first-time buyers by reducing the monthly cost of a mortgage repayment.

In summary, we expect affordability to improve further for first-time buyers this year on the back of slowing house prices and expected decreases in mortgage interest rates. However all of the factors in the market combined should make it easier for first-time buyers to get onto the first step of that property ladder. ●

Property Index

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ANALYSIS

Buying is more cost effective in the medium term, writes **Annette Hughes**

NOTWITHSTANDING the improvement in housing affordability, the current uncertainty over the future prospects for house prices is generating a dilemma for potential first-time buyers, who are faced with the decision whether to buy or rent property at this time. We consider the choice faced by first-time buyers below.

Developments in the rented market

The Daft.ie Rental Report 2007 showed that the supply of property available for rent on its website almost doubled nationwide in the previous year. The result has been a slowdown in the growth in rents over recent months. According to Daft.ie, rental inflation averaged 9.5 per cent nationwide in 2007, but the

growth in rents slowed in the final quarter of 2007. The latest data suggests that average rents nationwide increased by 5.3 per cent in the year to January 2008.

That said, strong rent increases are reported for selected property types and locations

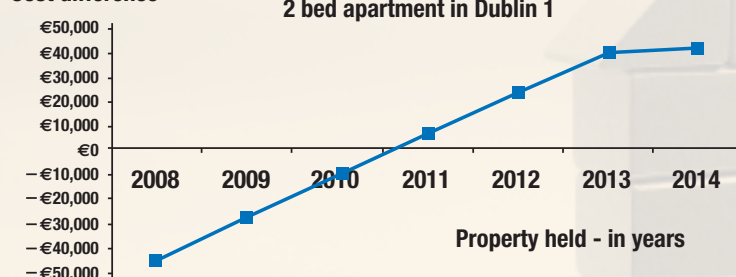


ANNETTE HUGHES:
Director of DKM Economic Consultants

in the Daft.ie report: the north-south premium, i.e. the difference between rent in south and north Dublin city has doubled in the last two years to over €220. Similarly, small

BUY OR RENT? POSITIVE VALUE MEANS BUYING IS BETTER

Buying versus renting
Cost difference



properties in north county Dublin recorded rent increases of 8.5 to 9.5 per cent, compared to the national trend of around 5 per cent. Cities and Dublin's commuter counties also continue to record rental growth of around 6 per cent or higher. In contrast, rents elsewhere are less than 2 per cent higher than one year ago in some locations and static in others.

Against this background, DKM has constructed a model that allows the buy versus rent decision to be evaluated.

Buying versus renting

The model is based on a set of assumptions for the key variables which impact on the decision to buy or rent. We begin with the assumption that the first-time buyer couple has the initial deposit (10 per cent of purchase price) and is faced with either using it to purchase a starter home, or investing it and renting a property instead. This is important to ensure that both options are consistent and comparable. We also assume that the first-time buyer couple typically stays in their first home for seven years, based on information received from EBS. Seven years is also the term for the state's maximum mortgage interest relief for first-time buyers.

The outcome – whether it is more advisable

to buy or rent – will depend on how one envisages the future development in the key variables given below. Our assumptions are set out in Table 1.

While house prices and rents are currently moving in opposite directions, we assume that their growth rates must converge at some stage over the medium term. As house price inflation resumes – making buying more attractive – rents are assumed to stabilize and eventually decline. We also assume that mortgage rates fall back to 4.5 per cent within two years.

Other assumptions underlying the model include:

1. The buyer couple takes a 35-year mortgage.
2. The buyer couple pays transaction costs equivalent to 1 per cent of the house price when buying in Year 1 and 2 per cent when selling in Year 7. If the first-time buyer couple chooses to rent, they do not incur these transaction costs but they pay a rental deposit of one month.
3. If the first-time buyer couple chose to rent a property, they invest the property deposit at an interest rate of 2 percentage points below the mortgage rate.
4. By choosing to rent, the first-time buyer couple can avail of rent relief of

TABLE 1: ASSUMPTIONS UNDERLYING DKM BUY VS. RENT MODEL FOR DUBLIN MARKET

YEAR END	HOUSE PRICE % GROWTH PA	MORTGAGE RATE % PA	RENT GROWTH % PA
2007 (Actual)	-7%	5.3%	7%-11%
2008	-10%	5.0%	8%
2009	3%	5.0%	5%
2010	3%	4.5%	2%
2011	3%	4.5%	0%
2012	3%	4.5%	0%
2013	3%	4.5%	-3%
2014	3%	4.5%	-3%
2008-2014 (Nominal)	+7%		+9%

Source: 2007 house price inflation from permanent tsb; 2007 rent inflation from Daft.ie; all projections from DKM

TABLE 2: POSITION AT END OF 2014 BASED ON BUYING / RENTING IN 2008

1	Buyer's buying costs Year 1	€4,200
2	Total cost of mortgage repayment over 7 years	€147,728
3	Total costs of rent over 7 years	€142,838
4	Additional accommodation costs to buyer (2-3)	€4,890
5	Buyer's total equity after 7 years	€109,447
6	Buyer's selling costs (2% of house price)	€9,027
7	Renter's funds on deposit	€50,579
6	Buyer better off compared with renter (5-1-4-6-7)	€40,751

€4,000 p.a. which works out at €67 per month. If they choose to buy, they earn mortgage interest relief, up to a maximum of €333 per month.

5 We do not take the "rent-a-room" scheme into account if the first-time buyer opts to buy. However, this is significant as it allows property owners tax free earnings of up to €10,000 a year from renting out a room. Daft.ie estimates the income earned by renting out a double room in Dublin city has increased by about 10 per cent over the last year.

Outcomes over the medium term

We selected two typical first-time buyer properties in two distinct Dublin locations:

Castleforbes Square, Dublin 1

- Located in Dublin Docklands beside the Point Village (currently under construction) and adjacent to Spencer Dock.
- A two-bed apartment costs €420,000 and would earn €1,500 per month in rent.

Belmayne, Balgriffin, Dublin 13

- Situated adjacent to the new four-star Hilton Hotel on the Malahide Road.
- A three-bed house costs €440,000 and would earn €1,600 per month in rent.

The decision to buy or rent is examined by looking at the difference between what the

total costs of buying at the end of each year would be versus the total cost of renting. For the couple who chose to buy, this is the total of any equity they have accumulated, less their mortgage repayments, less their transactions costs, less the interest they forego on investing the deposit. For the renter, it is the total cost of renting, less the interest earned on investing the deposit of €42,000. The chart shows how much the buyer is better off at the end of each year (i.e. buying less renting costs).

The model shows, based on our assumptions above, that there is very little difference between the two properties. Thus we report the result for the two-bedroom city centre apartment:

- Even given the conditions prevailing in the housing market at this point in time, our first-time buyer couple is better off buying than renting if they intend to hold onto their property for more than three years.
- A first-time buyer couple purchasing a property today would be better off by the end of 2011 than if they had rented from today.

The above is true because by 2011 it has cost the buyer less to buy his accommodation than it has cost the renter, after taking his equity into account. As the previous chart shows, the buyer is better off by around €5,000 by Year 4 (2011).

By Year 7 (2014), even after selling his property and paying his transaction costs, the buyer is better off by almost €41,000. This

figure of €41,000 reflects the fact that even though the couple would have paid almost €5,000 more in mortgage repayments than in rent (based on the assumptions in Table 1) over the 7 years, they would have accumulated equity of €109,500 at the end of Year 7 (2014). Assuming they sell on after 7 years, generating selling costs at 2 per cent of the house price in 2014 (€9,000), the couple who bought are still better off by €91,000.

However, recall that the renter invested his deposit of €42,000 and would have earned €8,600 in interest over the seven years, leaving the buyer better off by €41,000 by the end of 2014.

Table 2 summarises the position at the end of Year 7 (2014) assuming the couple decide to buy or rent today.

It must be borne in mind that renting will always be more attractive in the very short-term for the following two reasons:

- The renter has no transaction costs.
- Under our assumptions, the renter opts to invest his rental deposit and earns interest on it.

Thus, while there is some value in holding off buying in the immediate term, on the basis that house prices may have further to fall, our model indicates that, notwithstanding the trend in house prices, even if the couple buy today, they would be better off (in positive territory) versus the decision to rent after four years (see chart). It is important to stress that this conclusion is based on our assumptions for the key variables. The key assumption which most impacts on the results is what we assume about house prices, as it is the latter that gives rise to the buyer's equity.

We have not the space to explore other assumptions here. Suffice it to say that if house price growth were to resume earlier than suggested, the buyer would be better off after two years, assuming rents remain unchanged. Alternatively, higher rental inflation than projected would tilt the decision in favour of the buyer, while if rental growth followed the same pattern as house price growth, the buyer would not be better off until Year 5 (2012).

As we have seen above, rents arising from the "Rent a Room" scheme have been growing strongly. The average rent for a double room in Dublin city centre was €664 (increase of 12.5 per cent over past year according to Daft.ie). Although we have not included it in the buy versus rent model, the entirety of this income would be tax-free (rental income of up to €10,000 p.a., i.e. €833 p.m. tax free).

This measure, together with the improved ceilings for mortgage interest relief, has tipped the balance of incentives for the first-time buyer couple towards buying as opposed to renting over the medium term.

Affordability developments

Amidst all of the negative news commentary on the housing market over the past twelve months, there has been one consistent positive development. That has been the substantial improvement in housing affordability for first-time buyers since December 2006. This improvement has been generated by a combination of factors, namely the 8 per cent reduction in average house prices since the beginning of 2007, the favourable changes to mortgage interest relief and, more recently, the stabilisation in mortgage rates since June last year.

Affordability is an essential ingredient in any housing market, allowing more potential housebuyers to transact in the market. The latest figures from the EBS/DKM Housing Affordability, published by Irish Property Buyer magazine, shows that the average first-time buyer couple is currently spending 22 per cent of their net income on their mortgage repayments compared with 23 per cent at the end of last year and 26.4 per cent at the end of 2006. This improvement represents a reduction in average monthly mortgage repayments of €137 between December 2006 and March 2008.

The average Dublin first-time buyer couple is currently spending 26.6 per cent of their net income on their mortgage repayments, compared to almost one-third, 33 per cent, at the end of December 2006. Again, this is a substantial improvement, equivalent to a reduction of €211 in the average mortgage repayment over the last fifteen months. The larger reduction in Dublin reflects the benefit of the increased mortgage interest relief for Dublin buyers, who are traditionally faced with higher house prices. ●

WHAT IT MEANS

Housing affordability is a measure of the proportion of net income required to meet net mortgage repayments for first-time buyers on average earnings.

HOUSING AFFORDABILITY TRENDS DECEMBER 2005 TO JANUARY 2008 WITH PROJECTIONS TO JUNE 2008

	ACTUAL DEC 05	DEC 06	JUN 07	DEC 07	JAN 08	ESTIMATE MAR 08	FORECAST JUN 08
Avg. Mortgage Rate	3.63%	4.81%	5.30%	5.34%	5.34%	5.34%	5.34%
National First Time Buyer Working Couple							
Monthly Repayments	€1,018	€1,323	€1,266	€1,227	€1,210	€1,186	€1,150
As % of Net Income	21.6%	26.4%	24.1%	23.0%	22.4%	21.9%	21.0%
Avg. House Price (000s)	€249.5	€279.0	€270.1	€260.8	€257.2	€252.1	€244.6
Dublin First Time Buyer Working Couple							
Monthly Repayments	€1,295	€1,741	€1,663	€1,571	€1,561	€1,530	€1,484
As % of Net Income	25.8%	32.5%	29.7%	27.6%	27.2%	26.6%	25.5%
Avg. House Price (000s)	€309.6	€359.0	€351.9	€333.9	€331.9	€325.3	€315.6

ASSUMPTIONS**Incomes:****Terms of 'Towards 2016'**

+3.0% 1st Jan 2006
+2.5% 1st July 2006
+2.5% 1st April 2007
+2.5% 1st Oct 2007
Expires 31/3/2008

Monthly House Prices: permanent tsb/ESRI data;

Latest data to January; assume prices fall 1% per month up to June

ECB Rates: 4% since June 2007; unchanged up to June 2008.

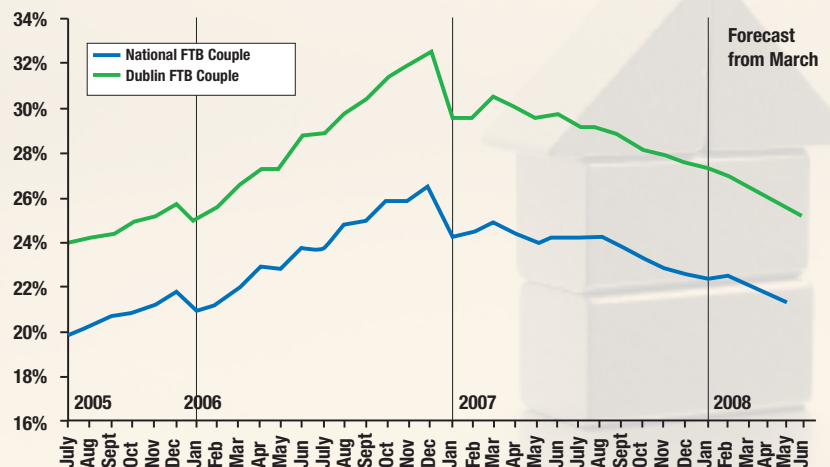
Average Mortgage Rates: Latest 5.34% in June 2007; unchanged to June 2008.

Max. Mortgage Interest Relief: Up from €267/mth to €333/mth in Jan. 2008

+10.9% cumulative over 27 months under 'Towards 2016' or 5.1% year-on-year in Dec 2007.

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

Forecast growth in incomes: Assume a further 2% in April 2008.

EBS/DKM HOUSING AFFORDABILITY TRENDS (MONTHLY)

My mortgage is **about the same** as it would cost me to rent in the same location”

See Niamh's story on page 26