



Housing Supply in Ireland

Highlighted issues and suggestions

For the six months ended 31 December 2017

Issues impacting housing supply

The issues affecting the supply of housing are many and varied and continue to be the focus of Government policy and close industry and media scrutiny. A key theme of Budget 2018 was housing and the Government announced a number of measures to help boost the supply of housing. We believe the immediate issues limiting supply are the costs of building residential properties and the availability of funding, primarily equity funding for residential development. Essentially the costs of building houses and apartments – especially the starter-home market and the affordable housing market – are, in general, still too high. Consequently, in the short term, we believe the solution centres around costs and equity capital and, in the longer term, it involves increasing the supply of serviced land available to builders.

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Residential development industry recovery from near collapse

The residential development industry is still recovering from collapse and is in the process of repairing its productive capacity and rebuilding equity in the sector. Without access to sufficient equity, the industry's capacity to build houses and apartments is severely restricted.

Cost of construction is still too high – primarily soft costs

The cost of construction of new builds has increased significantly over the last 10 years and this has made the viability of residential development ever more challenging. Despite the fact that residential property prices fell by approximately 50% to 60% during the economic crisis, '*construction costs rose by nearly a third – almost exclusively on newly built homes – due primarily to regulatory changes.*'¹ While the hard costs, such as materials, are on a par with other countries, it is a combination of levies, taxation and higher building standards that elevate the costs.

An immediate and effective measure to address the cost of housing is for the Government to review in totality the cumulative cost of VAT, taxes, levies, Part V requirements, and building regulations on the viability of construction. The cumulative impact means that the portion of costs attributable to the Government is in the region of 30% per residential unit of a typical three-bed semi-detached house. We look at each element and suggest possible changes, and also offer suggestions on how the planning system could be improved to aid supply.

Fiscal incentives and interventions

Government fiscal interventions have had a chequered history with respect to the housing market. From the Kenny Report to the Bacon Reports and current suggested policy reforms, there has always been significant pressure on the government to intervene. The Minister for Finance addressed a number of housing related issues in Budget 2018 and include:

- Help-to-Buy – the scheme was retained but will be reviewed again in 2019. We agree with the Minister's decision to retain the Help-to-Buy Scheme. We also look at the UK Help-To-Buy schemes for potential changes.
- Capital Gains Tax Exemption – the seven year time restriction was amended in the Budget with a reduction in the holding period.
- Vacant site levy – we support the introduction of a vacant site levy but would caution over its actual implementation.

There are a number of other measures that could be considered, each tackling different aspects of the market. Our suggestions include:

- Reduction in VAT – in lieu of a reduction in levies, a targeted cut in the rate of VAT should be considered for a period of time.
- Reform tax code for private landlords – we believe individual private landlords should be encouraged back into the market and placed on a more equal footing with their institutional equivalents.
- Encourage downsizing – help develop a senior housing market in Ireland in order to free up under-utilised family houses.

1, Source: Ronan Lyons – Housing: Supply, Pricing and Servicing

The Government has already taken meaningful steps to try and boost the supply of housing. However, given the short-term pressures facing the housing market, further judicious fiscal intervention could have a meaningful impact on boosting supply and could be used as a bridging mechanism until the longer-term supply response is achieved.

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Planning and regulatory constraints

The quality of house building has improved significantly over the last 10 years driven primarily by higher minimum building regulations. As a result of these efforts, housing and apartment standards in Ireland are among the highest in Europe. However, these improved standards have in turn significantly increased the cost of housing.

We do not believe there should be any diminution of standards when it comes to safety issues, but there are other more discretionary aspects that could be looked at.

To this end, it is very encouraging that the recently announced draft apartment planning guidelines should go a long way in addressing the cost of apartment construction. These measures only focus on apartment costs however, and we believe a similar review of the costs of starter houses (that is, a typical three bedroom semi-detached house) is also warranted.

As part of the regulatory oversight of the mortgage market, the Central Bank operates a set of macroprudential rules that govern loan-to-value (LTV) and loan-to-income ratios (LTI).

We suggest the following:

- Comprehensive review of building standards and requirements with a focus on apartments. The ongoing review of overall costs should help in this regard.
- Certain parts of Dublin city should be designated for even greater height and density than what the current regulations permit.
- The maximum residential price at which levies can be waived should be increased to €400,000 in Dublin and €350,000 in Cork.
- Increase resourcing in the main planning authorities. Consider establishing a single authority to set enforceable guidelines and also enforceable interpretations that in turn minimises the discretion on the part of individual planners.

Social housing

Ireland's social housing system has relied primarily on Part V (of the Planning and Development Acts, 2000-2006), where developers have to set aside 10 per cent of any new development for social housing. The previous requirement was 20 per cent. Prior to this, social housing was largely dependent on debt-financed publicly funded construction of new homes.

In a world of low interest rates and increased liquidity, institutional investors are struggling to find investments with the appropriate risk and reward characteristics. The pool of institutional money has never been bigger and thus the demand for such investments is intense. Therefore, the opportunity to attract institutional capital into the Irish social and affordable housing market should be realisable. Separately, we believe there is merit in expanding the home-ownership co-operative approach. An interesting example of how the co-operative housing model could be enhanced is the O'Cualann CoHousing Alliance.

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The problem facing developers is bridging the 35% to 40% funding gap and the consequent cost of equity.

Cost of equity

There has been considerable discussion regarding the lack of funding options for developers, and certainly the funding environment has dramatically changed pre and post crisis. The problem for developers is not access to senior debt per se, which is generally available at 60% to 65% LTC from a number of senior lenders in the market. The current source of equity generally available to developers is from private equity, which is expensive, short-term oriented and senior to the developers' own equity. What is needed is an alternative source of equity that ranks *parri passu* with the developers' equity and has a longer-term focus than the Internal Rate of Return (IRR) driven private equity model. The other funding constraint is the availability of funding for the acquisition and refinancing of zoned land without planning.

NAMA and Home Building Finance Ireland

The Minister announced the establishment of Home Building Finance Ireland ('HBFI') the aim of which is to make available debt funding to residential developers willing to build viable residential development projects. According to an Information Note from the Department of Finance, up to €750 million of ISIF funds will be allocated to HBFI to provide funding on market terms to 'viable residential development projects whose owners are experiencing difficulty in obtaining funding'.

AIB initiatives

AIB is very focused on its role in ensuring that housing supply increases and that we have the appropriate funding structures in place to help mortgage holders, developers, investors and social housing. The following are a number of new initiatives that we have already implemented or are considering:

Expansion of AIB Land and Development Team

Very significant increase in head count in the Land & Development lending team, with an increased focus on the small and medium sized developers. Currently funding the development of 3,000 plus residential units.

Appointment of a team of specialist housing lenders in the retail network

AIB has appointed a team of senior specialists in the housing sector operating in our local markets.

AIB to support the Buy-To-Let sector

AIB is currently reviewing its credit policies in order to assess how to provide enhanced funding support for prospective Buy-To-Let investors.

AIB and the ‘empty nester’ market

AIB is examining various lending and equity release initiatives in order to facilitate home owners to downsize. This may include bridging facilitates that will make the process more efficient for those considering to downsize.

AIB examining ways to further support the supply of new homes

AIB is exploring a number of possible funding solutions that would help provide longer-term equity capital to the residential development market. Another issue for developers is the lack of senior debt funding for zoned land without planning permissions. Again, this is an area that AIB is actively exploring.

AIB is increasingly active in social and affordable housing sector

AIB is committed to providing funding to the social housing sector and has already provided funding directly to a number of housing associations. We have also provided funding to a number of developers who are building on sites with pre-agreements in place with local authorities and housing associations.

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1. Introduction - Understanding the slow supply response

The slow supply response can largely be attributed to a number of key factors and these include:

- The collapse of the housing industry
- Construction costs on average exceeding the sale price of residential units
- A changed funding model for residential development

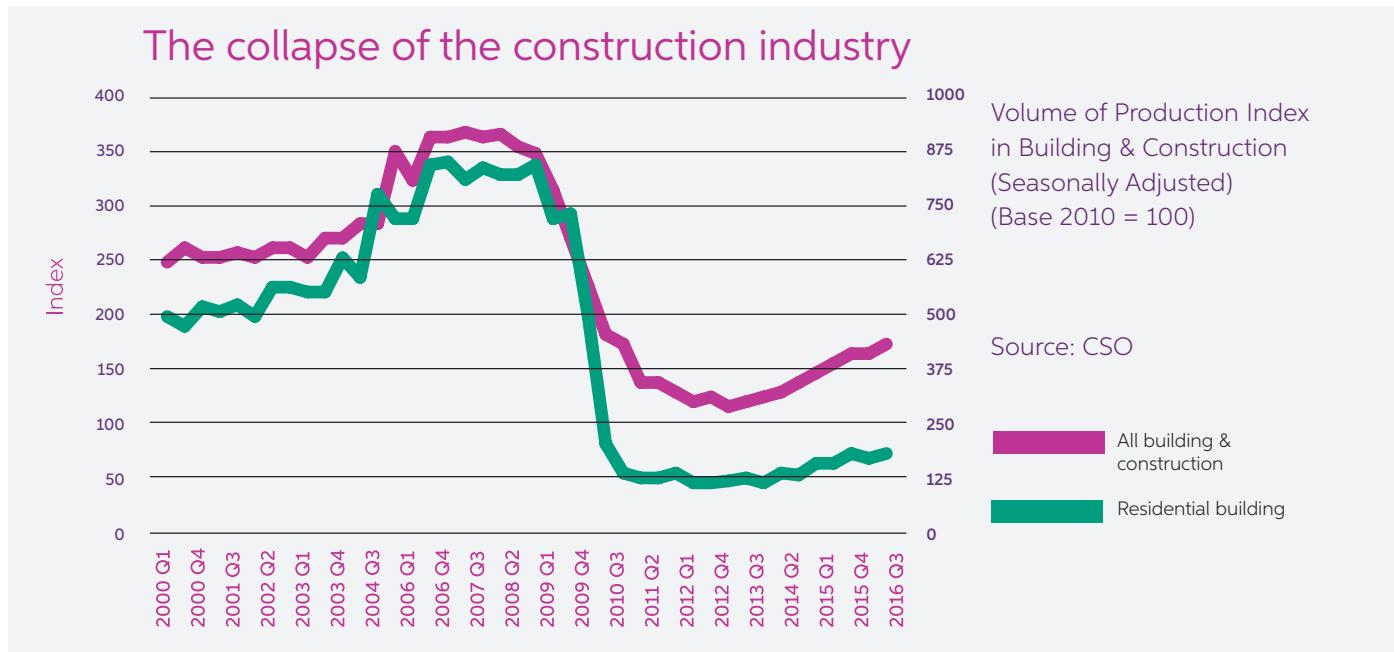
Any one of these factors would have impeded the supply of housing significantly; however, the combination of all three has caused the crisis in housing supply that we see today. While the industry has started to recover, it still faces significant hurdles and requires decisive action in order to meet the underlying demand for housing. Various estimates of housing demand range from 30,000 to 50,000 per annum, while the number of new builds is still only a quarter to a third of this amount at best.

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1.1 The collapse of the housing industry

The construction industry in general, and the residential development sector in particular, virtually collapsed during the economic crisis and both are still far from their respective peaks. At the end of Q2 2017, the CSO's index of construction activity was still 58% from its peak, while residential construction was 75% from its peak. While we are not suggesting the industry should revert back to peak levels, there is still a long way to go before it gets back to more normalised levels.

Chart 1.1(a)

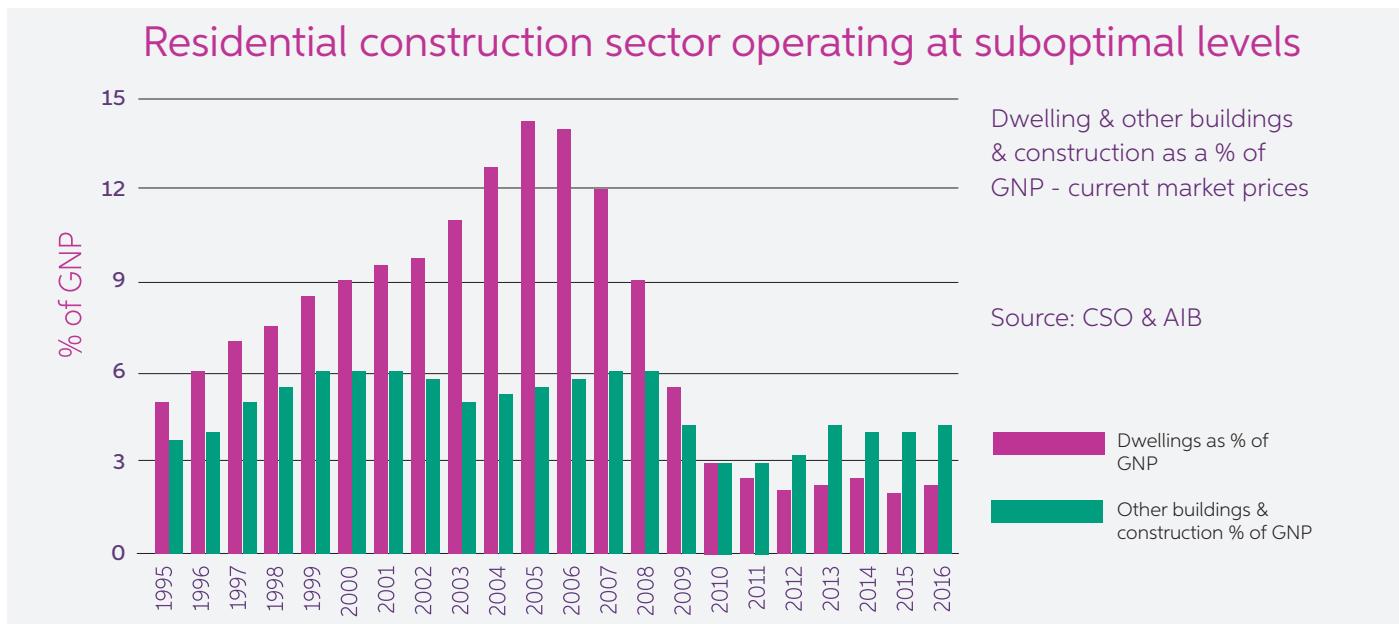


After bottoming in 2012, the construction sector has started to recover, with a noticeable pick-up in momentum over the last 12 to 18 months. However, the recovery is from a very low base and the overall sector is still a long way from operating at an optimum level for the economy. At its peak in 2006 the construction sector accounted for approximately 25% of GNP and 12% of employment – proportions that were unprecedented for a modern economy. The sector has now stabilised at circa 7% of GNP. However, an optimal proportion for the construction sector would be in the region of 10% to 12% of GNP.

Residential sector operating at suboptimal levels

Dwellings construction as a percentage of GNP peaked at 14%, but has now dropped to just under 3%. At 14% of the economy, dwellings construction was completely unsustainable, but at under 3% of the economy this level of activity is equally unsustainable. In the case of 'other buildings & construction', this sector has not suffered from the extreme excesses of the residential sector, and while it did decline in the downturn, its level of current activity is reasonable.

Chart 1.1(b)



Construction employment has increased. Can it keep growing at this pace?

The numbers employed in the construction sector stood at 147,400 at the end of Q2 2017, an increase of 10,500 from a year earlier, or an annual increase of 7.7%. This 147,400 number compares with a low of 96,300 in 2013 and a high of 273,900 in 2007. The numbers employed in the construction sector have made a meaningful recovery, adding an average of approximately 11,000 workers per annum over the past four years. A key issue for the sector going forward will be its ability to add more workers at a pace much faster than the annual average of the past number of years.

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Chart 1.1(c)



While the hard costs, such as materials, are on a par with other countries, it is a combination of levies, taxation and higher building standards that elevate the costs.

1.2 Construction costs, particularly soft costs – the key inhibitor

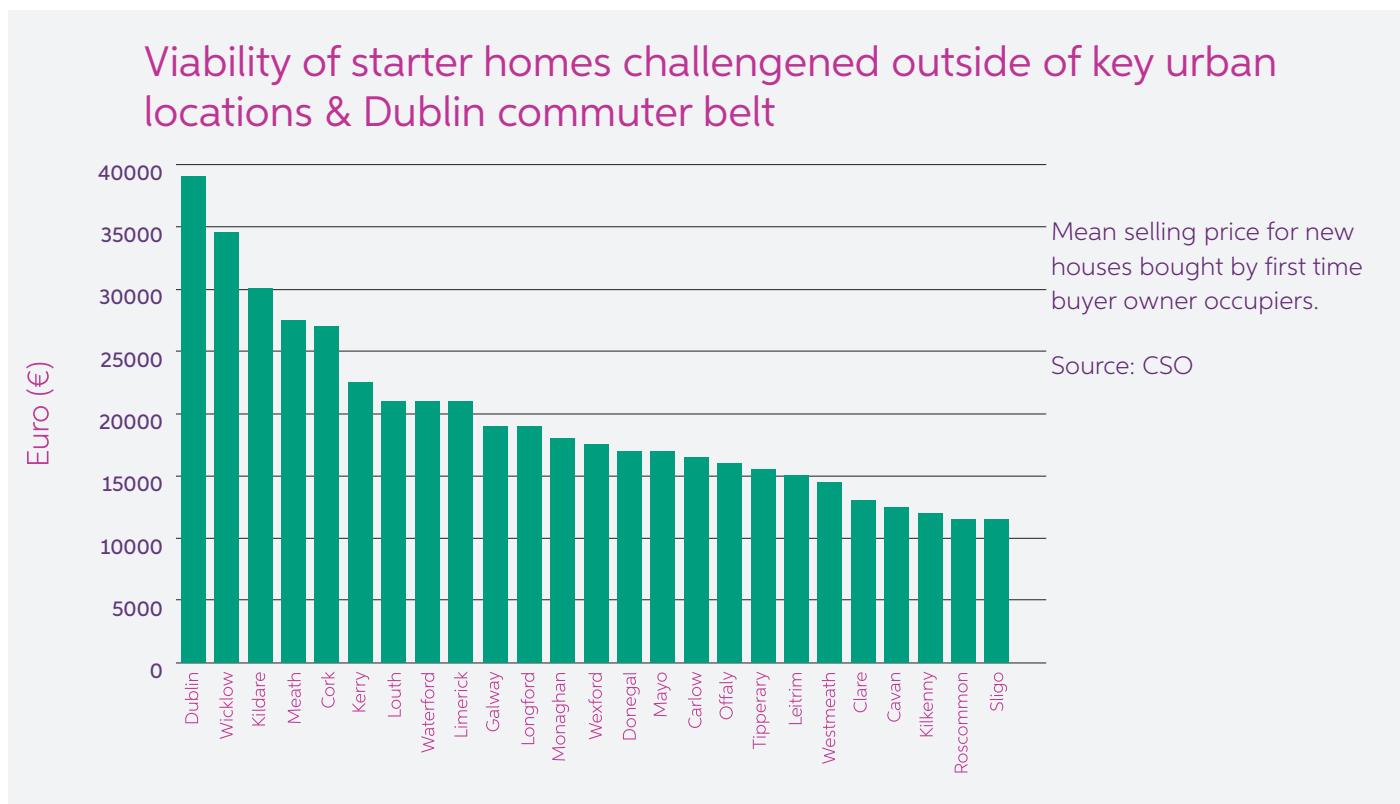
Construction costs for residential development in Ireland are high compared with many other European countries. While the hard costs, such as materials, are on a par with other countries, it is a combination of levies, taxation and higher building standards that elevate the costs. House prices have now reached a level that make the construction of mid-market houses and above viable in the key urban locations, their suburbs and the key commuter counties around Dublin.

However, the viability of starter homes is still challenging and is very much a function of the level of service infrastructure in place. New apartment construction is not viable with the exception of very prime locations in Dublin.

Focus on starter-home activity and pricing – viability still a major issue

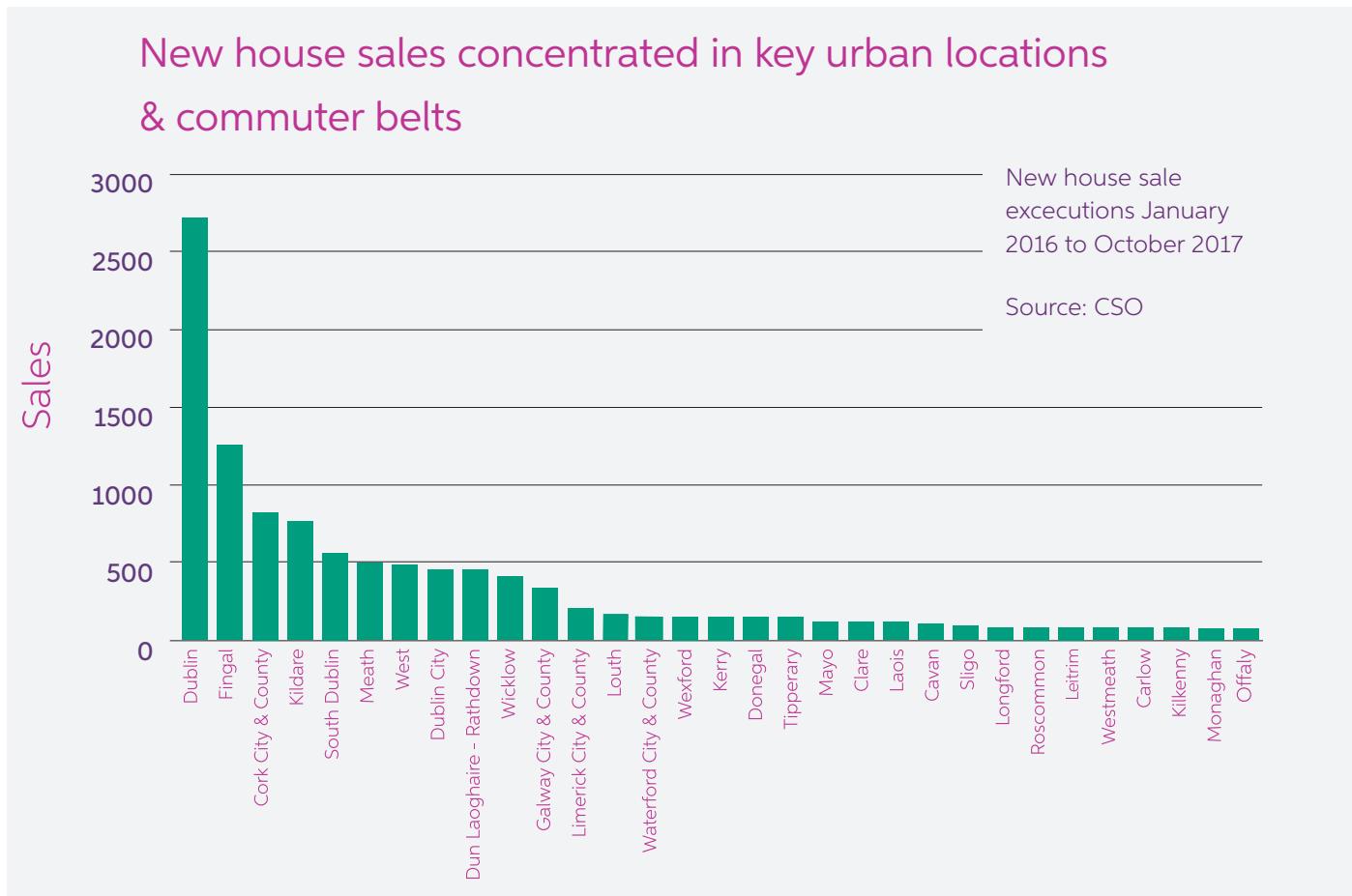
Chart 1.2 (a) shows the 2017 average price paid by first-time owner-occupier buyers for new homes in each county in Ireland. On average, as new house prices outside of Dublin need to be in the region of €300,000, and to be in the region of €350,000 in Dublin, then it is clear that the viability of starter homes still remains very challenging, if not impossible, in most locations. In short, the cost of second-hand homes in most parts of Ireland is still less than the cost of building a new house for the starter home market.

Chart 1.2(a)



As **Chart 1.2(b)** shows, the lack of supply of new starter homes is confirmed by the low level of new home sales that have occurred in each county over the past 18 months. The only locations that have seen any significant levels of activity are in the key urban locations and the commuter belt around Dublin. The level of transactions in other counties over the past 18 months was nominal in nature and probably reflects the completion of unfinished housing estates.

Chart 1.2(b)



Developer profit margins constrained

The profit margins that developers are working to are constrained and generally range from 10% to 15%. These profit margins are based on the analysis of business cases that have been submitted to AIB for funding applications over the past year. In general, we deem any development that has a profit margin of less than 10% as marginal given the inherent (and high) risks in building and selling houses.

1.3 A changed funding model for residential development

The current funding model for residential development is very different to what prevailed in the period leading up to 2007/2008. Today, senior lenders work to much more conservative loan-to-cost/loan-to-value ratios and this has resulted in the requirement for much bigger equity contributions from developers. In general, senior debt is limited to between 60% to 65% loan-to-cost. Bridging the 35% to 40% equity gap is a key challenge for developers and they generally have to use much more expensive mezzanine debt/equity from non-traditional funders.

Working with third-party equity providers is challenging, not just in terms of cost but also in terms of control and development strategy. Furthermore, this equity is in reality preferred equity and ranks senior to the developer's equity. All of these new realities take time to adjust to and this has contributed to the slow supply response.

It will be of great interest to the market to see how the establishment of Home Building Finance Ireland ('HBFI') will impact on the availability of residential development funding and whether it will be able to help in bridging the funding gap.

The current funding model for residential development is very different to what prevailed in the period leading up to 2007/2008.

2. Fiscal intervention – necessary, but careful consideration required

Government fiscal interventions have had a chequered history with respect to the housing market. From the Kenny Report to the Bacon Reports and current suggested policy reforms, there has always been significant pressure on the Government to actively intervene in the housing market. Unfortunately, however, the housing market is not functioning optimally at the moment, particularly as the residential development industry is still in repair mode.

Consequently, given the short-term pressures facing the housing market, judicious fiscal intervention could have a meaningful impact on boosting supply and could be used as a bridging mechanism until the longer-term supply response is achieved. There are a number of measures that could be considered, each tackling different aspects of the market. However, policy should be co-ordinated in order to ensure effective implementation and to achieve desired outcomes.

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2.1 Help-to-Buy scheme – not perfect, but has helped

The Help-to-Buy scheme is a demand-side incentive scheme and has been criticised by some for that very reason. At a time when the fundamental problem is supply, it is understandable why some critics have voiced their concerns. However, while there is very strong latent demand in the market for new housing, the demand side of the market is far from functioning freely and is faced with many constraints.

The Minister for Finance announced in the Budget that the Help-to-Buy scheme would be retained but would also remain under review. We agree with the decision to retain the Help-to-Buy scheme as we believe it has helped to make marginal sites viable and will over time help to increase supply.

The introduction of the Central Bank macroprudential rules has imposed greater discipline on both home buyers and the banking system. In addition, first-time buyers face significant headwinds in saving for a deposit, due to constrained real wage growth in the economy and the cost of rental accommodation. These factors have placed significant barriers for first-time buyers to get on the property ladder in a timely manner.

As noted in Census 2016, the age at which home ownership became the majority tenure category was 35 years in 2016. Prior to that age, more householders were renting rather than owning their home. When compared with the results of Censuses dating back to 1991, the ages that marked the changeover between renting and home ownership were 32 years (2011), 28 years (2006), 27 years (2002) and 26 years (1991).

In short, between 1991 and 2006, the age at which home ownership became the majority tenure choice increased by only two years, i.e. from 26 years of age to 28 years of age. However, since 2006, the age profile has jumped seven years, to 35 years of age. This clearly shows that a significant cohort of first time buyers needed help.

Our analysis shows that the Help-to-Buy scheme did stimulate demand by accelerating the purchase of houses by prospective buyers. It also had the secondary impact of giving developers greater confidence to bring more starter homes to the market, as the scheme helped to crystallise latent demand. In fact, we have seen a marked pick-up in funding applications for developments targeted at the first-time buyer market over the past 12 months, which coincides with trends evident in CSO residential transaction data as outlined in *Table 2.1(a)*.

Our analysis shows that the Help-to-Buy scheme did stimulate demand by accelerating the purchase of houses by prospective buyers.

Analysis of impact of Help-to-Buy Scheme – appears to have impacted both volumes and prices

The Help-to-Buy scheme was introduced at the same time that the Central Bank relaxed its macroprudential rules and both factors would have affected the demand for mortgages for new homes. Consequently, it is difficult to disentangle the precise effects of the Help-to-Buy scheme. Also, as noted in the Indecon report on the Help-to-Buy scheme commissioned by the Department of Finance, it is difficult to be categorical about the merits of the scheme given the limited amount of time that it has been in operation. Notwithstanding this limitation, the following summarises the main trends evident for residential transactions and prices for the period that the scheme has been in operation up to October of 2017.

Transactions and prices have picked up in the First-Time-Buyer (FTB) segment

An analysis of CSO data on residential transactions shows that there does appear to be a pick-up in the number of first-

time buyer owner-occupier transactions for new homes and also a modest acceleration in residential property prices in this particular segment of the residential property market. This is the particular cohort of home buyers and home type on which the Help-to-Buy scheme would have had the most pronounced impact.

Table 2.1(a) analyses the specific twelve-month time period of October of the preceding year to October of the following year for each year, starting in 2010 and continuing to October 2017. This twelve-month period reflects the time period that the Help-to-Buy scheme has been in operation since October 2016.

Table – 2.1(a) Household buyer - First-time buyer owner-occupier – New homes only

	Volume of Sales (Number)	Value of Sales (Euro Million)	Average Sale Price (% change)	Median Price (% change)
Oct'16 to Oct'17	3,144	947.2	11.5	10.9
Oct'15 to Oct'16	2,107	556	17.7	22.1
Oct'14 to Oct'15	2,060	459.1	15.5	24.3
Oct'13 to Oct'14	1,917	354	8.4	4.1
Oct'12 to Oct'13	1,758	310.5	7.7	4.0
Oct'11 to Oct'12	1,412	268.1	-14.8	-15.1
Oct'10 to Oct'11	2,321	501.7	-10.2	-11.0

Source: CSO

In the twelve month period from October 2016 to October 2017, the volume of new homes acquired by first-time buyer owner-occupiers was 3,144, which represents an increase from the previous twelve-month period from October 2015 to October 2016. In the comparable 2015/2016 period, only 2,107 new homes were transacted for this particular subgroup. Furthermore, the average number of transactions for the comparable twelve-month periods in the previous six years was only 1,929.

Residential property prices also appear to have modestly reaccelerated for this particular sub-group as well, as can be seen in Table 2.1(b). In the twelve-month period from October 2016 to June 2017, the price of new homes acquired by first-time buyer owner-occupiers increased by 11.5%. This rate of inflation is lower than the rate of house price inflation that this sub-group experienced in the same period in the previous two years. Also, the 11.5% rate of inflation for this sub-group is not significantly out of line with the rate of inflation of other sub-groups in the twelve month period from October 2016 to October 2017.

Table 2.1(b) - Average residential property price inflation by buyer type

% change	First Time Buyer Owner Occupier New	All Buyer Types All Dwellings	All Buyer Types New Dwellings	All Buyer Types Existing	First Time Buyer Owner Occupier Existing
Oct'16 to Oct'17	11.5	10	20.1	7.2	7.5
Oct'15 to Oct'16	17.7	13.7	24.8	11.9	13.1
Oct'14 to Oct'15	15.5	-2.0	3.1	-3.1	2.2
Oct'13 to Oct'14	8.4	18.6	12.6	19.3	25.1
Oct'12 to Oct'13	7.7	10.9	8.2	11.4	-2.6
Oct'11 to Oct'12	-14.8	-3.0	-11.1	-0.9	-6.9
Oct'10 to Oct'11	-10.2	-18	-11.8	-17.5	-15.4

Source: CSO

Help-to-Buy scheme – some suggestions

The Help-to-Buy scheme should have a set minimum life span in order to give certainty to the market. Developers and funders have made investment and lending decisions based on the assumption that the scheme would be in place until 2019. Any curtailment to the lifetime of the scheme may impact on the viability of some of these developments. Equally, the scheme should not be open ended but the criteria to end the scheme should be made clear and transparent in order to allow greater certainty for home buyers, developers and funders.

The Government could look to the UK models of the Help-to-Buy scheme

The UK operates a number of Help-to-Buy schemes. These schemes provide support to a wider range of potential home buyers than just first-time buyers. From the Government's perspective, the advantage of these models is that they allow the Government to potentially recoup the cost of the Help-to-Buy scheme from the beneficiary over time.

Help-to-Buy: Shared Ownership

One version of the Help-to-Buy scheme is the shared ownership scheme. Shared Ownership offers prospective purchasers the chance to buy a share of their home (between 25% and 75% of the home's value) and pay rent on the remaining share. Over time, the home owner can buy bigger shares and ultimately own the property outright if their financial circumstances allow it.

A home can be bought through the Help-To-Buy: Shared Ownership scheme in England if:

- a household earns £80,000 a year or less outside London, or the household earns £90,000 a year or less in London.
- the buyer is a first-time buyer, the buyer used to own a home but cannot afford to buy one now, or is an existing shared owner looking to move.

With the Help-to-Buy: Shared Ownership scheme the purchaser can buy a newly built home or an existing one through resale programmes from housing associations. The balance of the price will be funded via a mortgage or their savings. Shared Ownership properties are always leasehold.

Help-to-Buy: Equity Loan

Another version of the Help-To-Buy scheme is an equity loan scheme. The UK Government lends prospective purchasers up to 20% (up to a maximum of £120,000) of the cost of a newly built home. It requires that the buyers have a 5% deposit and a 75% loan-to-value mortgage. No loan fees or interest rates are charged on the 20% loan for the first five years of owning the home. For those buying in the London market, the Government will provide a loan of up to 40% (up to a maximum of £240,000) of the cost of a newly built home. An interest rate is then applied after five years and that interest rate is index linked. The total amount repayable will be the proportion of the market value of the home that was funded by this loan, plus interest and charges. This scheme is open to all home buyers, not just first time buyers.

Potential advantages for Ireland

The potential advantages are that the Irish Exchequer could recoup the cost of these Help-to-Buy schemes over time. In addition, the schemes could be designed to provide extra help for potential purchasers in the Dublin market, where prices are higher. They could also be tailored to the 'key-worker' segments of the economy.

VAT is only one option open to the Government when it comes to addressing the cost of housing. Other areas within the Government's remit to help reduce the cost of residential development are levies and building regulations.

2.2 Reduction in VAT

A reduction in the rate of VAT for home builders has generally been discussed, but is one that we believe could prove to be effective in encouraging an increased supply of housing, particularly in the short term. We believe that a cut in the VAT rate to 9% for a finite period should be considered, although it is worth noting that residential development is zero VAT rated in the UK. Also, a targeted cut in the VAT rate that is focused on the affordable home segment or the apartment sector could be considered as opposed to a blanket cut in VAT.

To reiterate, VAT is only one option open to the Government when it comes to addressing the cost of housing. Other areas within the Government's remit to help reduce the cost of residential development are levies and building regulations. Consequently, the Government has a menu of options that it can choose from to directly influence (and reduce) the cost of housing.

ESRI perspective

In 2015, the ESRI produced a paper for the Department of Finance that examined the impact of tax breaks on the residential housing market. In the paper it cautioned against reducing VAT and suggested that it would only be effective if excessive build costs was the primary reason behind the constrained supply in housing. The following extract from the paper summarises the ESRI's main conclusions:

'We (ESRI) have identified four possible reasons: lack of finance; the planning system; lack of infrastructure; building costs. It could be that all four factors are present and to varying degrees. Through our analysis of the effect of tax breaks, we would argue that any tax breaks aimed at developers will have little effect on supply if the first three factors above are the dominant factors in constraining house and apartment building. The uncertainty around whether these factors are operating or not creates a risk that any tax breaks would simply lead to a transfer of tax revenue from the state to developers without any significant effect on supply.'

The situation would be different if building costs are the primary reason for the slow pace of new house and apartment building. In this situation, a tax break could have an effect on output. However, any tax break would amount implicitly to the government paying the price of strict regulations. While this might be acceptable, it might be suggested that the regulations be reviewed to assess if the cost is appropriate relative to the benefit.'

Build costs and access to equity key

There is no denying that all four factors are constraining supply in the Irish market, but as stated in the introduction to this report, our view is that build costs and lack of longer-term equity finance are the most important factors. Furthermore, we believe that altering the VAT rate will help address both of these issues. In short, cutting VAT would directly reduce the cost of building and consequently would improve developers' ability to generate their own equity.

First, cutting costs would help make marginal projects viable and would see more residential units delivered to the market. Second, an increase in profitability would help developers repair their balance sheets and build equity from their own resources. This in turn would allow developers to fund more developments and ultimately increase supply. The increased viability of the sector would also attract new entrants into the market.

Cutting VAT may not be the most palatable of policy options and it has its drawbacks. A cut in VAT may not result in a reduction in house prices and might ultimately feed through to higher land prices. That is why the reduction in VAT should only be a temporary measure and should be time bound or linked to housing output. An alternative to cutting the VAT rate for all new residential developments is to consider a more targeted approach. In other words only cut VAT rates for residential units that are priced for the first-time buyer market. In short, apply a cut in VAT rates for residential units up to a maximum value of say, €350,000 to €400,000. To minimise any issues regarding price barriers, the VAT could be tapered between price points.

Cost of cutting VAT to 9% can be quickly recouped

According to the Minister of Finance, Revenue has tentatively estimated that introducing a 9% VAT rate specific to residential construction in Budget 2018 could cost in the region of €240 million. Calculating this cost estimate is difficult, as it is based on forecasts about new builds and average selling prices. The same difficulty applies to calculating the breakeven amount to achieve fiscal neutrality. We estimate that it would only take an extra 2,000 houses / apartments to be built in order to make the 9% VAT rate revenue neutral. This is based on the fact that the total tax and levies charged by government is far greater than the headline VAT rate charged on the sale of new homes.²

We estimate that it would only take an extra 2,000 houses / apartments to be built in order to make the 9% VAT rate revenue neutral.

2, See Appendix 1 for a summary of how the calculation of revenue neutrality is arrived at.

The benefits of cutting VAT

- It could be quickly implemented and have an immediate impact.
- It would make marginal residential development projects viable.
- It would help improve developer profitability and help repair balance sheets in the residential development industry.
- If the VAT reduction had a sunset clause or was linked to the minimum number of residential units built on an annual basis, this would help to frontload the development cycle.
- That is, it will increase supply in the short-term.
- It would quickly become self-financing, due to the relatively small number of extra houses that would need to be built in order to cover the cost of the reduction in VAT.

The costs of cutting VAT

- A cut in the VAT rate to 9% will have an immediate cost to the Exchequer of approximately €240 million.
- It may not lead to lower house prices.
- It could ultimately lead to higher land prices.
- It would use up scarce fiscal resources that could have been deployed elsewhere.

2.3 Vacant site levy – a necessary policy instrument

The efficient use of land, particularly zoned land, is critical to ensure the appropriate level of supply of housing in the economy. Without a doubt there are a large number of vacant sites in urban areas throughout the country that could be used to provide much needed additional residential units. It is estimated that in Dublin City that there are over 280 vacant sites amounting to approximately 60 hectares, many of which could be used for residential development.

From this perspective, the introduction of the vacant site levy appears to be an appropriate policy response. However, the actual implementation of the vacant site levy will determine its effectiveness and minimise the risk of unintended consequences.

In Budget 2018, the Minister for Finance decided to more than double the current 3 per cent levy rate that applies in the first year to 7 per cent in the second and subsequent years. What this means in practical terms is that any owner of a vacant site on the register who does not develop their land in 2018 will pay the 3 per cent levy in 2019 and then become liable to the increased rate of 7 per cent from 1 January 2019. The 7% rate will be levied for each subsequent year.

...the introduction of the vacant site levy appears to be an appropriate policy response. However, the actual implementation of the vacant site levy will determine its effectiveness and minimise the risk of unintended consequences.

Implementation key to avoid unintended consequences

As mentioned, the implementation of the levy will be key. Residential development companies need to have a stock of residential land in order to support their business models and ensure a steady supply of housing output. In the UK, typical house builders hold three to five years' worth of development land at various stages of zoning and planning. Imposing a vacant site levy without due consideration of the owner of the land and the true intended purpose could lead to some undesirable outcomes including increased cyclical in the residential property market and housing output. Ideally, the

vacant site levy should target landbanking for profit rather than landbanking to ensure a smooth supply of land as development opportunities arise.

Just because land has zoning does not make it viable

Also it should be noted that just because the land is zoned for residential development or even has planning does not automatically make it a viable site. For example, a site in Dublin might have planning for apartments, but the costs of construction does not make it viable except in very specific locations. However, as noted by Matheson, '*...absence of planning permission, lack of financial resources, or the fact that development is not commercially viable, are not listed as grounds for exemption from the levy.*' Consequently, the local authorities will have to use careful judgement and some discretion in the application of the vacant site levy having due consideration to the viability of sites in question.

Also it should be noted that just because the land is zoned for residential development or even has planning does not automatically make it a viable site.

The Vacant Site levy was introduced in the Urban Regeneration and Housing Act 2015 Act. According to Matheson the key features of the Act relating to the vacant site levy are:

- The levy will apply to land zoned solely or primarily for residential purposes ("Residential Land") and land designated with the objective of development and renewal of areas in need of regeneration ("Regeneration Land"), regardless of who owns it. In both cases the site must exceed 0.05 hectares (excluding a home and its associated garden).
- The planning authority is required to identify any such Residential Land which is vacant or idle, suitable for the provision of housing and situated in an area where there is a need for housing.
- In the case of Regeneration Land, the criteria for being designated a vacant site is that the site being vacant or idle has adverse effects on existing amenities or reduces the amenity provided by existing public infrastructure and facilities in the area, or has adverse effects on the character of the area.
- For the purpose of calculating the levy, a planning authority, or the Valuation Tribunal on appeal, may deem that a vacant site has a zero market valuation if appropriate in all circumstances. The Act refers in particular to circumstances where no market exists for the site, or the site is situated on contaminated lands and the estimated costs of remedial works necessary to use or develop the site exceed the market value of the site. *However, absence of planning permission, lack of financial resources, or the fact that development is not commercially viable, are not listed as grounds for exemption from the levy.*
- A site ought not to be designated a "vacant site", attracting the vacant site levy, unless it is properly serviced and has appropriate transport links for housing.
- Where a vacant site is subject to a "site loan" the vacant site levy is reduced down to zero in certain circumstances, where the outstanding loan exceeds the market value of the site. This concession applies only to the original mortgage loan for acquisition of the site.
- The vacant site levy is to be charged and levied beginning in 2018, becoming payable in arrears from 2019.

Source: <http://www.matheson.com/news-and-insights/article/the-urban-regeneration-and-housing-act-2015-has-been-signed>

An appropriate policy instrument

The vacant site levy is an appropriate policy instrument that the government and local authorities can use to encourage the supply of residential land. Used in conjunction with a broader policy set and consideration of the viability of sites, the vacant site levy should prove to be an effective measure.

2.4 Reform tax code for private landlords

Institutional investors will only focus on markets where they can achieve economies of scale in the Private Rented Sector (PRS) and for the most part that means Dublin and possibly Cork. In addition, these investors generally only target the mid- to high-end segment of the apartment market.

Large institutional investors will not be a solution to the shortage of rental accommodation in other locations in Ireland. Rather it will fall back on individual landlords to meet this demand.

Individual landlords dominant...

Statistics from the Residential Tenancies Board (RTB) confirm that the individual landlord is the dominant landlord type in Ireland, with almost 70% of landlords having a single tenancy, and more than 91% of landlords having three or fewer tenancies. The 20 largest landlords such as REITs, investment funds and companies account for less than 3% of tenancies.

...despite decline since 2012

However, it is notable that while the number of registered tenancies has steadily grown, increasing from 264,434 in 2012 to 325,372 in 2016, the actual number of landlords has declined from 212,306 to 160,160 in 2014, before recovering to 175,250 in 2016.

Chart 2.4(a)



At a time of robust demand for rental properties and strong rental growth, the fact that such a large number of landlords have exited the market is unfortunate but can be largely explained by more stringent regulations and standards coupled with the increased tax burden and costs that residential landlords face. The fact that some landlords got into financial difficulty also contributed to their exit from the market.

Large institutional investors will not be a solution to the shortage of rental accommodation in other locations in Ireland. Rather it will fall back on individual landlords to meet this demand.

The following summarises some of the main policy changes that have come into effect over the past five years:

- The phasing out of traditional bedsit accommodation. The regulations were introduced in 2009, but had a four-year period to be phased in and, as such, became binding in 2013.
- The introduction of the Central Bank macroprudential measures for the mortgage market in general and specifically requiring higher deposits for buy-to-let investors.
- The introduction of rent certainty measures and Rent Pressure Zones.
- Increased notice periods in respect of termination of longer-term tenancies and increased scrutiny around landlords terminating a tenancy.

The government should take some steps to mitigate the disincentive for individuals to invest in the buy-to-let residential market.

All of the above measures are laudable and correct in their own right and are designed to either improve the quality of rental accommodation, provide tenants with greater certainty, or enhance the resilience of banks and landlords to cyclical property markets. However, the cumulative impact has placed a significant burden on the shoulders of individual landlords. This burden was added to by higher levels of taxation. Furthermore, the timing of the implementation of many of these policy decisions occurred just as Ireland was heading into a significant housing crisis.

Concessions required to encourage landlords back into the market

The government should take some steps to mitigate the disincentive for individuals to invest in the buy-to-let residential market. To this end, the Tax Strategy Group recently published a paper to examine the tax treatment of rental accommodation providers.³ The paper outlined a number of policy options. The following options are ones that AIB think should be given particular consideration.

Mortgage interest deductibility

In Budget 2017, the Minister for Finance committed to restoring the full mortgage deductibility for landlords of residential property on a phased basis over five years. It had been restricted to 75% of qualifying interest in Budget 2009 and was increased to 80% of qualifying interest in Budget 2017. We would recommend that this phasing should be accelerated over the coming years. Consideration might also be given to allowing the Local Property Tax to be a deductible expense, which would further improve rental cash flows for individual landlords.

Reconsider rental income in the overall tax code

A longer-term option might be to consider, ‘*Separating rental income from other forms of income for the purposes of applying a separate tax treatment. For example, a new tax regime could be introduced for small landlords that simplifies their accounting and tax requirements and/or introduces a flat turnover tax in place of income tax on rental profits.*⁴

Simplifying the tax system and recognising the full suite of rental expenses as deductible expenses would prove attractive to potential investors.

Individual landlords to remain the dominant private landlord

The recognition of the importance of individual landlords and their inherent characteristics is critical when informing policy decisions. The capacity to manage major regulatory and compliance changes and, to absorb higher costs, is much more limited for individual landlords than for institutional landlords. In addition, institutional landlords have very specific investment criteria and will only focus on key segments and locations in the rental market. While institutional landlords’ share of the rental market will grow, the individual landlord will continue to be the dominant private landlord in Ireland and will continue to be a key supplier of rental properties.

AIB to support the Buy-to-Let sector

AIB is currently reviewing its credit policies in order to assess how to provide enhanced funding support for prospective Buy-to-Let investors.

3/4. Tax Strategy Group: TSG 17/03 Tax and Fiscal Treatment of Landlords

A key finding was that there was little evidence of housing mobility among this age cohort in Ireland, and significantly less mobility than occurs among this cohort in the UK and the US.

2.5 Encourage downsizing – will ‘empty nesters’ take flight

There is considerable merit in addressing the ‘empty nester’ issue and in designing policies that would incentivise older people to move house and ensure there is a supply of appropriate housing to better meet their requirements. This would in turn lead to a better utilisation of existing housing stock and would help alleviate the current housing shortage, particularly in urban areas.

Very limited downsizing activity in Irish market

In 2016, the ESRI conducted a study that closely examined the issue of people aged 50 and over and their housing choice and tenure. A key finding was that there was little evidence of housing mobility among this age cohort in Ireland, and significantly less mobility than occurs among this cohort in the UK and the US. The report found that older people living alone already live in smaller housing units and the issue of the ‘empty nester’ is less prevalent (but still significant in our view) in this subset compared with the older couple cohort. The report found that there is considerable scope for downsizing with couples aged 50 plus, as a significant proportion of this cohort live in large family homes by themselves.

Table 2.5(a) summarises the household structure of individuals aged 50 plus in Ireland in the period 2009 – 2011. The table categorises the households into five groupings: living alone, living with spouse only, living with children/grandchildren, living with other relative, living with unrelated people. The proportions in each of these categories are examined for the entire population aged 50 and above, as are specific age cohorts.

Table 2.5(a) Household structure of individuals aged 50 and above: 2009-2011

% of cohort	All	50-59	60-69	70-79	80 Plus
Living alone	31.1	19.7	26.4	43.8	63.0
Living with spouse only	32.4	23.0	44.2	39.2	19.4
Living with child/grandchildren	33.7	53.2	27.0	15.1	16.5
Living with other relative	2.4	3.3	2.0	1.9	1.0
Living with unrelated people	0.5	0.8	0.4	---	0.2
Total*	100	100	100	100	100
Population	875,632	341,829	262,273	184,569	86,962

*May not add to 100 due to rounding

Source: ESRI Housing and Ireland’s Older Population

The total estimated population of people aged 50 plus is 875,632. As can be seen in Table 2.5(a) the three categories that largely describe Ireland’s older population are those living alone (31.1% or 272,321), those living with a spouse only (32.4% or 283,704) and those living with children/grandchildren (33.7% or 295,088).

The ‘empty nester’ sector has huge potential to free up family homes

Table 2.5(b) provides very interesting information on housing size by household composition and a measure of the ‘empty nester’ factor in the Irish housing market. As the table shows, living alone households have a greater tendency to live in smaller housing units than other types of household structures. For example, 21.8% of living alone households live in terraced houses, the comparable figure for living with spouse only households is 14.8%. A quite sizeable percentage (47.9%) of living alone households live in detached houses and 32.9% of these households live in homes with six or more rooms. In short, based on the population size this would suggest that there are approximately 90,000 households living alone in houses with six or more rooms. The ‘empty nester’ issue is even more pronounced for couples as 60.2% live in detached houses and 54.9% live in homes with 6 or more rooms.

Table 2.5(b): Housing size and structure for individuals aged over 50: 2009-2011

Household structure	Living alone	Living with spouse only	Living with children	Living with other relatives	Living with non-relatives
Population over 50 (number)	272,321	283,704	295,088	21,015	4,378
Population over 50 (%)	31.1	32.4	33.7	2.4	0.4
Type of residence:					
Detached house	47.9	60.2	56.5	65.5	45.4
Semi-detached house	23.2	23.6	25.3	16.9	21.8
Terraced house	21.8	14.8	17.5	16.6	23.6
Apartment	6.7	1.2	0.5	1.0	9.3
Other	0.5	0.2	0.1	-	-
Number of rooms ⁵	Living alone	Living with spouse only	Living with children	Living with other relatives	Living with non-relatives
1	1.6	-	-	-	-
2	6.7	0.7	0.3	0.8	-
3	13.9	7.1	4.5	4.6	6.8
4	18.4	11.8	11.0	19.0	6.8
5	26.5	25.0	24.1	20.9	24.7
6	19.0	24.0	23.4	23.6	27.5
7 & above	13.9	30.9	36.4	32.1	34.1

*Includes bedrooms, dining rooms, living rooms and habitable cellars and attics; does not include bathrooms, toilets, corridors, utility rooms.

Source: ESRI Housing and Ireland's Older Population

Significant potential – but little mobility

However, while the data in Table 2.5(b) clearly indicate that there are significant numbers of households occupied by people aged 50 and above, there is little evidence of significant downsizing by this age group. The ESRI estimate that only 3% of these households moved residence between 2009/2011 and 2012. This compares with an estimated 11% of older home owners who moved residence in a similar two-year period in the US.

This greater mobility is underpinned by the fact that the senior housing market is an established part of the residential and commercial real estate market in the US. The US senior housing and care market was estimated to be worth US\$400 billion at the end of 2017.

The most important factor in encouraging an older population to downsize is to provide suitable accommodation in the location close to where they have lived in their local community. In addition, the accommodation must be designed for the specific needs of older generations. However, in Ireland, there is not enough suitable accommodation for older households to downsize to.

Changes to planning policy to designate certain developments in key locations with a mix of tenures and housing types should be considered as an important step to establishing a dedicated supply of senior housing. As suggested in the document *HOUSING FOR OLDER PEOPLE – THINKING AHEAD*, ‘Local Authorities’ Development Plans should contain a minimum requirement for age-friendly housing, both bespoke – independent and assisted living developments – and general accommodation, including apartment blocks.’⁶ This, combined with carefully crafted and closely monitored incentives and/or tax allowances, could be used to encourage such developments.

The most important factor in encouraging an older population to downsize is to provide suitable accommodation in the location close to where they have lived in their local community.

5. Rooms are defined as bedrooms, dining rooms, living rooms and habitable cellars and attics, whereas bathrooms, toilets and utility rooms are excluded.

6. HOUSING FOR OLDER PEOPLE – THINKING AHEAD, Commissioned by the Ireland Smart Ageing Exchange and the Housing Agency, 2016

AIB is assessing how it can support the ‘empty-nester’ market

AIB is examining various lending and equity release initiatives in order to facilitate home owners to downsize. This may include bridging facilitates that will make the process more efficient for those considering downsizing.

3. Planning and regulatory constraints and requirements – the path to good intentions...

The quality of residential construction has improved significantly over the past 10 years driven primarily by higher minimum building regulations. As a result of these efforts, housing and apartment standards in Ireland are among the highest in Europe. However, these improved standards have in turn significantly increased the cost of housing.

We do not believe there should be any diminution of standards when it comes to safety issues, but there are other more discretionary aspects that could be looked at. To this end, it is very encouraging that the recently announced draft apartment planning guidelines should go a long way in addressing the cost of apartment construction. These measures only focus on apartment costs however, and we believe a similar review of the costs of starter houses (that is, a typical three bedroom semi-detached house) is also warranted.

...housing and apartment standards in Ireland are among the highest in Europe. However, these improved standards have in turn significantly increased the cost of housing.

3.1 The regulatory factors

The set of regulatory factors that impact Irish residential construction costs are outlined in a recent paper by Dr Ronan Lyons⁷ and are:

1. Building regulations and per-square-meter construction costs
2. Size restrictions and density restrictions
3. Local authority levies
4. VAT (already discussed in Section 2.2)

Building, planning regulations and construction costs

Building regulations have significantly added to the cost of construction over the past 10 years. Higher building standards lead to better quality housing but a balance has to be struck between the costs and benefits of such regulations.

Issues such as BER and BCAR requirements, the dual aspect requirements for apartments, the number of apartments per core and the ratio of apartments to underground car-parking spaces have added significantly to overall construction costs. For example, the cost of adding an underground car parking space can add in the region of €30,000 to €50,000 per car space.

Concessions have been made with respect to the dual aspect requirement, which has been reduced from 100% of apartments to 50% of apartments in a development needing to be dual aspect and the number of apartments per core increasing from two to four.

BCAR regulations were introduced in 2014 and relates to building control functions and administrative processes to demonstrate compliance with existing regulations. Essentially, it is a quality assurance system to document the construction process in detail. However, various estimates put the cost of complying with BCAR as quite expensive⁸ and time consuming.

It is understandable from the authorities' perspective to have much improved building standards given some of the building scandals that have emerged in recent years. However, it appears the pendulum has swung too far in this direction. Essentially the building and planning regulations mean that the only type of houses and apartments that can be built are ones that can only be afforded by two income couples on the average income and above.

The goal of each of the building regulations that has been introduced over the past decade has been laudable. However, the combination of regulations has significantly increased the cost of housing. No cost-benefit analysis of this impact has been undertaken and the risk is that the costs now materially outweigh the benefits delivered.

Size, density and height restrictions

The density and height restrictions for apartments are generally overly restrictive in Dublin. As Brendan McDonagh, CEO of NAMA recently stated,⁹ "Height restrictions which apply under current planning policy have an impact on the viability of commercial apartment development. In some cases, statutory development plans set a height restriction which is less than the most cost-effective scale. A city centre apartment development project that is not commercially viable at 6 – 7 storeys is more likely to be commercially viable at, say, 12 – 15 storeys. In our view, the height restrictions currently applied, particularly in city centre locations, are no longer appropriate given current and prospective housing needs. Amending height restrictions to 15 storeys in city centre locations and to 10 storeys in suburban areas merits serious

7. Ronan Lyons – Housing: Supply, Pricing and Servicing

8. MKD Architects: IS RED TAPE KILLING OUR HOUSING SECTOR? - Building Control Regulation Costs for multi-unit housing, 2014.

9. Opening Statement by Mr. Brendan McDonagh, Chief Executive of NAMA, to the Joint Committee on Finance, Public Expenditure and Reform Thursday, 13 July 2017.

consideration.” In our view, certain parts of Dublin city should be designated for even greater height and density than what the current regulations allow. Obvious locations include the North and South Docklands although both areas would require further infrastructure investment to underpin such a change in strategy.

Table 3.1(a) summarises the changes in apartment sizes from 1995 to date.

Table 3.1(a) Minimum overall apartment floor areas

Square meters	1995	2007	2015	2017
Studio	---	---	40	37
One bedroom	38	55	45	45
Two bedrooms	55	90	73	73
Three bedrooms	70	100	90	90

Source: Sustainable Urban Housing: Design Standard for New Apartments – Guidelines for Planning Authorities, DoECLG, December 2015

As Table 3.1(a) shows, the 2007 requirements represented a huge increase on the 1995 requirements, with authorities imposing an average increase of 50% on the minimum allowable apartment size. The 2015 regulations have seen the minimum size requirement fall by an average of 15%, which puts Ireland more into line with European norms, albeit at the higher end. The proposed 2017 guidelines have reduced further the minimum size of studios. There is also a new guideline that differentiates between two bedroom apartments for 4 people as per the above table and two bedroom apartments for 3 people. The new two bedroom apartment for 3 people has a minimum size of 63 sq.m.

Apartment changes on the way

Just before Christmas, the Department of Housing, Planning and Local Government published new draft planning policy guidelines to encourage more cost-effective apartment developments and new rental accommodation models. The main planning policy changes being proposed are:

- 1. Minimum apartment types** - Apartment developments may include up to 50% one-bedroom or studio type units (with no more than 20-25% of the total proposed development as studios) and there shall be no minimum requirement for apartments with three or more bedrooms.
- 2. Application of minimum apartment types** – Does not apply to apartment developments up to 9 units, but no more than 50% can be studios. This requirement is scaled as the development size increases.
- 3. Minimum apartment floor area** – Proposed changes are to studios, reducing in minimum size from 40 sq.m. to 37 sq.m. and the introduction of a new guideline for two bedroom apartments for 3 people.
- 4. Dual aspect** - The minimum number of dual aspect apartments that may be provided in any single apartment scheme shall be 33% in more central and accessible urban locations, where it is necessary to ensure good street frontage and subject to high quality design. Otherwise, it is an objective that there shall generally be a minimum of 50% dual aspect apartments in a single scheme.
- 5. Number of apartments per core** - A maximum of 12 apartments per floor per core may be provided in apartment schemes in urban locations, where it is necessary to ensure good street frontage and subject to high quality design.
- 6. Car parking** - In larger scale and higher density developments, comprising wholly of apartments in more central locations that are well served by public transport, the default policy is for car parking provision to be wholly eliminated or substantially reduced.
- 7. Build-to-Rent** - (i) There are no restrictions on dwelling mix; (ii) There is flexibility in relation to the provision of a proportion of the storage and private amenity space associated with individual units; (iii) There shall be a default of no car parking provision on the basis of BTR development being more suitable for central locations and/or proximity to public transport services.
- 8. Shared accommodation** – Introduced the concept of shared ownership accommodation.

These measures should help improve the viability of apartment construction, which is a necessary step in solving the housing crisis. However, these measures are just part of the solution and do not address the costs of construction of a

typical three-bed room house for a first time buyer. This could be a deliberate policy stance in order to encourage more density and less urban sprawl but apartments alone will not solve the housing crisis.

Local authority levies

The following is an extract from Development Contributions Guidelines for Planning Authorities published by the Department of the Environment, Community and Local Government in January 2013.

'The primary objective of the development contribution mechanism is to partly fund the provision of essential public infrastructure, without which development could not proceed. Development contributions have enabled much essential public infrastructure to be funded since 2000 in combination with other sources of, mainly exchequer, funding.'

'Development contributions are not cash-cows: there is an important balance to be struck between the funding of public infrastructure and the need to encourage economic activity and promote sustainable development patterns. It is essential that development contribution schemes do not impede job creation or facilitate unsustainable development patterns.'

'While it is expected that planning authorities will ensure that developers make an appropriate contribution towards the costs of public infrastructure and facilities, the local authority must ensure that it avoids levying development contributions that are excessively high – development contributions are ultimately designed to offset only a portion of the costs of public infrastructure and facilities.'

'Planning authorities should consider whether there are any measures open to them to support new or existing enterprises in their areas by, for example, reduced development contribution rates, deferral payments, etc.'

Essentially, the amount of development levies that local authorities demand should be proportionate and should cover the cost of essential infrastructure. The standard levies cover roads infrastructure, drainage infrastructure, parks and open space facilities, community facilities, urban regeneration facilities, plus special development contributions.

It is estimated that for a standard three-bedroom house the development levies (excluding special development contributions) amount to between €13,000 and €15,000. These levies are not particularly onerous at around 5% to 7% of the cost of building a new house. However, the cumulative impact of these levies plus VAT, Part V, and income tax on profit and labour, means that the portion of costs attributable to the Government rises to around 30%.

Development levies for a new house selling up to €300,000 in Dublin and up to €250,000 in Cork have been waived. However, these maximum prices are too low and thus the waiving of the levies is of no financial benefit. We would suggest that the maximum price at which levies can be waived should be raised to €400,000 for a new house selling in Dublin and €350,000 for a new house selling in Cork.

3.2 Resource the planning authorities and simplify the legislation

Recent research¹⁰ in the UK identifies planning delays as a serious problem for housing supply and its ability to respond to increases in demand. Development and planning control, while crucial, is consistently a lengthy and uncertain process due to its complexity. According to the research '*developers' costs are increased, development is discouraged and developers have to hold high stocks of land, all of which further dampens supply elasticities.*' Similar problems are characteristic of the Irish planning system and Government efforts to improve the planning system should be accelerated.

...increased resourcing of the planning system in Ireland – combined with greater consistency and transparency in the application of building regulations and standards – would have a meaningful impact on planning time lines.

In the long term, success in lowering planning delay is only likely through radical simplification and consolidation of the legislation. In the short term, increased resourcing of the planning system in Ireland – combined with greater consistency and transparency in the application of building regulations and standards – would have a meaningful impact on planning time lines.

Minimise complexity

The Independent Review of An Bord Pleanála published in 2016¹¹ notes '*An unnecessarily complex and fragmented planning code acts as a barrier to access and must be regarded as a considerable challenge not only for An Bord Pleanála. It is the view of this Review Group that the Government should give*

...the cumulative impact of these levies plus VAT, Part V, and income tax on profit and labour, means that the portion of costs attributable to the Government rises to around 30%.

10. The Impact on Housing Supply in England of Planning Delay and Uncertainty, Michael Ball, University of Reading.

11. Organisational Review of An Bord Pleanála by the Independent Review Group

prompt consideration to establishing a review to address the complexity of planning law. Simplification of the legislative framework would also enable more efficient processes and practices among planning system participants, including An Bord Pleanála.'

Greater certainty, transparency and consistency required

One issue that is constantly raised by residential property developers and industry professionals is that the planning authorities require fully developed and detailed applications before any level of approval is granted. Significant amounts of time and cost are incurred by developers in the preparation of planning applications, and if a planning permission is turned down, the process resets all the way back to zero. In other countries, such as Germany, the planning process is staged where work done by developers at various stages of the planning process is banked and if there is a problem with a part of the planning application, the process does not have to revert back to the very beginning. This provides much greater certainty for the developer and helps to minimise risk and improve efficiency in the overall process.

Establish basic planning criteria and stick to them

Another issue that has been raised by residential property developers is that planning applications can progress significantly and yet be turned down because of issues such as height and density, – issues that could and should be resolved at very early stages of the planning application. Recent examples include a proposed 22-storey tower beside Tara Street railway station in Dublin; it was rejected due to height, despite the fact that according to *The Irish Times*, ‘*the 88m height of the tower was permissible under the council’s George’s Quay Local Area Plan, approved by councillors in 2012 to govern the creation of a new “midtown” for the city south of the Liffey to Pearse Street, and from Hawkins Street to Lombard Street. The site was also one of just four in the city earmarked for high-rise buildings, along with the docklands and Connolly and Heuston stations, under the Dublin City Development Plan approved last year.*’ Whatever the rights and wrongs of the application and its refusal, issues such as permitted heights and densities need to be fixed criteria from the outset and not end up being arbitrary conditions that can be subsequently changed.

The arbitrary application of planning requirements does not just exist across different planning authorities, it also exists within planning authorities. In other words, different planners within the same local authority can have different views and opinions on planning guidelines and requirements. Another instance of inconsistency is that developers can have pre-planning consultations with one planner, but once the application has been submitted another planner may become the assigned case manager with very different views and requirements. This is inefficient, costly and leads to unnecessary delays.

The scope for wider SDZ application

The fact that each development proposal is subject to discretionary appraisal in Ireland and the UK contrasts with planning systems in many other countries. This discretion necessitates lengthy and often complex negotiations both pre and post the date of the planning application. This creates significant uncertainty and delays in the planning process. In addition, pre-planning negotiations are not counted towards the time involved in making planning decisions in any of the data collated and produced by the local authorities or An Bord Pleanála.

More resources, greater centralisation, simpler legislation, increased incentives

Anecdotal evidence would suggest that the planning authorities need additional resources in order to meet the current planning requirements, never mind the expected growth in planning applications that can be expected over the coming years. Against a backdrop of retrenchment in the overall economy and the residential development industry in particular, many qualified planners and other qualified employees left the industry during the downturn and has resulted in the local authorities being understaffed. According to the CSO, there were 14,100 architects, town planners and surveyors in employment in Ireland in Q1 2007 and, as of Q1 2017, the number was 10,300 as can be seen in Chart 3.2(a).

Chart 3.2(a)



Greater centralisation and accountability

Greater centralisation of the planning system should be considered – one that still takes account of local considerations but streamlines decision-making and improves the level of consistency. Simplification and consolidation of planning legislation would also be of great benefit. At a minimum, all planning authorities should apply the same set of planning regulations and standards consistently.

As noted in 2015 by the Department of the Environment, Community and Local Government, ‘*some planning authorities have specified standards in their statutory development plans that significantly exceed those in the 2007 guidelines*’.¹² A senior person at Departmental level needs the authority to set enforceable guidelines and also needs the authority to adjudicate on enforceable interpretations; this would result in minimising the discretion of individual planners and would also create a more certain environment in which developers could operate.

Incentivise planning departments

Another option would be to consider The New Homes Bonus Scheme that was introduced in the UK but only applies to England. The New Homes Bonus (NHB) was introduced with the aim of encouraging local authorities to grant planning permissions for the building of new houses in return for generating additional revenue.

Greater centralisation of the planning system should be considered – one that still takes account of local considerations but streamlines decision-making and improves the level of consistency.

12. Source: Sustainable Urban Housing: Design Standard for New Apartments – Guidelines for Planning Authorities, DoECLG, December 2015

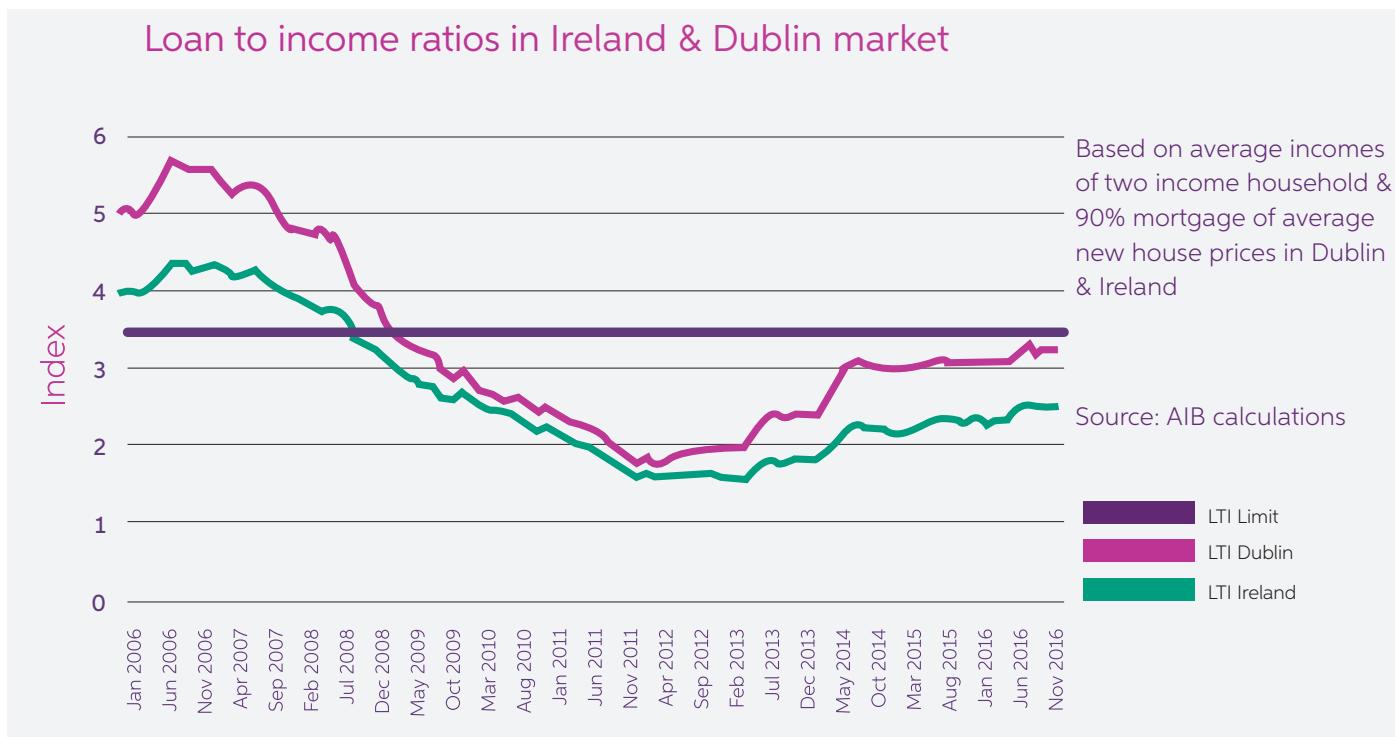
3.3 Central Bank macro prudential rules

The Central Bank introduced macro prudential rules in 2015 to govern loan-to-value (LTV) and loan-to-income (LTI) ratios in the Irish mortgage market. Slightly amended rules were introduced in 2017 and these are as follows:

LTV limits		
FTBs	90%	5% of new lending to FTBs allowed above 90%
Non-FTBs	80%	20% of non-FTB new lending allowed above 80%
For buy-to-let investors	70%	10% of new lending above the BTL limit is allowed
LTI limits		
FTBs	3.5 times income	20% of new lending above the LTI limit is allowed
Non-FTBs	3.5 times income	10% of new lending above LTI limit is allowed

The LTI limits are a binding constraint on average to low-income workers, especially those looking to buy a residential property in the Dublin market. See Chart 3.3(a). The combination of the cost to build starter homes and the LTI limits on incomes of the typical first time buyer has caused an affordability wedge that is not easily resolved. The Help-to-Buy scheme has helped first time buyers to accumulate a deposit but the problem of qualifying for a mortgage of sufficient size to acquire a starter home still remains a challenge.

Chart 3.3(a)



3.4 Land and Infrastructure

The long-term and most effective way to increase the supply of housing is to ensure a sufficient supply of land that has the appropriate level of infrastructure and services in place. There has been considerable debate regarding the issue of land hoarding but as we have already mentioned in the paper, just because land is zoned for development does not automatically make it viable for construction.

According to the Housing Supply Coordination Task Force For Dublin there was sufficient zoned Tier 1 land with planning permission for 29,466 residential units of which 5,800 were under construction in Q1 2017. Tier 1 relates to sites where a final grant of planning permission has been obtained and the permission can be implemented immediately. It is notable that of the 29,466 units with planning permission, 13,013 are houses and 16,453 are apartments. Given the fact that the cost of constructing apartments is particularly challenged, the pace of which these apartment permissions will turn into actual supply of apartments will be slow.

In addition to the 29,466 residential units with planning permission in Dublin, there are 47,615 Tier 2B sites that are on serviced land and ready to be developed and a further 56,828 units on sites that require infrastructure investment and/or Irish water investment. This tier consists of lands which are zoned and where there is an appropriate planning policy in place or being put in place, for example, lands as contained within a Development Plan, a Local Area Plan, and/or a Strategic Development Zone. The portion of these Tier 2B sites suitable for houses or apartments is not available but again those sites earmarked for apartments will not quickly translate into actual output.

More zoned, serviced land will always be a welcome attribute to the housing market as it should ensure land prices are lower and feed through to lower residential property prices. Nevertheless, there does appear to be a reasonable amount of zoned land in Dublin, and to a lesser extent serviced land. However, given that a large portion of this land is designated for apartments means that actual supply will not match the potential output due to the elevated costs of construction for apartments.

Increased infrastructure investment required

Also, increased infrastructure investment has the potential to unlock substantial amounts of sites for development. To this end, the launch of the Local Infrastructure Housing Activation Fund (LIHAF) in 2016 is a welcome development. However, there has been some industry concerns regarding the implementation of the fund. As noted above, further infrastructure investment is still required to unlock a greater supply of serviced land. Furthermore, this future infrastructure investment needs to be concentrated in areas of highest need. The Minister for Finance announced an extra €75 million in the Budget for the second phase of LIHAF.

Development process – long and protracted

Also it should be noted that the development process from site identification to house completion can take 4 to 5 years. As Brendan McDonagh CEO of NAMA stated recently, *“In practice, the development process from initial site assessment to the start of construction takes at least two years: it involves assessing a site, resolving issues relating to services or legal title, employing a design team, completing pre-planning consultations, lodging a planning application, dealing with additional information requests, awaiting planning permission, raising construction finance, tendering to construction firms, appointing a construction team and then commencing construction.”*

That two-year timeframe assumes that all goes well; however, in many cases there are delays which may be caused by planning refusals, objections, legal problems or funding difficulties. After that preparatory period of two years or more, building commences with the start-up phase and initial site works for roads and other infrastructure; thereafter, the completion of a 100-unit scheme can take another 18 to 24 months.”¹³

The Local Infrastructure Housing Activation Fund (LIHAF) was launched in 2016 is a welcome development. However, there has been some industry concerns regarding the implementation of the fund.

13. Opening Statement by Mr. Brendan McDonagh, Chief Executive of NAMA, to the Joint Committee on Finance, Public Expenditure and Reform Thursday, 13 July 2017.

4 Cost of equity – bridging the gap

The current funding model for residential development is very different to what prevailed in the period leading up to 2007 /2008. Today, senior lenders work to much more conservative loan-to-cost / loan-to-value ratios and this has resulted in much bigger equity contributions from developers.

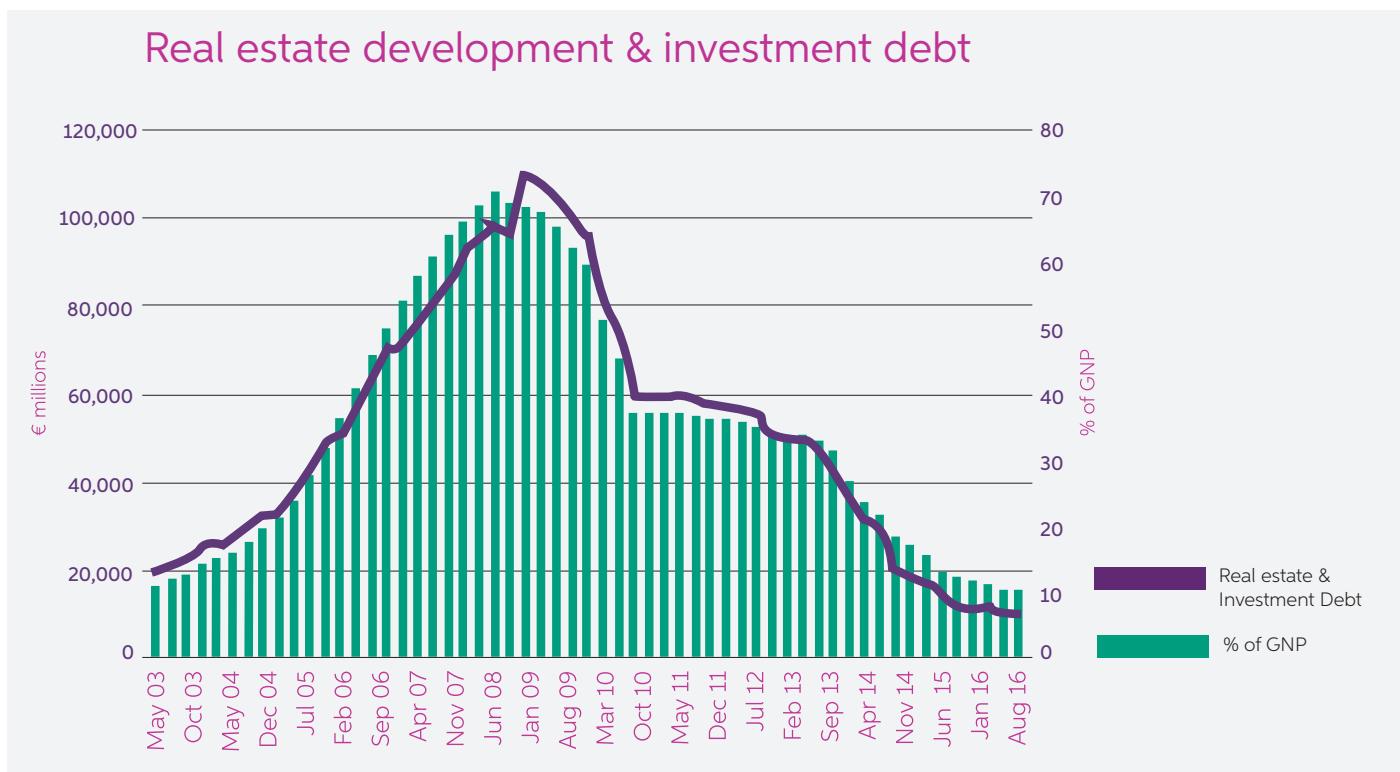
Banks are typically lending at around 50% LTV for site acquisition with full planning permission and around 60-65% LTC on work in progress. There is little or no appetite among the banks to fund sites that do not have planning permission or to take on risk through the planning process.

Adding to the availability of debt finance to the residential development market is Home Building Finance Ireland ('HBFI'). HBFI was announced by the Minister for Finance in the Budget and according to an Information Note from the Department of Finance, up to €750 million of ISIF funds will be allocated to HBFI to provide funding on market terms to '*viable residential development projects whose owners are experiencing difficulty in obtaining funding*'. According to the Information Note, the main characteristics of the fund are:

- Early activation of HBFI could be facilitated by the fact that HBFI will draw on NAMA's extensive expertise and experience in residential funding to NAMA debtors since 2014. While NAMA's expertise will be used to service this programme the HBFI would be a separate legal entity to NAMA and would not impact its existing objectives or its Board's strategic wind down plans.
- New HBFI lending would be on commercial, market-equivalent terms and conditions and would depend on the risk profile of each project, the quality of collateral and the creditworthiness of the borrower. This approach would be akin to a bank or private equity investor, in that HBFI would not be directly involved in development – its role would be solely as a commercial lender. Commercial viability testing will also ensure returns are the same as market norms. The lending approach will broadly mirror that applied by NAMA in funding the building of 5,600 residential units since 2014.

Given the expected growth in housing output over the coming years additional sources of senior debt will be welcomed by the market. However, we believe the key issue facing developers is the access to equity.

Chart 4.1(a)



Bridging the 35% to 40% equity gap is a key challenge for developers who consequently have to use much more expensive mezzanine debt / equity from non-traditional funders.

Bridging the equity gap is key however

Bridging the 35% to 40% equity gap is a key challenge for developers who consequently have to use much more expensive mezzanine debt / equity from non-traditional funders. Many developers currently lack sufficient equity capital to significantly ramp up development to meet their own needs or the needs of the market.

Working with third-party equity providers is challenging, not just in terms of cost but also in terms of control and development strategy. All of these new realities take time to adjust to, and this has contributed to the slow supply response.

Private equity are demanding paymasters

The current source of equity generally available to developers is private equity (PE). However, private equity investors are focused on IRR targets and are less interested in building business with a property developer long term. Furthermore, this source of equity comes with high fixed coupons plus a profit participation structure. As a result, PE equity is not only expensive it is in effect senior to the equity return available to the developer. What is needed therefore is an alternative source of equity that ranks pari passu with the developer's equity and has a longer-term focus than the IRR-driven PE model.

To this end, AIB are exploring a number of possible funding solutions that would help provide longer-term equity capital to the residential development market. Another issue for developers is the lack of senior debt funding for zoned land without planning permissions. Again, this is an area that AIB is actively exploring.

5 Social and affordable housing and funding

There is huge scope to get institutional capital to help fund the social housing sector in Ireland.

Ireland's social housing system has relied primarily on Part V (of the Planning and Development Acts, 2000-2006), where developers have to set aside 10 per cent of any new development for social housing. The previous requirement was 20 per cent. Prior to this, social housing was largely dependent on debt-financed publicly-funded construction of new homes.

There is huge scope to get institutional capital to help fund the social housing sector in Ireland. However, facilitating this would require a larger supply of projects of scale and greater certainty about the structure of the projects.

5.1 Direct build by local authorities

Direct build by local authorities as a way of solving the housing crisis has been debated at length in recent months. The merits of direct State house building is open for discussion, but the practical issue is that the State and local authorities have not built housing directly on a large scale for over 40 years. Consequently, the resources, experience and ability is absent, and it would take many years to build up this capacity again. Furthermore, the construction industry is already facing resource constraints on the employment front and any concerted attempt by the Government or local authorities to hire a direct workforce would drive up labour costs significantly and ultimately would prove counterproductive.

The main argument in favour of direct provision is that the Government would be able to slash costs, as it would not have to pay VAT, levies and developer profit margins. However, these cost savings could be readily achieved without going to the expense and time of resourcing direct building provision. It could, for example, cut VAT and levies for dedicated social and affordable housing developments built by existing developers. While developer margins would still feature, it would still be a more cost effective way of providing social and affordable housing in our view.

Review of the application of Part V

The main principles of Part V requirements are endorsed by the industry, and the merits of mixed private, affordable and social housing in one location are well supported. However, there are issues with the practical application of Part V and the calculation of the site value and developer contribution/cost. The authorities calculate the price of the site and this value is deducted from the price they pay developers.

However, the valuation approach used by the authorities is based on market evidence rather than a net residual calculation. This can lead to over-inflated values for the site and also lead to higher developer contributions than what is justified by the economics of the development in question, i.e. on a net residual value basis. In addition, negotiations about the Part V contributions can be protracted and form part of the pre-commencement requirements which can cause considerable delay to the start of a development project.

Attract private capital – the ingredients are there

In a world of low interest rates and increased liquidity, institutional investors are struggling to find investments with the appropriate risk and reward characteristics. The pool of institutional money has never been bigger and thus the demand for such investments is intense. Therefore, the opportunity to attract institutional capital into the Irish social and affordable housing market should be realisable.

Long-term leases with reasonable returns are the ingredients

The long-term leasing arrangements that are available from local authorities is a model that has the ability to attract considerable amounts of private capital, whether it is traditional bank funding, credit union funds or pension fund money. The combination of long-term leases and rental agreements and guarantees of between 80% and 92% of the market rent from local authorities make this a very attractive investment proposition.

Based on these very high level investment characteristics housing associations should be able to structure investment vehicles to satisfy the demands of institutional investors. The low risk, security and steady return of social housing make it a compelling investment for institutional investors.

One of the main factors that may be discouraging such initiatives is that individual opportunities might be too concentrated and too small for institutional investors. The Housing Finance Agency or NAMA could play a key role in solving this problem as they could act as an aggregator of different projects. The Housing Finance Agency or NAMA would also have the expertise to handle the structuring and management of these investments.

The model can be extended to developments

This leasing funding model could be extended to the development of sites for a mix of social, affordable and private housing. If a local authority or housing association were to pre-commit to leasing or purchasing a certain number of houses in a particular development, this would have the potential to unlock funding, both debt funding and equity funding, for a developer.

What is needed is a larger supply of good projects to finance, and this requires access to appropriate sites at the right prices, along with appropriate planning permissions. Variations of this are already occurring in the Irish market but on a piecemeal basis. Again, the Housing Finance Agency or NAMA could play a key strategic role in the assembly of sites and the co-ordination of projects.

5.2 Co-operative model – an approach that tackles the affordable housing problem

According to Co-operative Housing Ireland (CoHI), co-op housing in Ireland dates back to the 1950s, with the aim of providing affordable homes for their members. Since 1973 more than 3,500 co-operative dwellings for ownership have been developed and 1,800 rented homes continue to be managed by local co-operative societies.

CoHI outline a number of forms of co-operative housing that are possible and include:

- Social rented housing co-operatives provide housing to members who are usually recruited from Local Authority waiting lists in the areas where co-ops are located.
- Home-ownership co-operatives help members who have the financial capacity to do so to build or buy their own homes. When suitable sites and finance are available co-operative group schemes of 10 – 30 homes can be developed. Most of these co-operatives have been developed in the Dublin area.
- Shared ownership co-operatives help members to part-purchase their own homes while a portion of the interest in the property remains owned by the co-operative.
- Mixed tenure co-operatives are usually larger housing co-operatives where it has been possible to provide a mix of rental and ownership types across the development.

The O'Cualann CoHousing Alliance – evolution of the Co-op model

We believe there is merit in expanding the home-ownership co-operative approach. An interesting example of how the co-operative housing model could be enhanced is the O'Cualann CoHousing Alliance.

O'Cualann's objective is to make available quality housing at affordable prices to people whose needs are not adequately served by the commercial housing market and who do not qualify for social housing.

The characteristics of the model are:

- All housing units are pre-sold to co-op members at affordable prices.
- Purchasers must be from, or working in, the local area.
- There are maximum caps on the salary of potential purchasers to make them eligible to participate in the scheme.
- Purchasers must have a 10% deposit.
- In respect of the residual 90% of the purchase price they must have mortgage approval in principle at the contract signing stage (with full mortgage approval prior to closing).
- They must hold the house for 10 years.
- The land is provided by the local council / local authority at a nominal value and all development and planning charges are waived.

The approach taken by the O'Cualann CoHousing Alliance has the potential to be scaled up and supply a meaningful amount of affordable homes. It is probably not feasible for Local Authorities to hand over land at nominal values and also waive development and planning charges. However, some type of subsidised model is required. Furthermore, legislation to enact the construction of new, privately financed, affordable housing in integrated social/affordable developments on Local Authority land in collaboration with the co-operative AHB sector would be helpful in scaling this model.

We believe there is merit in expanding the home-ownership co-operative approach.

AIB is increasingly active in this sector

AIB is committed to providing funding to the social housing sector and has already provided funding directly to a number of housing associations. We have also provided funding to a number of developers who are building out sites with pre-agreements in place with local authorities and housing associations.

Appendix 1: VAT reduction model - reducing VAT to 9% is inexpensive

The net financial cost to the Exchequer of a reduction in VAT/tax is a function of a number of variables and includes:

- Total tax take associated with a new build
 - There are various estimates of the total tax take, ranging from 25% to 36%.
 - The 25% estimate is sourced from a paper produced by Bill Nowlan ¹⁴
 - The 36% estimate is sourced from the CIF's 2017 pre-Budget submissions.
 - Both are used to give a range of results.
- The scale of the VAT reduction
 - VAT currently stands at 13.5%. We have looked at the impact of reducing VAT to 9% and to 0%.
- We use an estimate of 10,000 houses.
- An estimate of how many houses would have been built in the absence of the reduction in VAT
 - Rather than estimate how many residential units will be built, we highlight the minimum number of new homes that would have to be built in order for the Exchequer to break even on the VAT foregone on the 10,000 units that would have been built in the absence of the VAT reduction.
- In making the calculations, we assume the average new house price is €300,000.
- The breakeven number of new units to be built under the various scenarios are as follows:

Scenario 1 – Tax accounts for 25% of total costs

- Vat reduced to 9% - number of extra homes required: 2,195
- Vat reduced to 0 – number of extra homes required: 11,740

Scenario 2 – Tax accounts for 36% of total costs

- Vat reduced to 9% - number of extra homes required: 1,429
- Vat reduced to 0 – number of extra homes required: 6,000
- To note these extra homes are not forecasts. Rather they are the number of extra new units that need to be built in order for the Exchequer to breakeven.

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