# The Residential Market - A crisis that needs an appropriate response

Marian Finnegan discusses the imbalance between supply and demand in the residential property market and what needs to be done to help rectify this divergence.

Marian Finnegan is the chief economist and director of research with the Sherry FitzGerald Group. Marian's position involves monitoring and analyzing economic and property indicators in the domestic and international markets. She is also the spokesperson for the Group and regularly writes and lectures on the property market.

The residential property market is one of the greatest challenges for Ireland today. We suffered an incredibly deep and painful recession and while there is much greater stability today, there are still so many obstacles to overcome.

To put this simply, our economy has recovered much quicker than our property market. The need for accommodation to live in has grown and the market has not been able to respond quickly enough. As such, we are in the midst of a supply side crisis. The word crisis is appropriate and as such we need an appropriate response.

Rebuilding Ireland was launched eighteen months ago, this month. This, together with additional measures announced in Budget 2017 and the relaxation of the macroprudential policy have largely served the market well.

Firstly, activity levels have improved. The Property Price Register reveals that approximately 35,600 single transactions took place in the first nine months of 2017, a 9% increase on the equivalent period in 2016. 2017 also witnessed increased mortgage activity and saw first-time buyers gain a larger foothold in the market. These developments were, in part, helped by the introduction of the Help to Buy scheme at the start of 2017 and the relaxation of macroprudential rules by the Central Bank the previous year.

Furthermore, the average value of new dwellings sold in Dublin in the first nine months of 2017 rose by a modest 1%. The year also saw some increase in the delivery of new housing with an upturn in completions, registrations, commencements and planning permissions being granted, albeit from low bases.

However, despite these developments, the demand for housing still far outstripped supply in 2017. This imbalance manifested itself through sharp price increases across the country. Prices rose sharply in the year, 8.8% in Dublin, up from 3.7% in 2016, while outside the capital, prices rose from 5.2% in 2016 to 7.9% in 2017.

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In summary, both of these initiatives have been positive, however it is simply not enough.

Arguably, the most immediate need lies in the residential lettings market. Our latest in-house analysis of vendor and purchaser profiles in 2017, reveals a continued outflow of investors from the buy to let market. Reflecting the trends of recent years, 33% of vendors were selling their investment properties, while investors entering the second-hand market represented only 20% of purchasers. The volume of investors in the new homes sector is negligible, outside of the multi-family sector.

The lettings market has effectively lost tens of thousands of units in recent years. Rental levels in our key urban centres are now greater than the peak levels achieved at the height of the Celtic Tiger. Current market conditions are clearly a direct response to inadequate supply levels, and yet the Government's policy to date does not address this imbalance at all in the short term. Instead, it focussed on capping rental inflation to 4% in key urban areas. This was disappointing and ineffective as is evident by that latest RTB data on rental inflation which show annual inflation levels of greater than 9% in both Dublin and Ireland as a whole.

There is clear evidence that rental yields for private investors are too low. If one takes the example of a two-bed apartment in the Central Business District of Dublin, with a 70% LTV mortgage. Based on current capital values, rental levels and taking into consideration all expenses, the current net yield is 1.76%.

In this example, the Government will receive 24% of the total rent paid by the tenant through tax.

Clearly this is just one example, but it does beg the question, are investors being taxed out of the market?

In short, there is no doubt that private landlords require a more equitable tax treatment particularly given the very favourable tax structure offered to other investment vehicles such as REITs etc.

Steps to address the loss of properties from the rental sector are required immediately. However, they will be only part of the solution. While much has been achieved to date, we are still too far away from equilibrium in the market. As such, every effort needs to be made to fast track the supply of property to the market in the short to medium term.

The lack of accommodation is leading to significant hardship for many and is a potential threat to our future economic success. We should leave no stone unturned in seeking a solution, however unpalatable to the populist culture.

Looking to the immediate future, the outlook for the residential property sector in 2018 and further into the future remains distinctly mixed. As the UK's exit from the EU drags on, the consequences for Ireland still remain unclear. Unfavourable developments in the second round of negotiations, beginning in March, could still have a major impact on Ireland's economic circumstance.

At a national level, given the expected development of the economy, the strength of the labour market, as well as demographic pressures, the severe imbalance between supply and demand is likely to persist. Thus, the sustained price growth experienced last year is likely to continue with current indications suggesting that prices will increase by 6-8% in the established housing market in 2018.

Progress has been made by the Government to stimulate greater supply. The fast track planning initiative, along with the measures introduced in October's budget should go some way to rectifying the divergence between demand and supply in 2018. Similarly, the Help to Buy scheme is likely to have a continued positive impact in inducing the supply of starter homes over the course of the year. Nevertheless, further efforts to increase supply in all locations is needed. Current construction output still cannot deliver the approximate 40,000 new homes, Sherry FitzGerald estimates needs to be delivered per annum between 2018-2021, if supply is to equate to demand. Furthermore, the Government's prolonged inaction in addressing the crisis in the rental market has been a frustration. Measures to encourage investors to enter the market and raise the supply of buy to let properties are also needed, if there is to be any stabilisation in rents over the year.