

Sliding over the Edge

The Demise of the Irish Housing Market

by Andy Wilson

While predictions that the Irish housing market was on the brink of collapse have been sounding for over a year, in the last few months it has become clear that the bubble really has burst. In Issue One of Sustainability, Richard Douthwaite warned about the rising level of mortgage related debt and drew comparisons with Japan, where house prices fell for sixteen years in succession following the collapse of the property market in 1990.

House prices in Ireland peaked soon after Richard wrote that article and have now begun to fall. All the signs are that this is no temporary aberration. Although the main financial institutions have remained upbeat and are still talking about a soft landing, for them to admit they have been lending money recklessly for a number of years, and that they chose to ignore the fact that Ireland was following in the footsteps of a number of different countries worldwide which experienced house price crashes as the result of excessive speculation, too high a level of borrowing, and supply overshooting demand.

Falling Prices

By the end of August (the last month data was available for prior to going to press), house prices had fallen 3-4% from the start of the year. Falling prices are expected to continue

throughout the rest of the year and it is likely the rate of fall will steepen during the autumn and early winter... traditionally the time of year when the housing market is at its lowest ebb. By the end of the year, prices may have fallen by around 6-7 percent, which, when coupled with the current rate of inflation, means depreciation in real terms of 11-12 percent.

Back in 2004, the OECD warned that house prices in Ireland were 15 percent overvalued. Since then prices have risen by a further 30 percent while wages have risen by only one quarter of that. This suggests that house prices are now 40 percent over-valued... a conclusion supported by data from the CSO which shows that since 1994 house prices have risen by a whopping 350 percent while average wages have risen by only about 80 percent.

The Game is Over

Perhaps not surprisingly, the construction industry has realised that the game is over and confidence within the sector is now plummeting. While the number of house completions reached an all time high last year, at 93,400 units (houses and apartments combined) estimates for this year are being revised downwards on a month by month basis. There are other signs too.

The number of approvals on planning applications for new dwellings has been on a downward curve since it peaked during the second quarter of 2004. The number of housing starts dropped by one fifth in the first half of

2007, and this was on the back of a 10 percent fall in the previous six months. Even the most optimistic forecasts predict a 20 percent fall in the number of house completions in 2007, while by 2010 the number of houses being built is likely to be 75-80 percent down on 2006. See fig 1.

Economic Implications

Economically, this has severe implications for the Irish economy. Residential construction accounts for two thirds of all construction activity and the construction industry accounts for 13 percent of the total national workforce. The retail value of the houses completed in 2006 was €28.5 billion and some one sixth of the Irish economy underpinned by residential construction. Even a 20 percent downturn will mean tens of thousands of layoffs and potentially billions of euro less in circulation.

An examination of the type of loans being approved reveals the extremely precarious nature of the lending sector, and the high probability of default. In 2006, three fifths of property loans granted were for mortgages for over 90 percent of the value of the property, and over one third were for 100 percent mortgages. Over half of first time buyers were under 30 years of age, while three-fifths of mortgages granted were for mortgages of over 30 years in duration. Interest rates are now at their highest level for 6 years.

Comparisons with other European countries also demonstrate the incredible rate of house construction in Ireland. In the Eurozone, the number of new houses built proportional to the total population has remained fairly static for the last decade, at 56 new houses per annum per 10,000 people. In the UK the figure is even lower, at about 31 houses per 10,000 population. In Ireland, the figure reached 147 in 2002 and stood at over 220 in 2006, four times the Eurozone average, and seven times higher than in Britain. At the start of 2007, houses completed during the previous twelve months comprised 5.5 percent of the total housing stock in Ireland, compared to only 0.8 percent in Britain and 1.3 percent in the Eurozone.

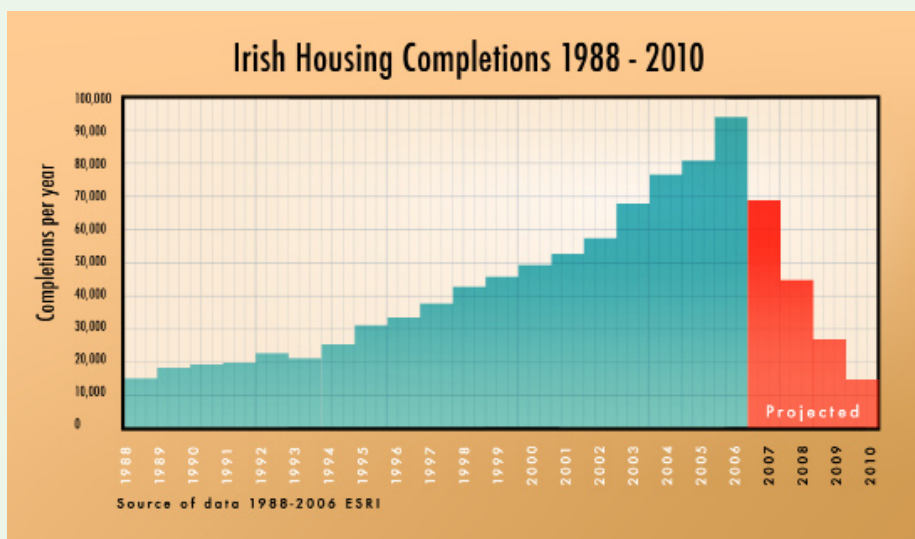


fig 1



Empty Houses

There is also a growing number of empty houses in Ireland and many of these are houses built for speculative reasons but not yet sold. Even when the number of declared holiday homes is removed from the equation, the number of unoccupied houses in Ireland stands at about 265,000 or about 14 percent of the total housing stock. The percentage was only 7.1 percent as recently as 2002 and 6.3 percent in 1996. Derelict houses or houses under construction are not included in these figures. See fig 2.

Far from there being a housing shortage, there is a housing surplus. The houses currently unoccupied would house (at average occupancy rates of 2.9 persons per dwelling) over three quarters of a million people, meaning Ireland is unlikely to have a shortage of housing again until the population surpasses five million. Far from rising, in the short term Ireland's population could easily fall as Eastern European migrant workers employed in the construction sector return to their

native countries or move elsewhere in search of work. The Irish population is unlikely reach five million until at least 2020.

Housing Crashes Elsewhere

The experiences of other countries which have experienced collapses of housing bubbles makes sobering reading. Following dramatic rise in prices between 1975 and 1978, the Netherlands experienced a 40 percent fall in property prices between 1978 and 1982. It took 20 years for the property market to recover. In the 1980s, Norway suffered a 40 percent fall in house prices in just four years. The recovery period was 13 years.

Between 1989 and 1993, house prices in Finland fell by 50 percent and in real terms, house prices are still below 1989 values. In Switzerland, house prices fell by 40 percent during the 1990s and are still lower than they were in the 1970s. In Germany and Japan, house prices have been falling non stop since the early 90s and when inflation is factored

in prices are lower than at any time in the last 30 years.

With the exception of Germany, all of these countries had experienced a sharp increase in the price of property relative to household income in the years preceding the crash. Typically they had experienced a 30-50 percent rise in the price to income ratio over the preceding period of 3-12 years.

The most spectacular crashes, namely those of the Netherlands and Finland, occurred after increases of 50 percent in just three years. By way of comparison, Ireland has experienced a rise of 150 percent in the price to income ratio in the space of about twelve years, over one third of it since 2002. Some authorities put this figure even higher: see Morgan Kelly *ESRI Economic Quarterly Commentary 2007*.

The property boom in Ireland is over, and the steep descent while inevitably follows such booms is already beginning to gather momentum. What is also worrying is the time it will take for Ireland's economy to recover given external factors such as rising energy costs, disruptions of global food production as a consequence of global warming, and the growing likelihood of a worldwide recession. Perhaps the only surprising thing is that the bubble lasted so long.

Solutions

It is already much too late to be talking of solutions. The only steps which might be taken now are those of a damage limitation type. For people who are already paying off recently acquired mortgages there is a very high likelihood of negative equity. Inevitably there are going to be casualties.

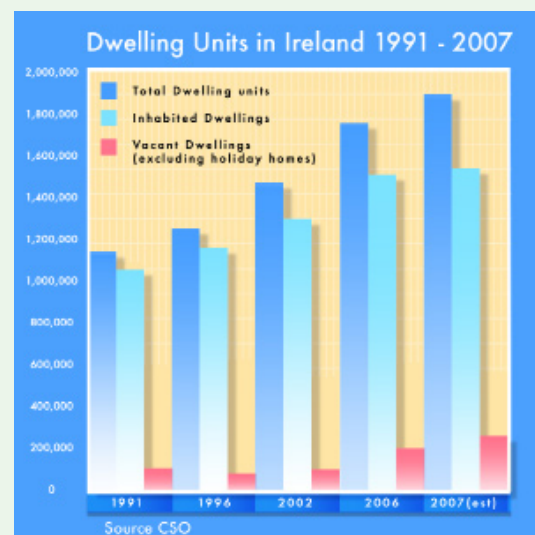


fig 2

Probably the only way for the main lending institutions to remain afloat is for them to look for creative ways to deal with borrower insolvency. Although this may be a case of shutting the gate long after the horse has bolted, they will also be obliged to tighten up lending criteria. 100 per cent mortgages will rapidly become a thing of the past. In order to cover



themselves against repossession and forced sales, banks will not want to lend a higher proportion of the value than they will get back from selling in a falling market.

Playing *Monopoly* with Real Money

*I*f there is any good which can come out of this unfortunate, if entirely predictable outcome, it will be the exposure of the the foolishness of treating the housing market like a rigged horse race in which the backed horse always comes home first. While one can easily blame greedy financial institutions, property speculators and developers, or even the Government, the individuals who bought chips at this property roulette table must also accept some responsibility too.

Unfortunately, far too many people believed or wanted to believe the myth that property would always go up in value - and were prepared to pay the inflated prices asked for houses and house sites. Ireland will have plenty of time to reflect on the follies of playing *Monopoly* with real houses and real land, as it faces into many years of falling property prices and the various unwelcome economic consequences.

Footnote April 2008

*M*any of the predictions in this article, which was written in October 2007, have been proved correct.