

# Ireland's Property Market – How did it come to this? And where to next?

**Ronan Lyons (Oxford / TCD / Daft.ie)**

*Challenges Facing the Irish Economy*

*European Commission Conference, Galway,*

*March 24<sup>th</sup>, 2012*

# By way of introduction...

- Today's theme:  
importance of internet  
and social media to  
modern commentators  
(and academics?)
- My own benefit
  - [ronanlyons.com](http://ronanlyons.com)
  - @ronanlyons on twitter
  - LinkedIn even got me a  
job!

Free Economy | World Economy | Property Market

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# Ronan Lyons

Economic analysis: stats, graphs etc.

## Irish Economy

13 MAR 2012

### The Fiscal Compact – Vote Yes to Silliness (It's all about the cash)

Last week, I outlined some of the many reasons why the EU's Fiscal Compact should have been sent back to the drawing board when first seen by European leaders and their economic advisers. The experience of Spain since then sums these up pretty well. Spain had been given a target deficit of 4.4% of GDP [...]



Should Ireland vote yes to the EU Fiscal Compact?

## World Economy

11 OCT 2011

### Nine million jobs – the cost of inaction on the global debt crisis

The Nobel Prize in Economics, awarded yesterday, highlighted the important role of expectations. The IMF's World Economic Outlook has given the world an important barometer of expectations about the economic climate and how they change over time. This post uses IMF figures to estimate how many jobs will be lost over the period 2011-2015 in the Eurozone, the USA and in the rest of the developed world, due to politicians' inaction on the debt crisis over the last twelve months alone.



Region	Estimated Job Losses (Millions)
Europe	~2,200,000
USA	~3,200,000
Other developed countries	~2,800,000

How many jobs are being lost due to the debt crisis?

## Property Market

09 FEB 2012

### Buyer power: Latest rent figures suggest review of rent supplement will have an impact

Where is there oversupply in the Irish rental market? And where might there be shortages? This post reviews the figures from the latest Datté Rental Report, whose commentary is given by Minister Joan Burton. The headline figures suggest stability in rents, but that hides very different trends between the major urban markets, Dublin and Cork in particular, and the smaller rental markets. A comparison of supply and demand across the country suggests that rents should be falling faster in many parts of the country – turning the focus back on to rent supplement levels.



Region	Percentage Change
Dublin city centre	~10%
North Dublin city	~10%
South Dublin city	~10%
North County Dublin	~10%
South County Dublin	~10%
West Dublin	~10%
East city	~10%
Galway city	~10%
Waterford city	~10%
Dublin commuter suburbs	~10%
West County	~10%
South East Central	~10%
Midland (ex-urban)	~10%
Connacht (ex-urban)	~10%
Other (RPS)	~10%

Percentage change in rental market share by region (2010-2011)

Where is there still oversupply in the rental market?

# Today is based around four “stylised facts”

- Real estate is a bad investment
- The property market is imperfect
- Accommodation is a service
- Governments can manage the property market

# Context: We've seen it all before...

- Price of Mountjoy Square townhouse after construction in 1791:
  - £8,000
- Price of Mountjoy Square townhouse in 1849:
  - £500
- Fall: 94%



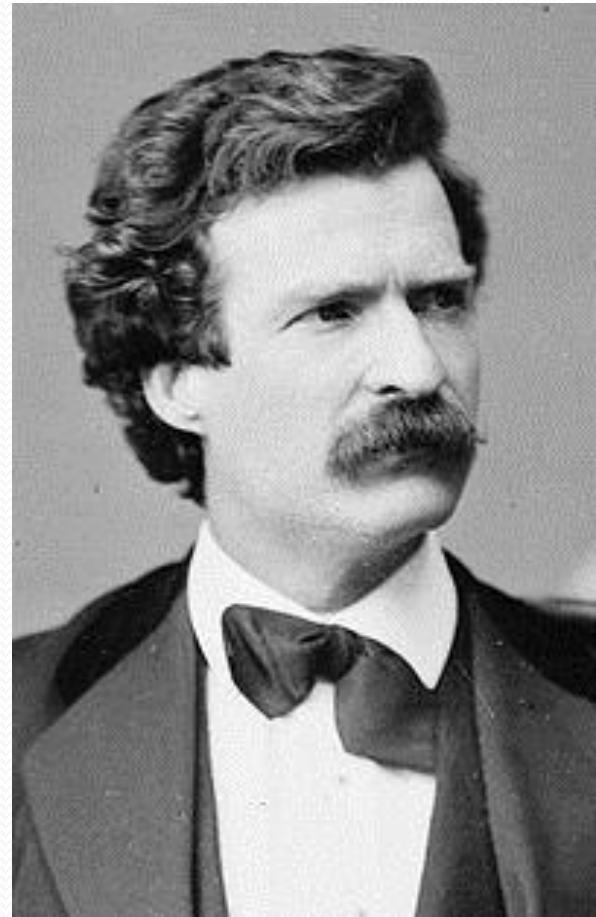
# Outline

- **Real estate is a bad investment**
- The property market is imperfect
- Accommodation is a service
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# But surely...

“Buy land – they’re not making it anymore!”

Mark Twain



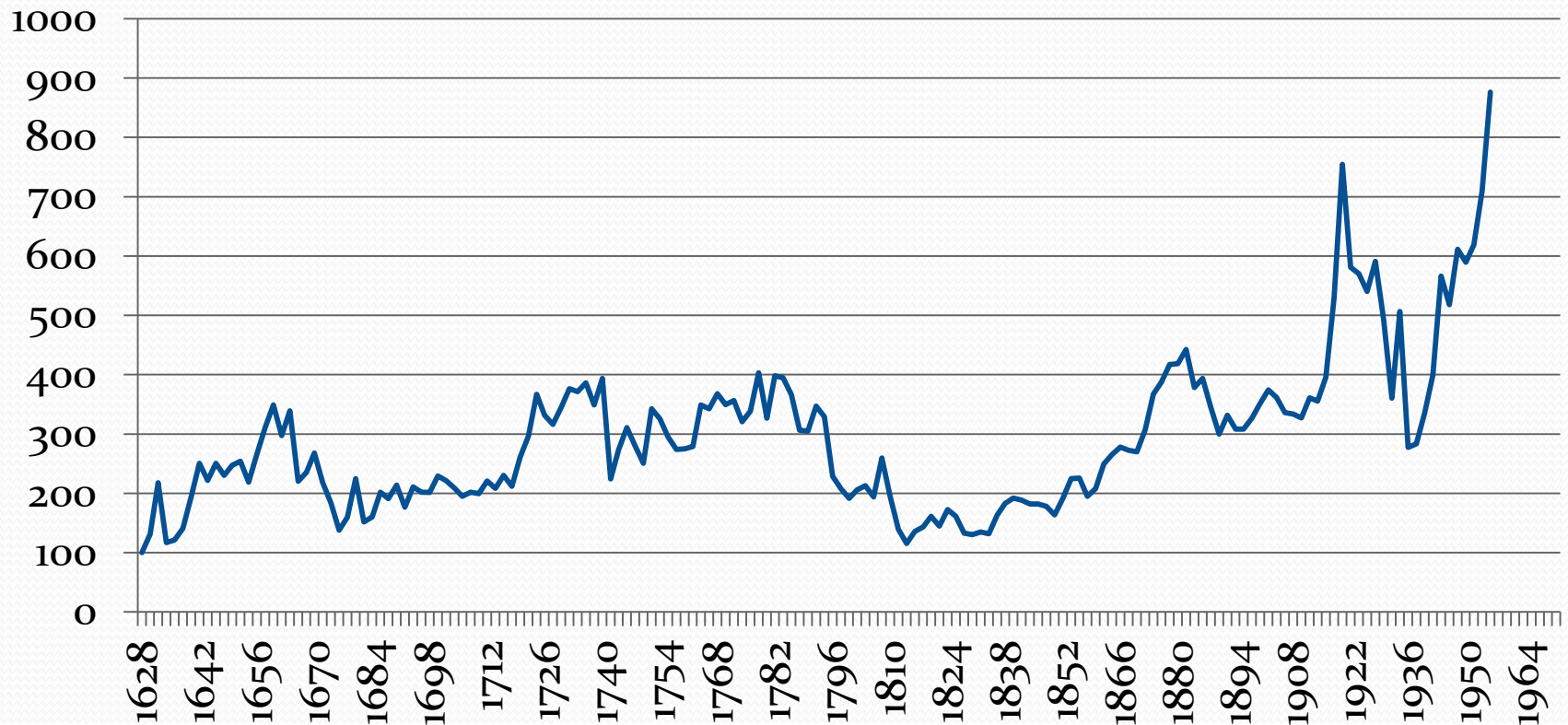


This is Amsterdam's Herengracht...



# On the face of it, house prices do seem to rise at least some of the time

**Herengracht house prices, 1628-1962**

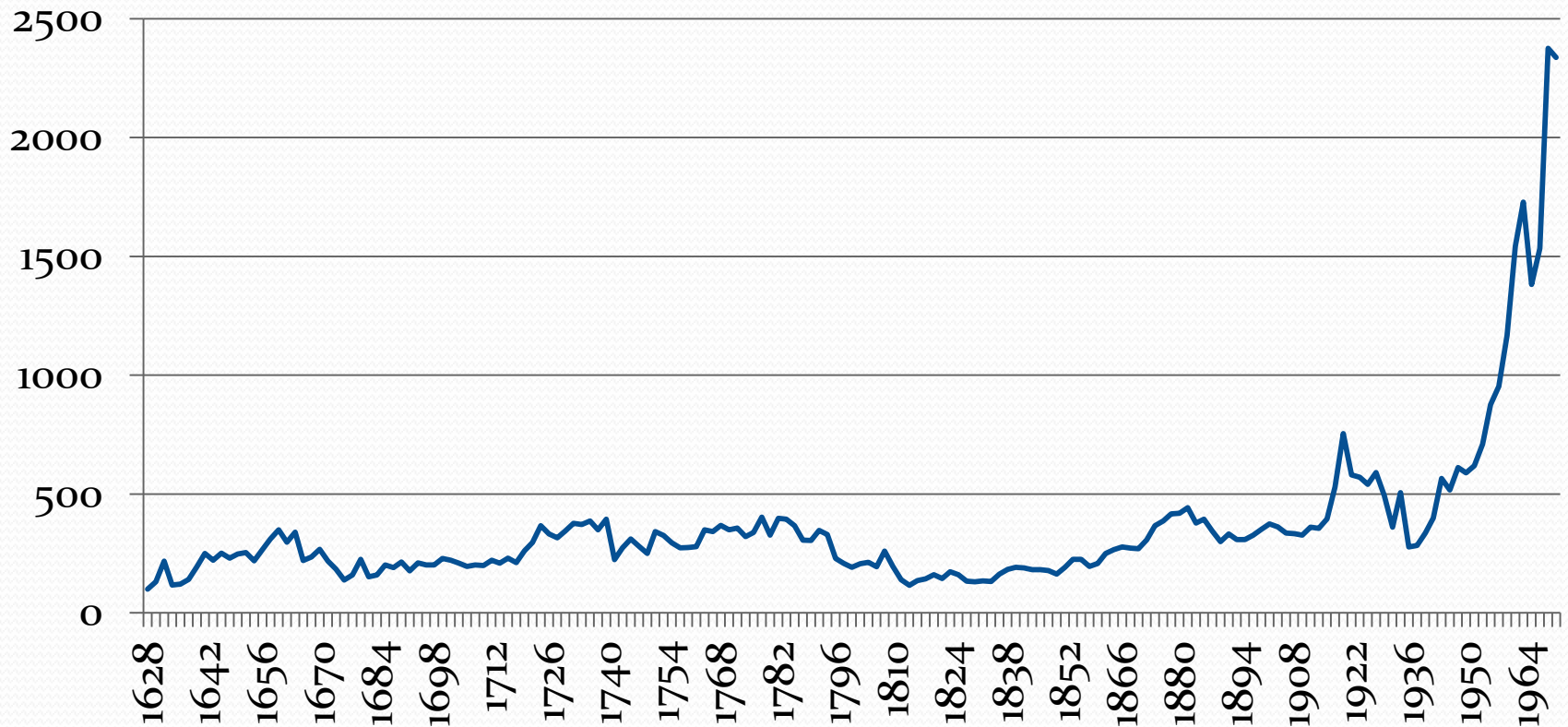


1628 = 100 – Source: Piet Eichholtz



...and rose dramatically 1950-1970

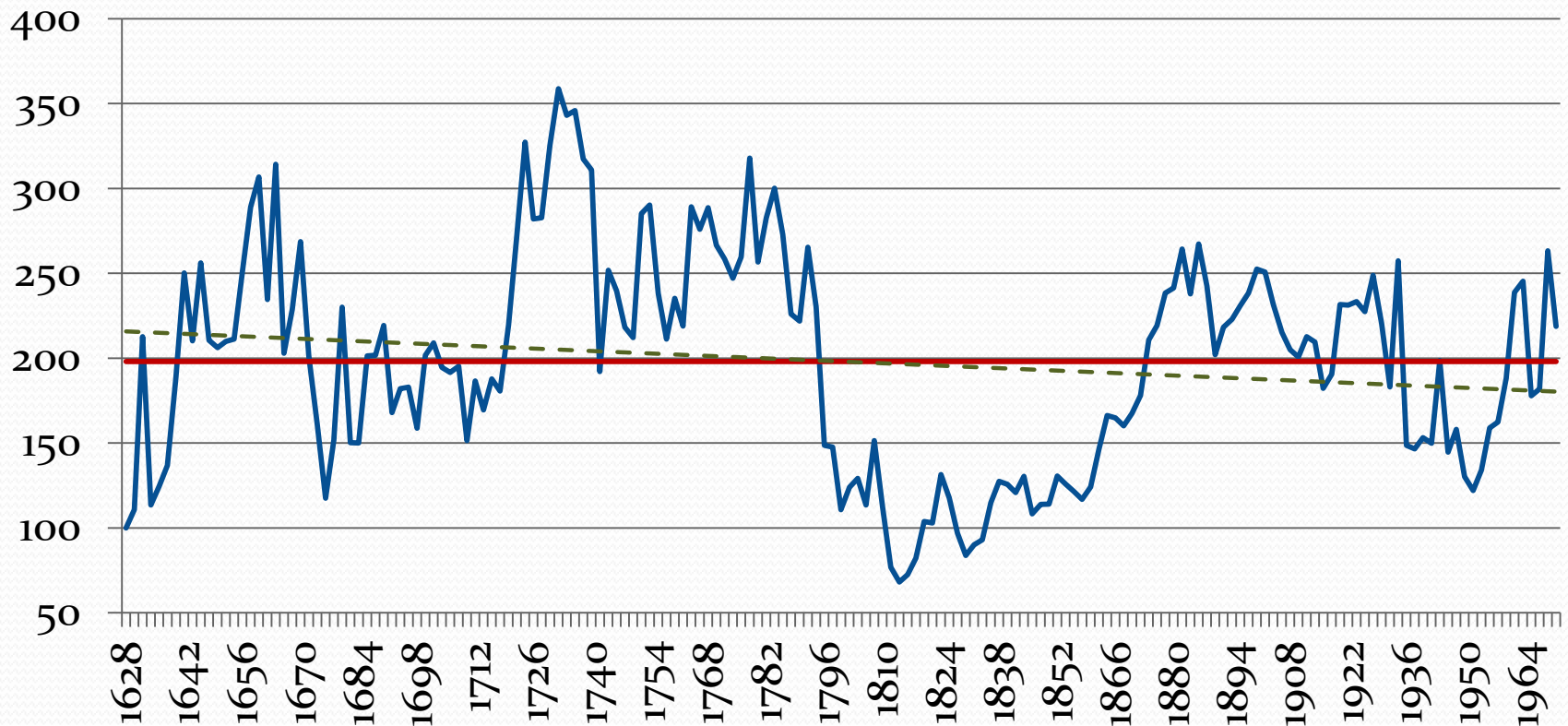
Herengracht house prices, 1628-1972



1628 = 100 - Source: Piet Eichholtz

# Correcting for inflation, though, substantially alters the picture

**Inflation-adjusted Herengracht house prices**

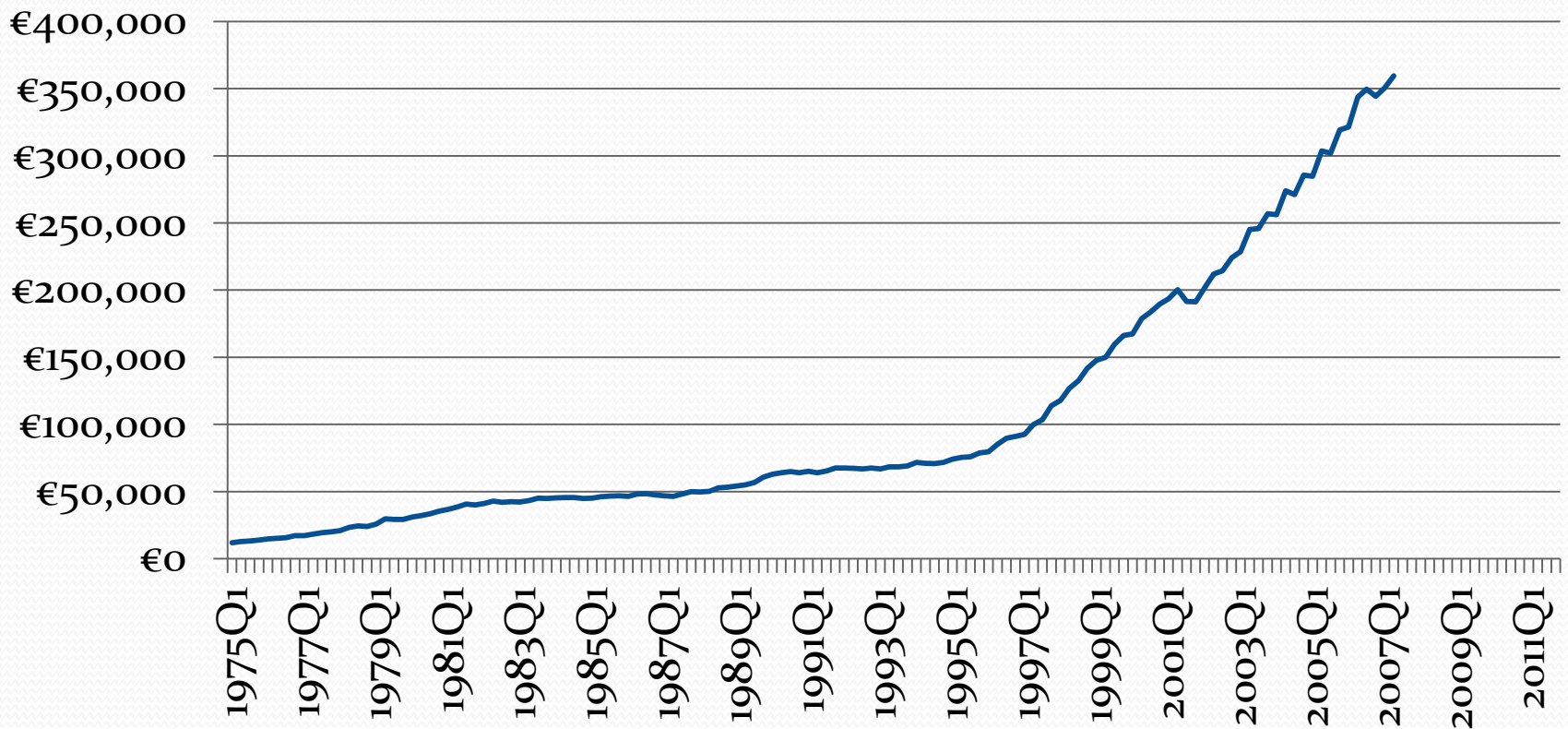


# Property stores value – but little more

- Relative to the cost of living, prices in Central Amsterdam were no higher in 1975 than in 1875 or 1640
- “Stylised fact” (1): over time, house price increases on average match inflation – but don’t beat it
- This can be investigated worldwide
  - The literature on long-run house prices around the world is small but pretty clear on this point – e.g. New York commercial real estate or Boston house prices
- “Bad investment” in the sense of capital gains – need to look at the “dividend” instead – rents

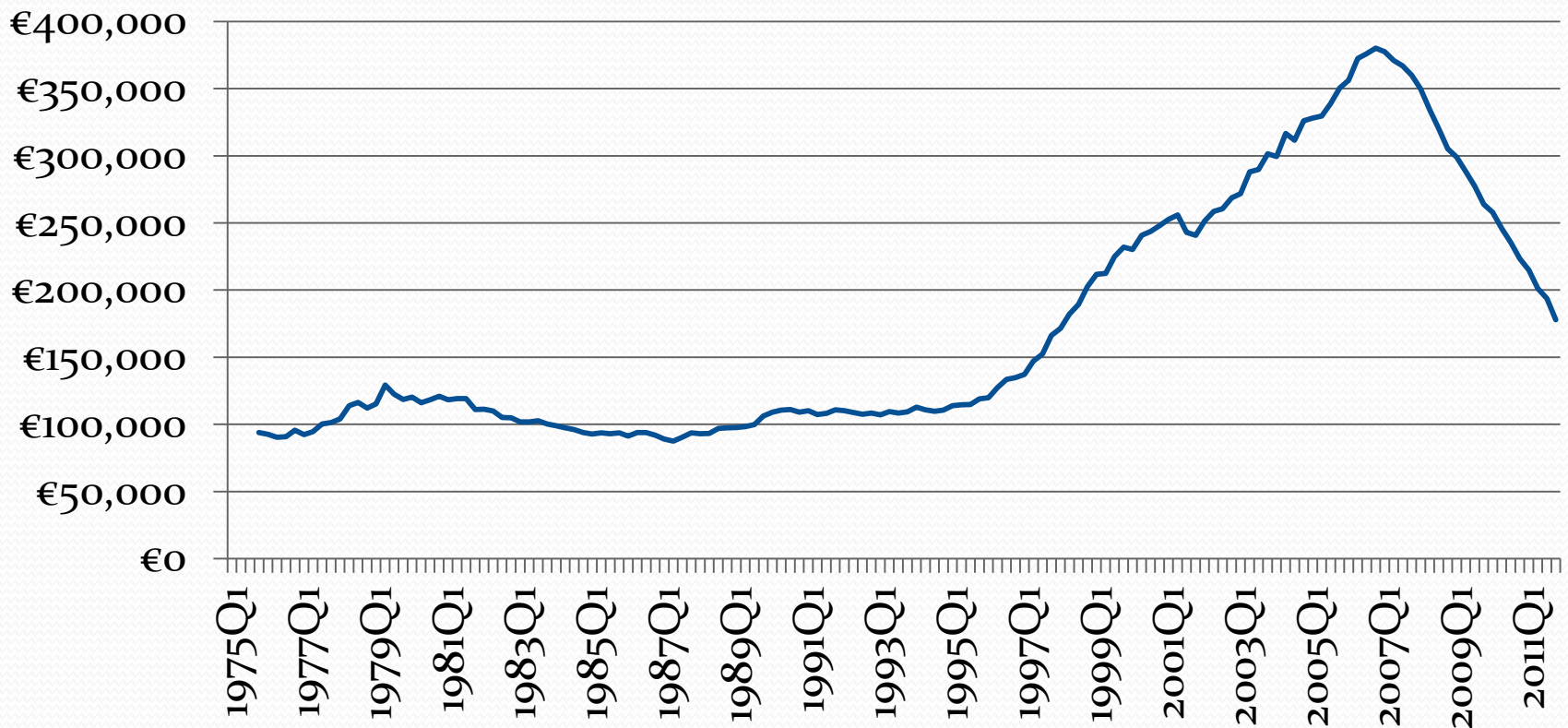
# But surely Ireland is different?

Average house prices in Ireland, 1975-2007



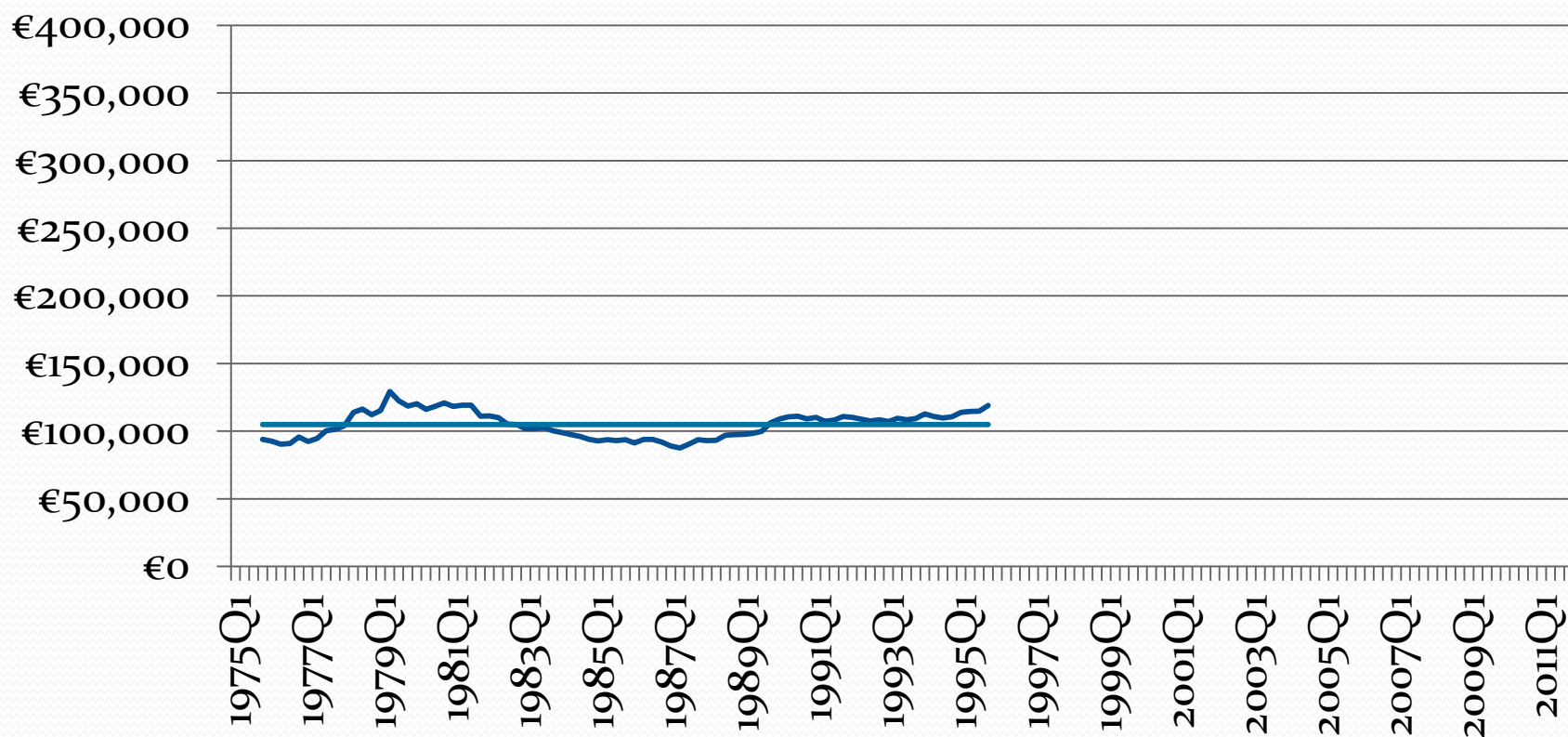
Again, we need to correct for inflation  
(and add in the post-2007 period!)

**Inflation-adjusted house prices, 1975-2011**



# The period to 1996 looks familiar!

**Inflation-adjusted house prices, 1975-1996**



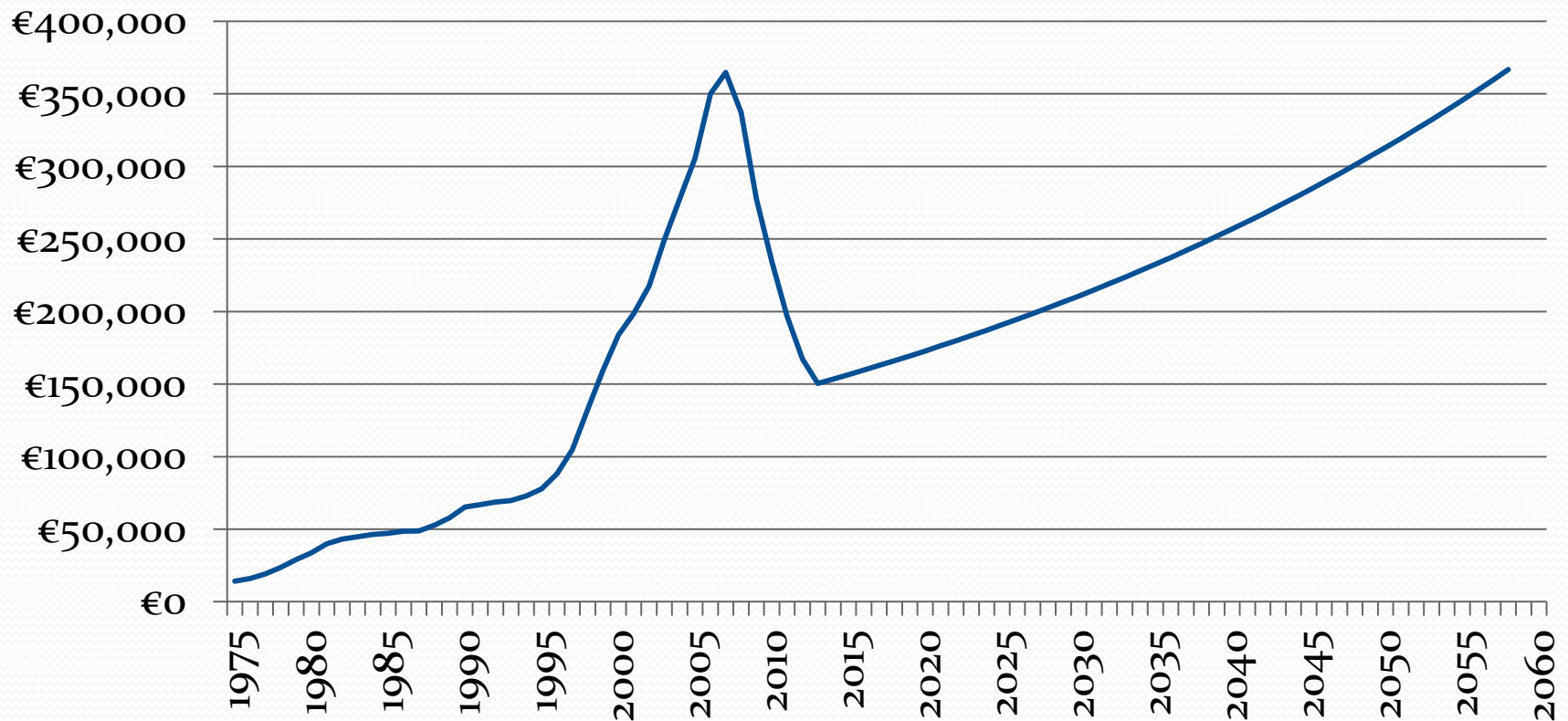


# Our expectations about the future should reflect this

- **We should only expect house prices to increase the same rate as inflation**
- This has big implications for those who bought during the bubble (or those who bailed out bubble-era lending)
  - They can't expect inflation to eat away their problem – they will have to wait until the principal is paid off to sell their property

It may be the 2050s before prices reach levels seen at the peak

**Potential for house prices in Ireland, 1975-2060**

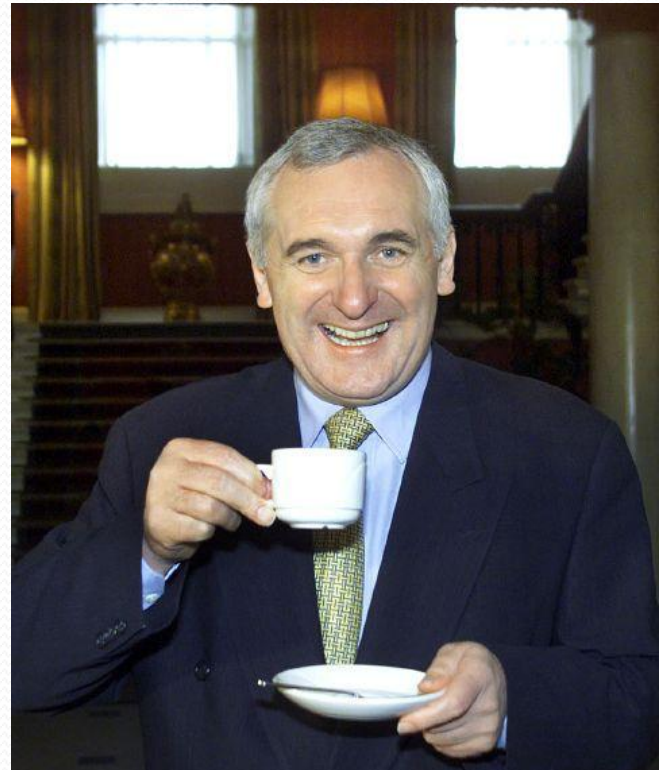


# Outline

- Real estate is a bad investment
- **The property market is imperfect**
- Accommodation is a service
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# How did prices reach 2007 highs?

- The short answer:
  - Ticking all the boxes of a textbook bubble-and-crash...
  - ...in a market with “adaptive expectations”, where momentum is key



"Bad advice given by so many resulted in some people making mistakes when they should have bought property last year."

*Bertie Ahern, April 2006*

# Economics likes assumptions

- Assumptions are needed to come up with any sort of model of the world
- Assumptions typically either...
  1. Strip away unnecessary detail
  2. Simplify a process we don't understand yet
- The danger is when economists mistake a type (2) assumption for a type (1) assumption

# “Rational expectations” is one contested assumption

- “Rational expectations” means that consumers know all information and can process it
- An alternative is “adaptive expectations”
  - i.e. people do not process every last bit of information – instead they look at the past and extrapolate into the future
  - This has very different implications for policy
- Property markets exhibit strong tendencies of “adaptive expectations”
  - We can see this in Ireland over the last ten years

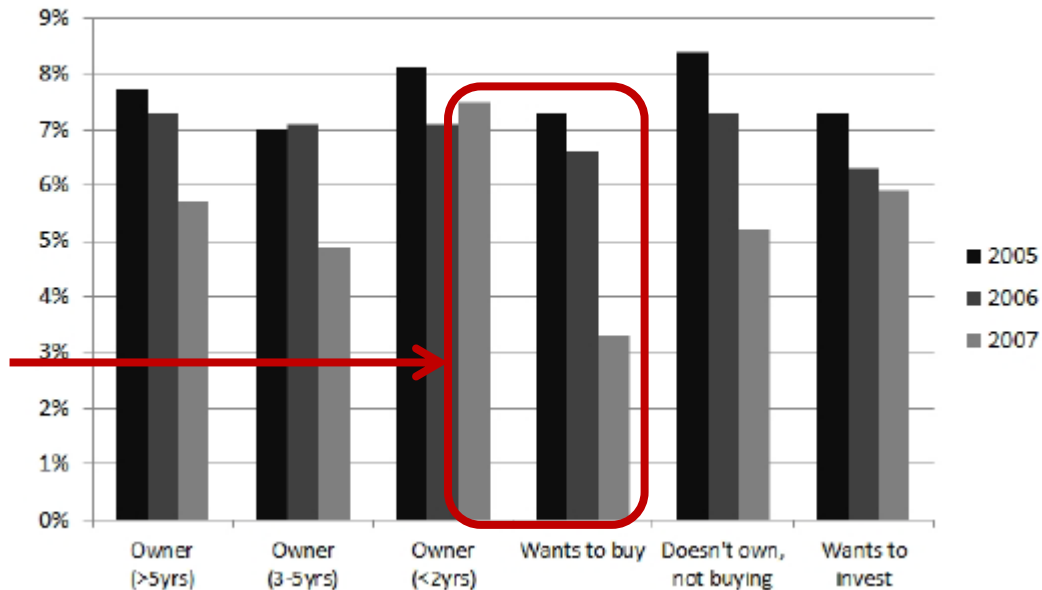


# Bubbles occur when a favourable change is amplified by easy credit

1. A bubble starts out with an initial **change in conditions**, often a desirable one
  - In Ireland, this was moving from 1980s stagnation to 1990s export-led growth
2. Boom becomes bubble when prices detach from fundamentals – this needs a generous **supply of credit**
  - Entering the Eurozone gave Irish banks access to German savings to lend – a failing at EU level
3. For the bubble to suck in large numbers of people, generous **supply of the asset** itself is needed
  - Tax breaks for both builders (Section 23) and borrowers (mortgage interest relief) were domestic policy errors

# Despite all this, people did not see the end of the bubble

Figure 6.2: *Expected price change over coming 12 months, by group*



Cognitive  
dissonance?  
People seeing  
what they want  
to see...

Source: Analysis of ESRI-IIB Consumer Sentiment Surveys

# People also find it hard to see the end of the crash

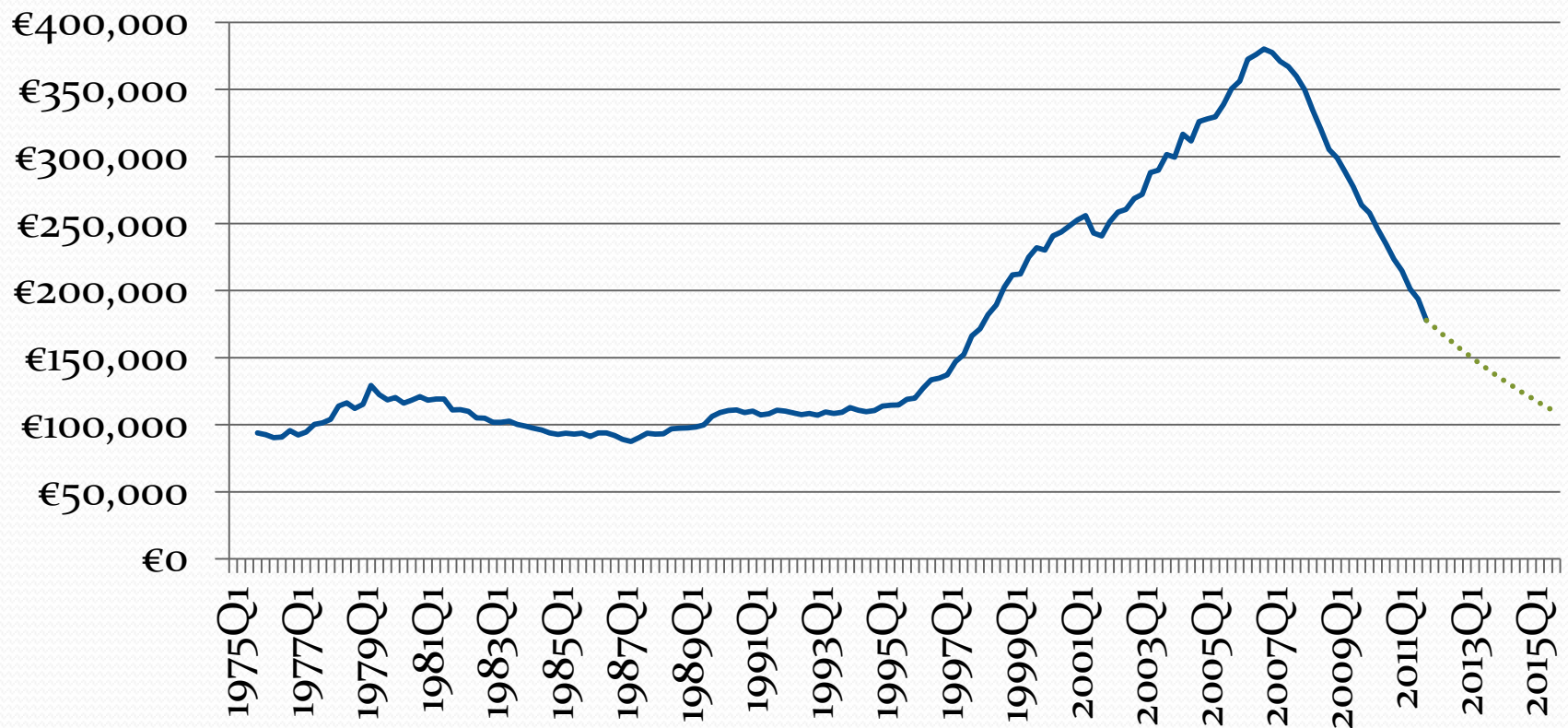
- The typical respondent to a survey on the property market in January 2012 expected house prices to fall a further 10% this year
- Just one in six sees house prices being higher in 2017 than they are now
  - This is only slightly above the number who believe house prices will fall by a further 35% or more during the same period

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# Economics is not: “what goes up must come down”

**Average house prices in Ireland 1975-2015**



# Economics *is* about: supply and demand

- Supply is largely fixed
  - Both generally: in housing markets (compared to other markets) supply moves slowly
  - And specifically: in Ireland at the moment, very little construction activity happening
- To understand where house prices will “land”, we need to understand demand
- This is often thought of “in short-hand” as the ratio between incomes and house prices

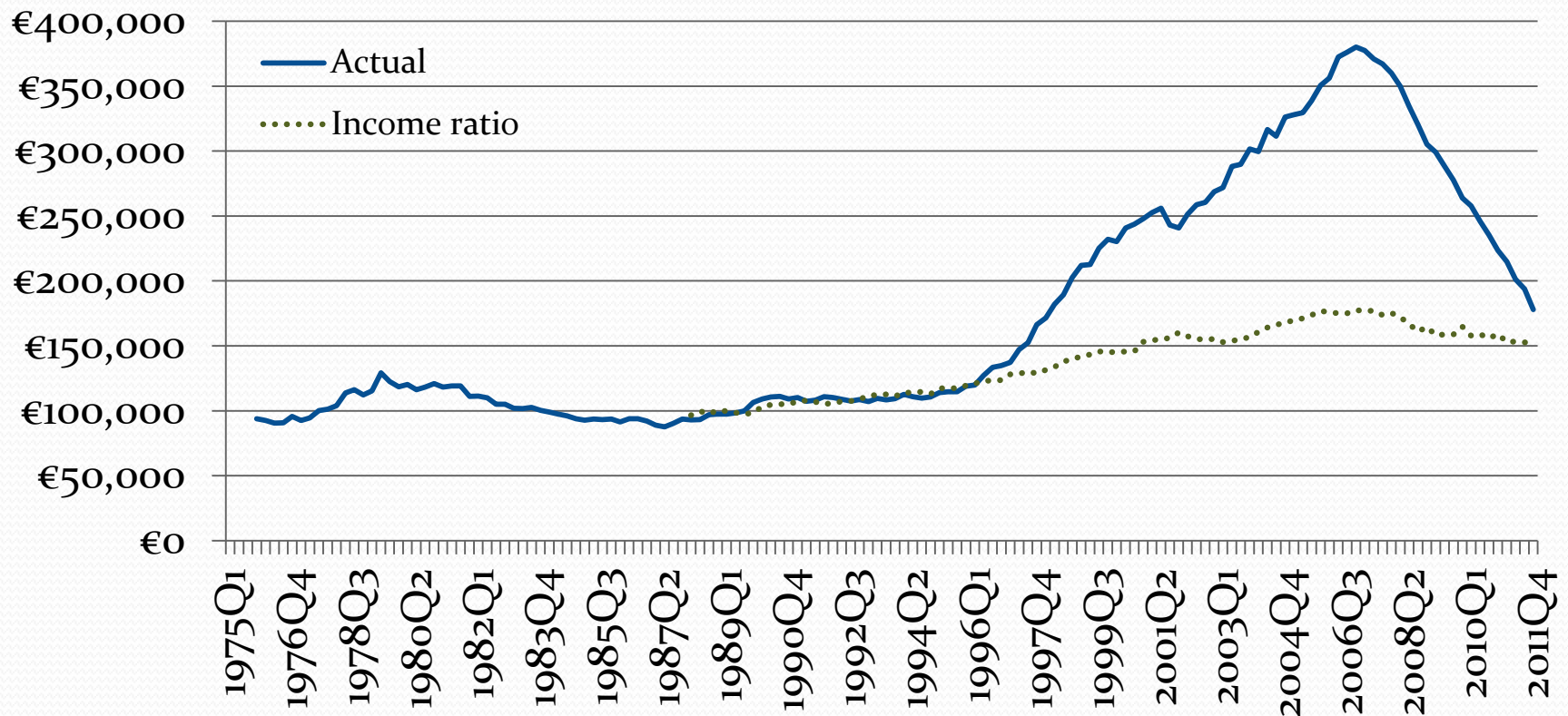


# House prices relative to incomes

- Between 1988 and 1995, the average house price was 3.6 times household income
  - Household income in 1990 was 1.15 times average income (compared to 1.33 in 2005)
- The ratio in 2005-2007 was over twice this (an average of 7.4)

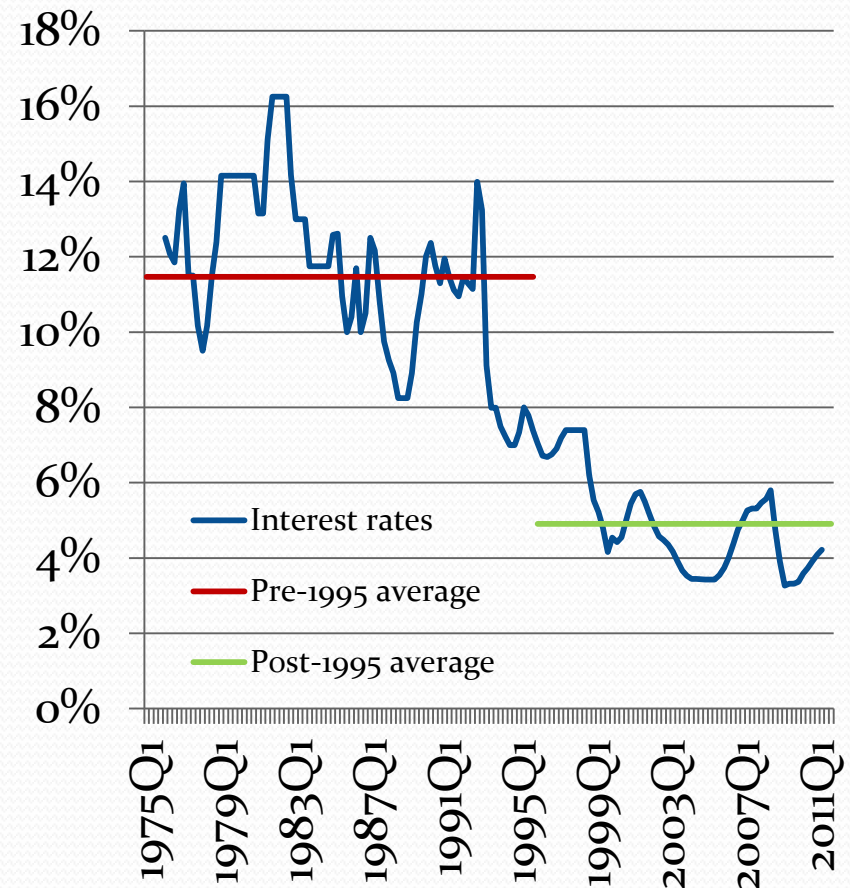
# What if house prices had reflected household income?

**Inflation-adjusted house prices in Ireland**



# But the income ratio is a symptom – not the cause

- Some of the increase above the dashed line may not be due to a bubble
- It may be because Ireland went from a high interest rate environment to a low one



# The ultimate value of real estate comes from the service it offers

- Income multiples also tell us very little about why house prices vary spatially
- Rents matter – even if you are not a renter or a landlord
- One of the most important services in a developed economy's GDP is “imputed rent”
  - What would an owner-occupier pay in the rental market to enjoy their accommodation?
- The ratio of rents to house prices is the fundamental measure of health in a property market

# Rents and house prices reflect a huge range of “non-market” services

Amenity	Bubble	Crash	Urban	Rural	Sales	Let
Coast (+)	9.8%	11.1%	14.5%	10.2%	10.2%	6.5%
Bathe (+)	19.3%	15.4%	17.9%		17.9%	14.8%
Lakes (-/+)	1.7%	3.5%	2.4%		2.4%	4.5%
Rivers (-/+)	-1.5%	-1.9%	0.0%	-1.8%	-1.8%	-0.2%
Waste (-)	2.0%	-0.4%	2.8%	0.5%	0.5%	-0.9%
Pollute (-)	-1.0%	-1.9%	-4.5%	-1.4%	-1.4%	1.4%
Roads1 (+)	3.3%	1.4%	2.3%	2.1%	2.1%	1.6%
Roads2 (+)	3.4%	3.0%	2.8%	3.0%	3.0%	1.0%
Station (+)	11.0%	10.9%	11.1%		11.1%	9.5%
Track (-)	-2.7%	-1.7%	-3.8%	-2.5%	-2.5%	-2.9%
P/School (-/+)	-8.9%	-9.8%	-9.4%	-8.8%	-8.8%	-2.9%
S/School (+)	2.2%	2.2%	3.5%	2.6%	2.6%	2.6%
Hosp (-/+)	-4.4%	-6.5%	-2.7%	-5.6%	-5.6%	-3.8%

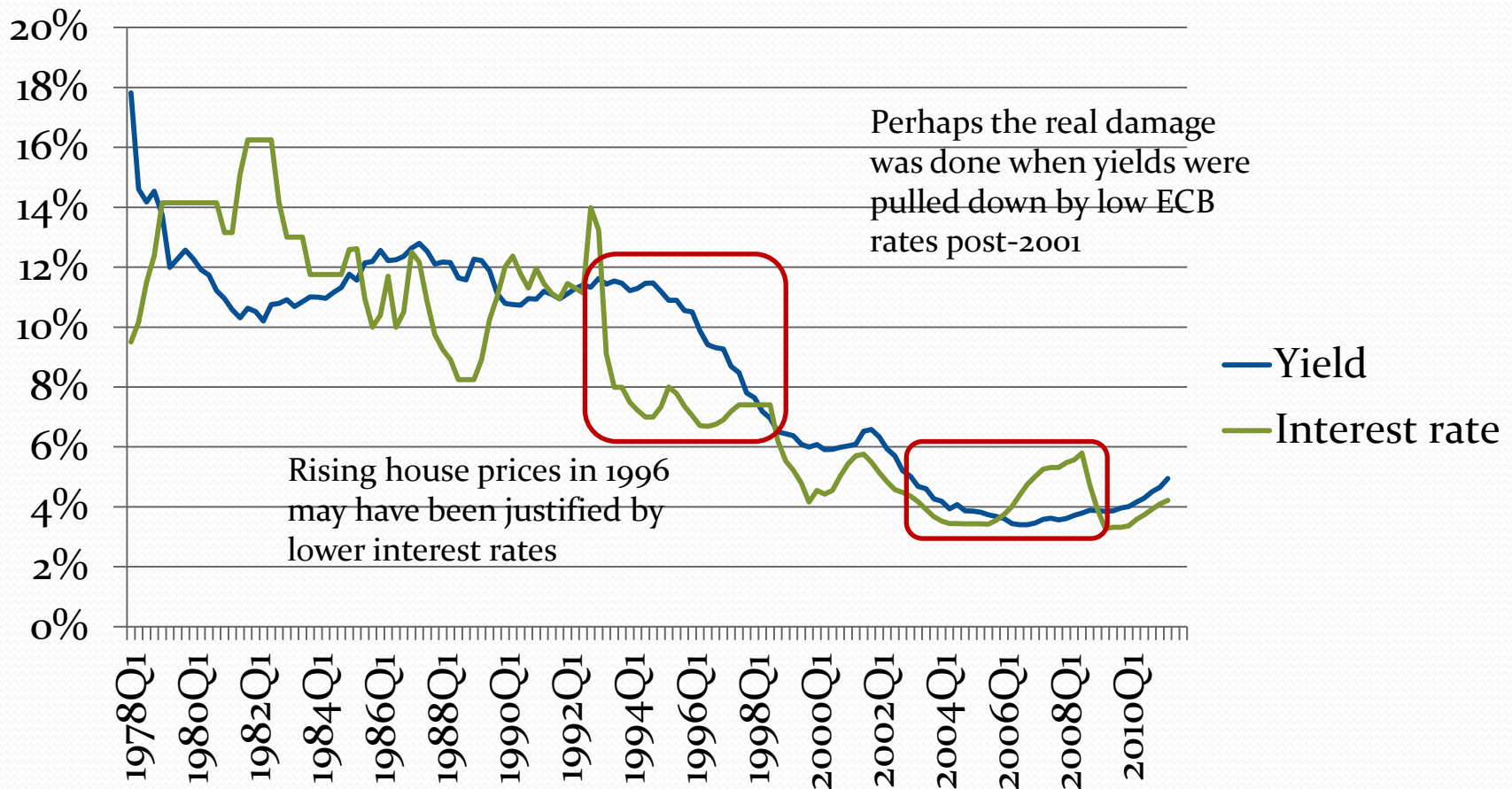
*Figures show the estimated effect of moving a property from 1km away from a particular amenity to 100 metres away*

# The ratio of rents to house prices is like the “return” on housing

- Think like an investor: a property that rents for €800 a month has an annual rental value of €10,000
- Knowing that this property has an annual “dividend” of €10,000, what would you buy this property for?
  - If you had lots of cash, you would compare the return to, say, interest rates on savings accounts
  - If you were borrowing, you would compare the return to the cost of borrowing

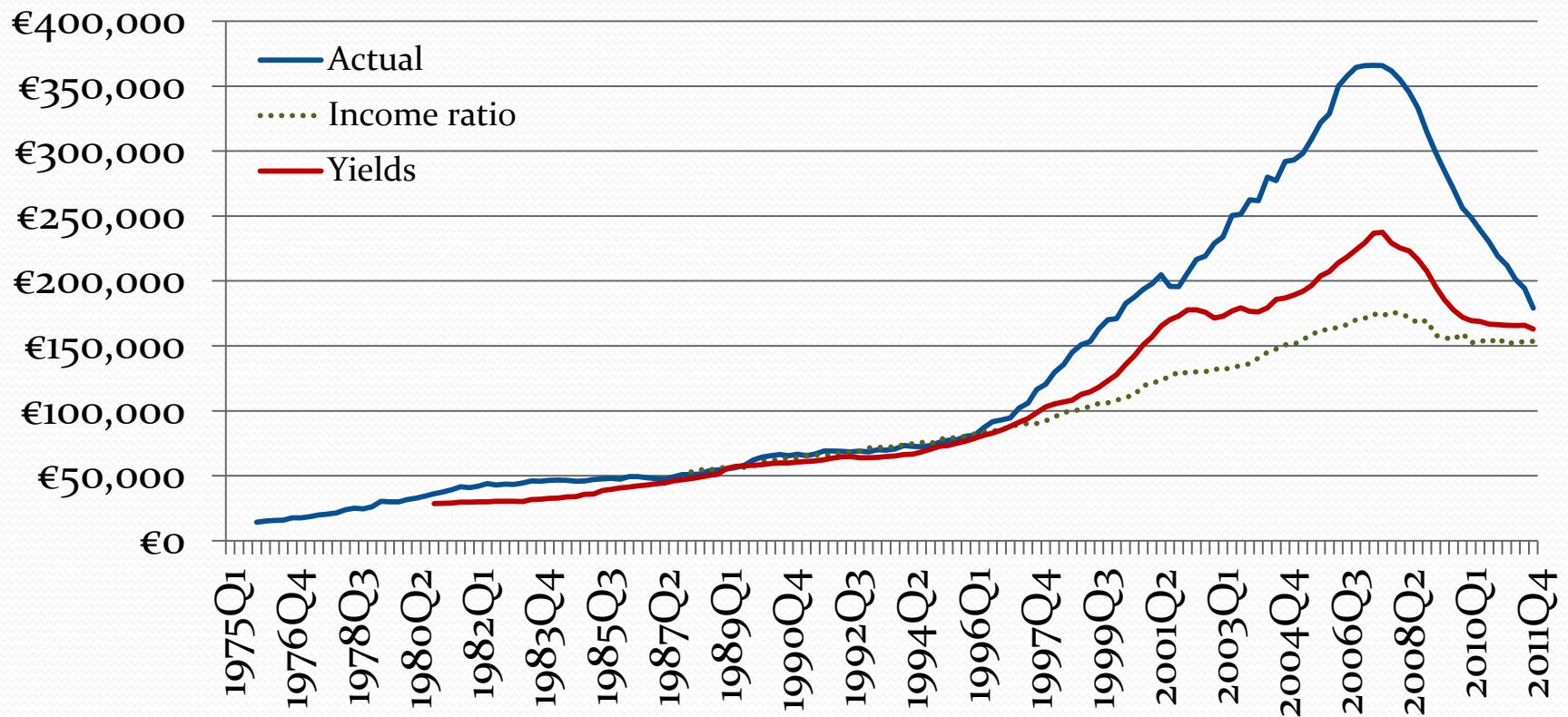


# The rent-to-price ratio is closely related to interest rates



# What if house prices had reflected rental yields?

House prices in Ireland 1975-2011



# Crystal-ball gazing

- Asking prices fell by an average of 52% between 2007 and the end of 2011
  - If asking prices have fallen a further 5% since then and accepted bids are typically 10% below the asking price, then prices are down 58%
- The average transaction price now is in the region of €155,000
  - This is in line with both income multiples and rental multiples...
  - ... but prices won't actually stabilise until credit returns

# Outline

- Real estate is a bad investment
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- Accommodation is a service
- **Governments can manage the property market**

# Government can put in place good market foundations

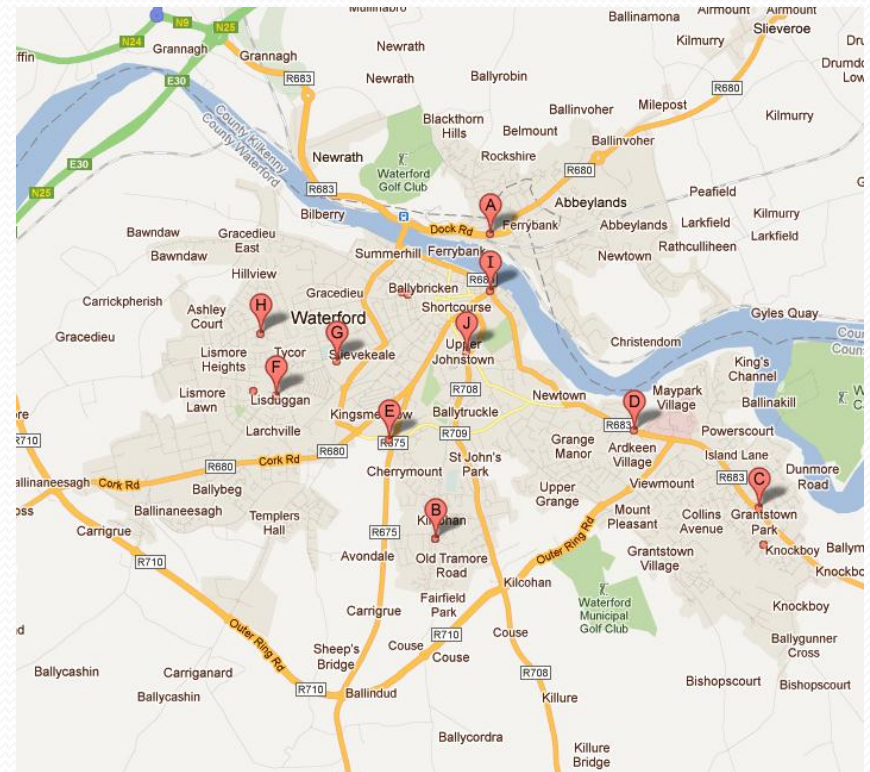
- Caution: Intervention was part of the problem
  - As of 2006, the Irish property market the most intervened in among developed economies
  - In addition to tax breaks for construction and mortgage interest relief, also no annual property tax or capital gains tax!
- New intervention has to be aware of the stylised facts of property markets

# Three principles will go a long way

- Sensible land use
  - E.g. site value tax, which encourages socially beneficial use of land and penalises land banks, derelict sites
- Sensible lending
  - E.g. “covered bonds”: to lend over 30 years, banks must borrow over 30 years – effectively creates culture of fixed rates so Ireland would be less prone to ECB decisions

# Three principles will go a long way

- Sensible borrowing
  - E.g. improving the “informational infrastructure” – publicly available house price register
- Huge role for information technology and the internet



# Thank you

- Comments and questions welcome
- For more, see [ronanlyons.com](http://ronanlyons.com) or get in touch on Twitter (@ronanlyons)