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## Housing and Ireland's Economic Recovery

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### SUMMARY

In this *inBrief*, we focus on the role housing can and will play in Ireland's emerging economic recovery. In it we make three key points:

First, housing is an important part of the economy.

Second, housing should be an important part of the recovery.

Finally, we suggest that Ireland needs to enter a new era for housing and housing policy; one where the primary and dominant role for housing is seen as providing accommodation rather than easy and excessive capital gains.

### KEY POINTS

- Housing has been one of a number of issues that has sat at the core of Ireland's recent economic collapse.
- The very expensive lessons of recent years must not be lost; excessive house prices were not good news for the economy or society generally.
- There are approximately 50,000 unemployed or underemployed workers who are likely to regain employment in the housing sector as it recovers and returns to levels equivalent to European norms.
- As a return to normal conditions is awaited, there is merit in Government investing in a new social housing programme which would simultaneously address social housing waiting lists and in the short-term boost activity, output and employment in the housing sector.
- A new era for housing policy is required. It must be one where the primary and dominant role for housing is seen as providing accommodation rather than easy and excessive capital gains.

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*Research for new economic policies*

## Introduction

Despite numerous false dawns, Ireland's economic recovery seems to be finally commencing. However, as the NERI and other economists reviewing the data have stressed, the recovery to date has been fragile and various risks remains. Among these is the slow pace of consumer spending – the largest component of economic activity in Ireland. Households are still cautious and absorbing the effects of tax increases, pay decreases, historic debt levels and ongoing declines in real earnings.

In this *inBrief*, we focus on the role housing can and will play in the economic recovery. In it we make three key points. First, housing is an important part of the economy. Second, housing should be an important part of the recovery. Finally, we suggest that Ireland needs to enter a new era for housing and housing policy; one where the primary and dominant role for housing is seen as providing accommodation rather than easy and excessive capital gains.

## Housing is an important part of the economy

Housing has been one of a number of issues that has sat at the core of Ireland's recent economic collapse. The house price and building bubble is outlined in table 1. Between 1995 and the house price peak in 2007, three-quarters of a million units were built representing almost 40% of the housing stock. Construction peaked at 93,000 units in 2006 and prices a year later. Compared to average household gross incomes, house prices climbed from a ratio of just under 3½ to 5½ in the years from 1995-2006; a significant increase that carried obvious implications for affordability and personal debt. Recent house price declines have reduced the ratios with average incomes and earnings, representing some movement back towards affordability. However, between their peaks and 2013, house prices declined by an average of 27% and completions by 91%.

Many of the legacies of the housing collapse remain to be addressed and the lack of

sufficient progress on these issues further elongates the impact of the crisis on the economy. In particular issues of long-term mortgage arrears, the repossession of unsustainable mortgage properties and the protection of tenants in rented investment properties that are foreclosed remain. Similarly, the lack of a robust conclusion on the 'capital holes' in the banks as a result of mortgage defaults, repossession and restructures remains a damper on the overall economic outlook. Addressing and resolving these issues, including assisting households that face restructure and repossession, remains a key part of reestablishing a stable outlook for the exchequer, the banking sector, business and households.

The severity of the collapse in commercial land and property prices, followed by the decline in residential prices and associated employment and economic activity has impacted hard on the economy. Aside from the legacy bank rescue costs, the completion data in table 1 point towards levels of activity well below normal. Similarly, uncertainty and high mortgage debts continue to suppress spending and broader economic activity. The housing sector, an important part of a normal economy with sustained employment, investment and consumption, remains worryingly suppressed.

However, the very expensive lessons of recent years must not be lost. Excessive house prices were not good news for the economy or society generally. Overall and for various reasons, a key sector of the economy was let get out of control and allowed to alter from its core role of accommodation provision to instead pursue capital gains.

## Housing is an important part of the recovery

A further legacy of the recent economic collapse is that policy makers are reluctant to engage in anything related to housing. However, just because previous policy initiatives were flawed and inappropriate does not mean that current and future initiatives are to be avoided.

**Table 1: Irish house completions, average prices and comparisons with income/earnings. 1995-2013**

Year	No. of dwellings completed	Average house prices (€)	Relative to gross household income	Relative to disposable household income	Relative to gross average earnings
1995	30,575	77,994	3.43	4.18	-
1996	33,725	87,202	-	-	-
1997	38,842	102,222	-	-	-
1998	42,349	125,302	-	-	-
1999	46,512	148,521	-	-	-
2000	49,812	169,191	4.87	5.88	-
2001	52,602	182,863	-	-	-
2002	57,695	198,087	-	-	-
2003	68,819	224,567	4.96	6.24	-
2004	76,954	249,191	5.05	6.45	-
2005	80,957	276,221	5.41	6.82	-
2006	93,419	305,637	5.55	7.00	-
2007	78,027	322,634	5.39	6.72	-
2008	51,724	305,269	5.04	6.22	8.30
2009	26,420	242,033	4.28	5.27	6.57
2010	14,602	228,268	4.22	5.29	6.32
2011	10,480	230,303	4.35	5.51	6.41
2012	8,488	220,415	4.22	5.44	6.11
2013	8,301	234,301	-	-	-

**Notes:** This table updates an analysis from Drudy and Collins (2011). Household income data are averages from the CSO's Household Budget Surveys and Survey on Income and Living Conditions. Disposable income is income after taxes and social transfers. Average earning data is only available from 2008 onwards.

The collapse in house completion figures (see table 1) has occurred despite recovering demand for housing and untapped potential for additional supply. On the demand side there are underlying market needs linked to the structure of the population, the slow recovery in employment and a gradual emergence of lending capacity. Furthermore, the demand for social housing remains extremely high with 89,872 households recorded as on waiting lists in May 2013; more than twice the level in 2005.

On the supply side, a profile of the unemployed points towards large numbers of males with skills and experience in the skilled trades who are unemployed. Across Europe in 2012, 7.2% of those employed worked in the construction sector while the Irish figure was 4.7%, a number that implies that more than 50,000 workers are likely to regain employment in this sector as it

recovers and returns to levels equivalent to European norms.

For housing to play the role it should in Ireland's economic recovery, a number of policy initiatives are preferable. These are spread across various sectors of the economy and collectively assist in re-establishing economic stability and encouraging a revival in housing investment. Central is the emergence of a more stable economic environment, one where unemployment continues to fall, households feel more financially secure and real earnings (wages adjusted to take account of price rises) begin to increase once again. As the domestic economy stabilises and recovers, activity should pick up in the housing market and further buttress an economic recovery.

The emergence of a more normal banking environment, where individuals and

businesses with good lending prospects can access finance, is also key. Since their rescue, banks have remained overly focused on building capital buffers and the protracted period of banking uncertainty, which seems likely to continue for at least another few months, has played a key part in keeping Ireland's levels of investment at around 10% of GDP – considerably below normal levels and hardly sufficient to replace existing capital stock. Greater availability of credit would fuel overdue domestic economy investment and recovery.

New tax incentives for property development are bound to be suggested as a method of further encouraging activity and recovery in the housing sector. In that regard we note the review of tax expenditures by the 2009 Commission on Taxation and its conclusion that previous schemes raised issues of effectiveness, deadweight and adverse equity and that it was “reluctant to recommend them as appropriate policy instruments”. However, as a return to normal conditions is awaited for the housing market, there does seem to be merit in Government investing in a new social housing programme which would simultaneously address the aforementioned waiting lists and in the short-term boost activity, output and employment in the housing sector. Structured on a commercial basis, and perhaps drawing on some of the funds available from the new Ireland Strategic Investment Fund and other sources such as pension funds, a plan to build 20,000 additional units over 4 years seems feasible. These units would be in addition to the 4,500 units that NAMA has committed to provide. Based on Department of Finance job multiplier estimates, such a scheme would create approximately 16,000 jobs in the sector (4,000 per annum over each of the 4 years). An investment of this magnitude would move Ireland closer to the average level of public investment as a percentage of GDP in the EU. As that programme winds down, the broader housing sector should be in a better place to absorb these workers and maintain its return towards more normal levels of activity and employment.

### A new era for housing policy

Given Ireland's recent economic history, recovery must not mean a return to the ways of the past. As a society we cannot afford to repeat the housing boom experience. The scars of high housing debt and excessive commuting remain for many families while more generally the economy has been scarred by reduced activity, unemployment and a ballooning of the national debt which has climbed from 25% to 125% of GDP.

A new era for housing policy is required. It must be one where there are no more massive increase in house prices – these should more or less track inflation and give a return to their owners in terms of accommodation, or sustainable flows of income to landlords, rather than large capital gains. New policy tools, such as the residential property tax or reforms to the exemption of capital gains on principal private residences, should be used if needed. Overall, policy needs to recognise the dangers of a repeat of history and aim for a stable and unexciting property market which serves the sole function of providing accommodation.

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An earlier version of this paper was published in the Chartered Institute of Housing Journal *Housing Ireland* (Spring 2012). A subsequent *inBrief* will develop points around investing in social housing.

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