

Housing and National Competitiveness

A Report for the National
Competitiveness Council

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Anthony Murphy
Department of Economics
University College Dublin

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Executive Summary

1. Irish House Prices

(a) Background

Ireland's booming housing market has attracted and continues to attract a considerable amount of attention, both domestically and internationally. Irish house prices are extremely high by historic and international standards, both in absolute terms and relative to incomes. The strength and duration of the house price boom is unique. Many other countries and regions have experienced large house price booms. However, at least in the 1980's and early 1990's, most of these booms have ended in a house price bust.

(b) Some Adverse Consequences

The house price boom has adverse macroeconomic and microeconomic consequences. At the macroeconomic level, the boom in house prices has driven household consumption and borrowing. Financial liberalization, equity withdrawal and the increased fungibility / spendability of housing wealth have grown hand in hand. Many commentators worry that, as a result, the economy has become more vulnerable to adverse shocks.

The direct effect of house prices on consumer prices is small. The indirect effect of high house prices on earnings is larger but has not been studied in Ireland. A great deal of research on this topic has been carried out in the UK. High house price clearly have knock on effects on wages and current and future competitiveness. No one disputes the fact that Ireland has become an expensive place to live and work.

At the microeconomic level, the very generous tax treatment of housing encourages over-investment in housing and generates large efficiency losses. The

housing boom has also redistributed resources from the young, who generally do not own property, to the old who do own property and from the less well off to the better off, especially land owners and developers. Affordability of houses has been a problem for almost a decade. Housing waiting lists have risen. For many individuals and households, getting a foothold on the housing ladder has become increasingly unlikely. The house price boom has discouraged mobility both within Ireland and internationally. The high level of Irish house prices deters many skilled migrants and return migrants. While many have gained from the house price boom, a great many have also lost out, either directly or indirectly.

(c) Housing Supply

The supply of new houses has continued to rise both nationally, and in the Greater Dublin Area, as infrastructure deficits have been rectified, more land is zoned and serviced and higher residential densities kick in. New house completions have reached historical highs, almost 70 thousand in 2003 versus an estimated long run requirement of 45 to 50 thousand houses per annum. New house completions are forecast to reach 83 thousand units this year. By comparison, about 185 thousand new houses were completed in the UK in 2003, a country whose population is 15 times larger than Ireland's.

The effective supply of new homes is somewhat less since some of these new house completions are holiday and/or second homes. Holiday and second homes raise housing demand but do little or nothing to increase the effective housing stock or supply. As a result, they drive up house prices.

(d) House Prices and Rents

Surprisingly, house prices have continued to rise both in nominal and real terms and also relative to incomes. Unfortunately, government fiscal policy has almost as often raised demand as reduced demand, thus contributing to the rise in house prices. Private sector rents have fallen in real and nominal terms. Rents have

also fallen relative to house prices. In the medium to long run, these disparate trends cannot continue.

(e) Supply of Zoned and Serviced Land

Official figures suggest that sufficient zoned and serviced land is available nationally, as well as in the Greater Dublin Area. For example, last year 12.8 thousand hectares were zoned and serviced nationally which, under reasonable density assumptions, would accommodate almost 370 thousand housing units, or approximately 28% of the permanent housing stock in 2003. This is a more than adequate supply, given the current high levels of completions and the likely requirement for 45 to 50 thousand new homes in the next decade or so. The increase in supply in Dublin is particularly impressive.

The data suggest that policies aimed at increasing the supply of zoned and serviced land - higher densities, the Department of Environment Heritage and Local Government's strategic land initiative designed to service land, some re-zoning etc. - have been successful. Of course, there is a substantial time lag between servicing land and new houses being completed. The figures also suggest that the planning system has been quite responsive to market forces.

(f) The Future Outlook

Given the strong supply response, as well as the econometric evidence that housing demand is above fundamental or long run values, real house prices and the ratio of house prices to income are likely to fall back in the medium term. Of course, many commentators dispute the fact that house prices are above fundamental values.

However, there is no disputing the fact that affordability will continue to be an problem for many households, especially those privately renting or that there is an ongoing need for more social and affordable housing. The focus of housing policy

needs to be broadened and more tenure neutral policies are required.

2. Affordability

As a result of low interest rates and rising incomes, the affordability of mortgage repayments has stabilised in past couple of years. However there is an affordability gap for many individuals or couples who would like to purchase their own home. Many people on moderate incomes have difficulty saving up the deposit. Affordability is also a major problem for many, who by choice or necessity, end up as private renters.

3. Explaining Irish House Prices

The standard or textbook model of the housing market is a useful framework to use when explaining the boom in Irish house prices. The demand for housing has both consumption and investment components. The demand for housing depends upon real incomes, the user cost of housing and demographics inter alia. The user cost of housing, which has been highly negative in the past decade, depends upon the real mortgage interest rate, taxes and expected capital gains.

Continually rising demand and sluggish supply explain the boom in Irish house prices. Housing supply is responsive to higher house prices. However, since supply reacts with quite long lags and speculative frenzy adds to demand, house prices tend to overshoot their long run / fundamental values in the short to medium term.

There is some confusion over which factors determine fundamental values. The evidence suggests that Irish house prices are some way above their fundamental values. Over time, house prices should revert to their fundamental values given the record levels of supply in recent years.

4. Land Prices

In the short run, house prices drive land prices. In the medium to long run, a greater supply of zoned and serviced housing land will reduce house prices, other things being equal. The limited available evidence suggest that neither a lack of zoned and serviced land nor planning delays fully account for the poor response in the supply of new houses in Dublin during the housing boom. Land hoarding and slow build-out rates are probably important factors explaining the trickle out of new housing.

5. Planning Restrictions, Land Prices and House Prices

Land use planning generates significant benefits and costs. The international literature shows that the costs of restrictive planning include higher house and land prices, reduced housing supply, increased densities and reduced choice. Infrastructure delays have similar effects in the short to medium term.

6. The Planning System in Ireland

The planning system in Ireland has become more become more complex with more layers and competing objectives. In many ways it resembles that in the UK. However, the Irish system is far more flexible and responsive, especially in relation to housing. Unfortunately, it is not clear that the resources available to the planners have risen in line with the demands on the system.

The planning authorities appear to have zoned sufficient housing land and the DoEHLG guidelines on residential housing densities are taking effect. The incidence of planning delays has fallen in the past few years. Some planning delays are inevitable, especially when dealing with large developments. On balance, a somewhat slow planning system may be better than having to live with bad planning decisions.

7. Infrastructure Deficits and Delays

Much of the house price boom can be attributed to deficits in infrastructure rather than to binding planning restrictions. Many of the infrastructure deficits have been addressed. The serviced land and other initiatives of the Department of Environment, Heritage and Local Government have worked well.

A lot of money has been spent on roads and public transport but it is not clear that the public is getting value for money. Planning delays and the high cost of land are only part of the problem. The suggestions of the All Party Oireachtas Committee on the Constitution (2003) for avoiding unnecessary delays in key infrastructure projects should be adopted.

8. Private Renting, Social and Affordable Housing

Housing policy in Ireland appears to be focused on maximizing the level of owner occupation. This is not the optimal policy. More tenure neutral housing policies are required.

The range of schemes designed to help local authority and other tenants buy their own homes need to be rationalized. The role of the social housing sector needs to be reviewed. Details of all Part V agreements should be published and the allocation of all new social and affordable made more transparent.

The recent changes to the rent supplement scheme are restrictive and constrain the choices that households can make. It is not at all obvious that the new measures are superior to some form of tenure neutral housing benefit.

9. Taxation of Housing and Development Land

Overall the favourable tax treatment of housing has added to rather than reduced housing demand and contributed to the house price boom. From the economic point of view, the fiscal treatment of housing is inconsistent and has large

efficiency costs, including overinvestment in housing. The system should move away from taxing housing flows to taxing the housing stock, thereby reducing housing demand and house prices.

Overall the favorable tax treatment of housing has added to rather than reduced housing demand and contributed to the house price boom. From the economic point of view, the fiscal treatment of housing is inconsistent and has large efficiency costs, including overinvestment in housing. The system should move away from taxing housing flows to taxing the housing stock, thereby reducing housing demand and house prices.

Unnecessary tinkering with stamp duty rates etc. should be avoided. Very often, well intended policies have had unforeseen, negative effects elsewhere. In many cases, the less well off were those adversely affected.

Section 23 type reliefs for residential property add to demand and have large deadweight and displacement effects. The current rate of CGT on development land is very low and should be reviewed. Some form of site value taxation would reduce land hoarding. There are good social and economics reasons for wanting to capture a greater share of planning gains for the public. However, proposals for capturing part of the planning gain need to be considered carefully, to ensure that they are fair and cannot be manipulated.

1. Irish House Prices - Background, Recent Trends and Some Consequences

1.1 Introduction

Ireland's booming housing market has attracted and continues to attract a considerable amount of attention, both domestically and internationally. Irish house prices are extremely high by historic and international standards, both in absolute terms and relative to incomes. The strength and duration of the house price boom is unique. Many other countries and regions have experienced large house price booms. However, most booms have not lasted as long and, at least in the 1980's and early 1990's, most of these booms have ended in a house price bust (IMF 2001, 2003).

1.2 Some Adverse Consequences of the House Price Boom

The house price boom has both macroeconomic and microeconomic consequences. At the macroeconomic level, the boom in house prices has driven household consumption and borrowing. Financial liberalization, equity withdrawal and the increased fungibility / spendability of housing wealth have grown hand in hand. Many commentators worry that, as a result, the economy has become more vulnerable to adverse shocks.

The direct effect of house prices on consumer prices is relatively small and slow acting¹. For example, suppose that, for whatever reason, house prices since 2000 were 5 percentage points lower than they actually were. Then the CPI measure of mortgage interest payments would be approximately $\frac{3}{4}$ of a percentage

¹The direct effect of house prices on consumer prices feeds into the consumer price index or CPI via mortgage interest repayments on an simple average of current and past outstanding mortgages over the past 20 years. The direct effect of changes in mortgage interest rates on the CPI is larger and much quicker acting.

point lower in 2000, 1½ percentage points lower in 2001, 2 percentage points in 2002 and 2½ percentage points lower in 2003. Since the share/weight of mortgage payments in the CPI is only 4.6%, the effect on the CPI is very small. Of course, the CPI is not designed to measure the costs of living of first time buyers or potential immigrants.

The indirect of high house prices on earnings is undoubtedly larger but, as far as the author is aware, has not been studied in Ireland. The unions raise the issue of high house prices in the social partnership talks. High house price clearly have knock on effects on wages and current and future competitiveness. Ireland has become an expensive place to live and work.

A number of studies have examined the effect of house prices on earnings in the UK. Bover et. al. (1989) examined the interrelationship between housing, wages and UK labour markets. They identified five possible housing market channels of influence on national wages and unemployment:

- The first is the effect of housing tenure on mobility rates which, *ceteris paribus*, are highest for private renters and lowest for those in public housing, whilst owner occupiers have intermediate mobility rates².
- The second is the cost of living effect on workers already in the region and also on potential immigrants from house prices. This can generate temporarily high labour market mismatch as a result of temporarily high regional house price/earnings differentials.
- The third is the cost of location effect from land prices on firms already in the region and also on potential movers.
- The fourth is a wealth effect on spending.
- The fifth is an expectations effect that future earnings may be capitalized in house and land prices.

Higher house prices generate upward pressure on wages and prices via

² See Hughes (1981), Hughes and McCormick (1987,2000), and McCormick (1983,1997) *inter alia*. The ranking of mobility rates by tenure is similar in Ireland.

channels two to five. *A priori*, there is no particular reason to believe that higher house prices do not have the same effects in Ireland.

Bover et. al. (1989) find that lagged house price / earnings ratios and regional differentials in this ratio are significant determinants of the deviation of real wages from trend productivity. Blackaby and Manning (1992) and Cameron and Muellbauer (2001) both find that regional house prices are important determinants of regional earnings in the UK. Bell et. al. (2002) also looked at regional wages in the UK and found a significant, positive, long-run relationship between real wages, unemployment and real house prices consistent with a zero migration condition.

At the microeconomic level, the boom has had a great many effects.

- The very generous tax treatment of housing encourages over-investment in housing and generates large static (at a point in time) and dynamic (inter-temporal or over time) efficiency losses. This tax expenditure could be better spent elsewhere.
- The housing boom has had large redistributive effects. Resources have been redistributed - from the young, who generally do not own property, to the old who do own property and from the less well off to the better off, especially land owners and developers.
- Affordability of houses has been a problem for almost a decade. Housing waiting lists have risen. For many individuals and households, getting a toehold on the housing ladder has become increasingly difficult and unlikely.
- The house price boom has discouraged mobility both within Ireland and internationally. The high level of Irish house prices deters many skilled migrants and return migrants³.

³ Duffy et. al. (2003) have examined the labour market effects of allowing net migration to Ireland depend on Irish house prices as well as relative real wages after tax. It reduces the elasticity of labour supply which, *ceteris paribus*, raises wages. This research is ongoing.

Muellbauer and Murphy (1988) looked at the effect of house prices on international migration to the UK and internal migration to London and the South East. High houses prices deterred migration. Jackman and Savouri (1992) and Cameron and Muellbauer (1998) both find that house prices have a significant direct effect on inter-regional migration flows in the UK. Oswald (1999) also emphasizes

While many have gained from the house price boom, a great many have also lost out, either directly or indirectly. It is not clear that the house price boom has resulted in an overall increase in welfare.

1.3 Recent Trends - New House Completions, House Prices and Private Sector Rents

The supply of new houses has continued to rise both nationally, and in the Greater Dublin Area, as infrastructure comes on stream, more land is zoned and serviced, and, higher densities kick in. New house completions have reached historical highs. Almost 70 thousand new homes were completed in 2003 versus an estimated long run requirement of 45 to 50 thousand houses per annum (Fitzgerald et. al., 2003; McCarty et. al., 2003). The long run requirement is based on the convergence of the Irish headship rate to the UK or average EU headship rate in the next decade or so. A third or more of the 45 to 50 thousand new houses are required in Dublin.

**Table 1.1
New House Completions**

Year	Dublin	Meath, Kildare and Wicklow	Ireland
1996	9446	4222	33725
1997	9325	4560	38842
1998	8957	5266	42349
1999	10035	5193	46512
2000	9405	6153	49812
2001	9605	6893	52606
2002	12623	8052	57695
2003	14399	8458	68819

Source: DoEHLG Housing Statistics Bulletin

the link between the housing market and the labour market via the low mobility of owner occupiers.

New house completions are forecast to reach 83 thousand units this year (DKM, 2004). By comparison, about 185 thousand new houses were completed in the UK in 2003, a county whose population is 15 times larger than Ireland's. Table 1.2 sets out some comparative figures for EU countries.

— Table 1.2 Here —

Of course, the effective supply of new homes is somewhat less since some of these new house completions are holiday and/or second homes (Fitzgerald et. al. 2003; McCarty et. al. 2003 and NESCS, 2004). Holiday and second homes raise housing demand but do little or nothing to increase the effective housing stock or supply. As a results, they drive up house prices. McCarthy et al. (2003) suggest that 32 thousand of the 69 thousand new homes completed last year were replacement houses, holiday homes or second homes. A priori, these figures seem rather high.⁴

Surprisingly, (annual) house prices have continued to rise both in nominal and real terms and also relative to incomes. Unfortunately, government fiscal policy has almost as often raised demand as reduced demand, thus contributed to the rise in house prices (Murphy, 1998; Murphy and Brereton, 2001; Berry et. al., 2001; Ball RICS, 2004 and IMF, 2004b). By way of contrast, in the past few years private sector rents have fallen in real and nominal terms. Rents have also fallen relative to house prices. In the medium to long run, these disparate trends cannot continue. This is one of the reasons why DKM suggest that a correction in house price may be on the way in their review of the construction industry (DKM, 2004) published for the

⁴The new house completion data, which are based on ESB electricity supply connection data, overstate the number of new house completions. For example, the ESB data include farm connections (McCarty et. al., 2003). A priori, it is not obvious that the ratio of actual new house connections to recorded ESB connections should have changed in recent years.

However, the evidence suggests that the ratio of new house connections to recorded connections has fallen in recent years. For example, the increase in the number of households between the 1996 Census and 2002 Census is a good deal less than the recorded number of new house completions during this period. Better measures of new house starts and completions should be collected as a priority.

Department of Environment, Heritage and Local Government. In addition, zoned land continues to command a huge premium relative to unzoned agricultural land. Inevitably some developers complain about the cost of residential land (Williams et. al., 2003)

Table 1.3
New and Second Hand House Prices in Euros

Year	Dublin		Ireland	
	New	Second Hand	New	Second Hand
1996	97058 +12.0%	104431 +17.4%	87202 +11.1%	85629 +15.2%
1997	122036 +25.7%	131258 +25.7%	102222 +17.2%	102712 +20.0%
1998	160699 +31.7%	176420 +34.4%	125302 +22.6%	134529 +31.0%
1999	193526 +20.4%	210610 +19.4%	148521 +18.5%	163316 +21.4%
2000	221724 +14.6%	247039 +17.3%	169191 +13.9%	190550 +16.7%
2001	243095 +9.6%	267939 +8.5%	182863 +8.1%	206117 +8.2%
2002	256109 +5.4%	297424 +11.0%	198087 +8.3%	227799 +10.5%
2003	291646 +13.9%	355451 +19.5%	224567 +13.4%	264898
Ave Inflation 1996-2003				
Nominal House Prices	17.0%	19.1%	14.5%	17.5%
Real House Prices	13.2%	15.2%	10.7%	13.6%
Real Per Capita PDI	7.8%			
Real Per Household PDI	7.3%			

Source: DoEHLG Housing Statistic Bulletins and CSO

Notes: PDI is personal disposable income.

Table 1.4 shows house price inflation in various countries between 1997 and 2004. Over this period, Ireland had the highest rate of house price inflation at 181% followed by South Africa (168%), Britain (132%) and Spain (125%). House price

inflation in the rest of Europe was much lower.

Table 1.4
House Price Inflation
The Economist's House Price Indices

	Year to 2004 Q2	1997- 2004		Year to 2004 Q2	1997- 2004
Spain	17.2	168	Hong Kong	28.7	-55
France	14.5	68	South Africa	25.5	168
United Kingdom	13.8	132	New Zealand	22.1	51
Ireland	11.1	181	Australia	10.9	110
Italy	10.8	62	China	10.4	na
Sweden	10	77	United States	9.4	57
Belgium	8.2	50	Canada	7.3	42
Denmark	5	44	Singapore	-0.8	na
Netherlands	3.9	74	Japan	-6.4	-24
Switzerland	2.1	11			
Germany	-1.7	-3			

Source: The Economist (2004), "The Sun Also Sets", 9th September.

1.4 The Supply of Zoned and Serviced Land

For a number of years the Department of Environment Heritage and Local Government (DoEHLG) has collected and published details of the amount of zoned and serviced housing land in each county and city council area. Serviced land refers to land that has "the necessary water, sewerage, transport and other services required to bring the land into development and sufficient for planning permission to be granted and construction to commence".

The most recent published housing land availability figures for the end of June 2003 suggest that sufficient zoned and serviced land is available nationally, as well as in Dublin and the rest of the Greater Dublin Area (Dublin plus Meath, Kildare and Wicklow). For example, the amount of zoned and serviced housing land in June 2003 stood at 12.8 thousand hectares. This land would, under reasonable density

assumptions, accommodate almost 370 thousand housing units, or approximately 28% of the permanent housing stock in 2003. This is a more than adequate supply, given the current high levels of completions and the likely requirement for 45 to 50 thousand new homes in the next decade or so. The increase in supply in Dublin is particularly impressive.

**Table 1.5
Zoned and Serviced Land
Potential Housing Units**

	Dublin	Meath, Kildare Wicklow	Cork	Galway	Limerick	Waterford	Ireland
Jan 1998	38907	-	-	-	-	-	-
Dec 1999	41461	27740	37332	15376	20907	4760	-
June 2000	67017	28742	36669	16391	18664	4436	-
June 2001	91390	30072	-	16706	14104	7300	-
June 2002	96700	26661	37358	15996	19420	15083	327784
June 2003	118187	20910	35128	13962	13962	6558	368705
2003 House Completions	14394	8458	7378	5475	2985	2167	68819

Source: Bacon et. al. (1998), Bacon and McCabe(2000) and DoEHLG Housing Statistics Bulletin

The data suggest that policies aimed at increasing the supply of zoned and serviced land - higher densities, the DoEHLG's strategic land initiative designed to service land, some re-zoning etc. - have been successful. Of course, there is a substantial time lag between servicing land and new houses being completed. The boom in Irish house prices in the late 1990's was almost inevitable given the (largely unanticipated) strength of pent-up demand and the rather sluggish response of supply, in the form of new house completions.

The evidence suggests that Dublin house prices lead national house prices so it is worthwhile looking at the Dublin figures in more detail (Osborne, 2003; Stephenson, 2003a). The amount of zoned and serviced land in Dublin rose from 1,828 ha in 2000 to 2,555 ha in 2003. The corresponding number of potential housing units rose from 91 to 118 thousand units. Of course, the permission status of these units varies. Between 2000 and 2003 the numbers of housing units in

Dublin with full planning permission rose from 17½ to 40 thousand units. The corresponding figures for units awaiting local authority decisions are 6¾ and 5¼ thousand units; on appeal to An Bord Pleanála, 4¼ and 7¾ thousand units and in pre-planning discussions with local authorities, 31¾ and 20½ thousand units. These figures suggest that the planning system has been quite responsive to market forces.

1.5 The Outlook for House Prices

Given the strong supply response in the past few years, as well as the econometric evidence that housing demand is above fundamental or long run values, real house prices and the ratio of house prices to income are likely to fall back in the medium term. Of course, many commentators dispute the fact that house prices are above fundamental values.

However, there is no disputing the fact that affordability will continue to be an problem for many households, especially those privately renting, or that there is an ongoing need for more social and affordable housing. The focus of housing policy needs to be broadened and more tenure neutral policies are required.

The fiscal treatment of housing also adds to demand. If the system moved away from taxing housing flows to taxing the housing stock and if unnecessary tax reliefs were eliminated, house prices would be even lower.

Table 1.2
Housing Stock and House Building in European Union 2002

Country	Population (000's)	Population Density (per km ²)	Dwelling Stock				Dwelling Completions	
			Total (000's)	Per 1000 Population	Average Household Size	% Owner Occupied	Total (000's)	Per 1000 Population
Austria*	8110	97	3718 [^]	399	2.4	57%	55.4*	6.8*
Belgium	10310	338	4249 ⁺	415	2.4	68%	36.5	3.5
Denmark	5368	125	2523 ⁺	470	2.2	51%	17.1	3.2
Finland	5195	15	2544 ⁺	499	2.2	64%	27.2	5.2
France	59626	110	29495	503	2.4	56%	302.9	5.2
Germany	82537	231	30,986 ⁺	459	2.1	45%	289.6	3.6
Greece	10940	83	5,454 ⁺	505*	2.8*	34%	89.4*	8.2*
Ireland	3917	56	1337	341	2.9	79%	57.7	14.7
Italy*	57680	191	26,526 ⁺	460	2.6*	68% [#]	142.4*	2.5*
Luxembourg	444	172	176 ⁺	394	2.5	67%	1.6	3.7
Netherlands	16105	392	6711	417	2.3	54%	66.7	4.1
Portugal	10407	113	3313	495	2.8*	75%	105.6	10.2
Spain	41838	83	20,823 ⁺	510	3	74%	426.7	10.2
Sweden	8941	21	4,308 ⁺	484	2	46%	19.9	2.2
United Kingdom	59208	244	25,390 ⁺	430	2.3	69%	183.1	3.1

Source: Housing Statistics in the European Union 2003.

Notes: See the notes to the tables in Housing Statistics in European Union 2003. The superscripts * refer to 2000 data, ⁺ to 2001 data, [^] to 1999 data and [#] to 1995 data.

2. Affordability

2.1 Affordability and Housing Policy

The provision of affordable housing, across all tenure types, is the stated objective of Irish housing policy. According to the Department of the Environment, Heritage and Local Government (DoEHLG), the aim is “to enable every household to have available an affordable dwelling of good quality, suited to its needs, in a good environment and, as far as possible, at the tenure of its choice”.

2.2 Measuring Housing Affordability

A crucial aspect of measuring the success or failure of policy is measuring affordability. Affordability has many dimensions, some of which are hard to measure. There is no single, agreed upon national or international definition of what constitutes affordable housing.⁵ See Bourassa (1996) Duffy (2004) and Fahey (2004) inter alia. Therefore it should come as no surprise that there are a great many measures of housing affordability.

Since no single measure of affordability captures the main aspects of affordability, it is important not to focus on one, favourable or unfavourable, measure of affordability, generally the ratio of net mortgage repayments to disposable income or the ratio of house prices to average earnings. Unfortunately, many commentators on the Irish housing market do just that.

⁵ Fahey (2004) notes that the tenure neutral notion of affordability in the 1988 Housing Act conflicts with pro owner occupier notion of the 2000 Planning and Development Act. The concept of social housing need in the Housing Act, which refers to people “not reasonably able to meet the cost of accommodation which they are occupying or to obtain suitable alternative accommodation”, is tenure neutral. However, affordable housing in the Planning and Development Act is for people needing accommodation who otherwise would have to pay over 35% of net income on mortgage repayments.

2.3 Various Types of Affordability Measures

Some affordability measures are direct; others are indirect. Some measures apply to all tenure groups - owner occupiers, private renters and social (local authority and voluntary sector) renters. Other, more common, measures are only applicable to owner occupiers buying a house with a mortgage. In turn, these measures may be split into those which primarily focus on access to a mortgage and on ability to repay a mortgage.

Direct measures of affordability for owner occupiers and others include house price to income ratios, deposit to income ratios, mortgage or rent payments to income ratios and housing expenditure to total expenditure ratios. Indirect measures include the numbers homeless, the number of individuals or households on housing waiting lists, the self-reported difficulty of first time buyers in managing their mortgage payments and the incidence of mortgage arrears.

The available data for measuring affordability are not ideal. Many measures are based on aggregate data e.g. loan to value ratios are generally calculated using the ratio of average loan to the average house price rather than the average of the individual loan to value ratios. In other cases, the data are not as “clean” as they could be or not dis-aggregated enough. For example, the house price data currently produced by the DoEHLG are not mix-adjusted, include transactions which are not “at arms length” and remortgages, and not produced separately for first time buyers and other buyers.

(a) Affordability Measures for Owner Occupiers

Duffy (2004) shows that both average house price to income and deposit to income ratios have risen sharply since 1995, indicating that saving for a deposit has become more difficult, especially for those on low incomes. The (very limited) availability of affordable houses under Part V of the Planning and Development Act (PDA) as well as the current low interest rates and more relaxed lending criteria of mortgage providers clearly help potential borrowers somewhat, but the difficulty remains. A substantial number of potential first time buyers cannot afford the down-

payment on a new house.

In terms of ability to repay a mortgage, Duffy (2004) shows that the ratio of mortgage repayments to disposable income (based on aggregate data) rose rapidly between 1995 and 2001 or so, as house prices rose rapidly, but fell back a little since then as interest rates fell. The ratio is a little lower than during the early 1990's and a good deal lower than in early 1980's.

These aggregate results are confirmed in the Table 2.1 which updates the “typical” first time buyer examples in the various Bacon reports (Bacon et. al., 1998, Bacon and MacCabe, 1999 and 2000). The indices show the ratio of net mortgage repayments to disposable income for typical one and two earner households.

**Table 2.1
Affordability Indices**

Year	Net Mortgage Repayments as % of After Tax Income	
	One Earner Household	Two Earner Household
1996	33.8%	23.1%
1997	37.6%	26.0%
1998	43.3%	29.8%
1999	40.5%	28.0%
2000	44.6%	29.4%
2001	44.8%	29.5%
2002	41.6%	26.7%
2003	42.0%	27.1%

Source: Bacon and McCabe (2000) and own calculations.

Notes: Figures based on 90% mortgage.

In terms of the repayment burden, low interest rates, reduced direct taxation and rising incomes have offset the rise in house prices. The repayment burden figures are sensitive to the level of interest rates. A small rise in interest rates would hike up the burden dramatically, especially for those with mortgage debt to income ratios. See Table A in Kearns (2004) for example.

(b) Affordability Measures for All Tenure Groups

Fahey (2004) looks at direct and indirect measures of affordability across all tenure groups, including recent first time buyers. He examined the size distribution of monthly mortgage and rent payments by tenure type using data from the Housing and Households module of the CSO Quarterly National Household Survey for the third quarter of 2003. Even though rents have fallen in the private sector, “tenants in the private sector are more likely than recent first time buyers to pay large amounts for their housing” and “make up a disproportionately large share of those with high housing costs”. Less than 12% of first time buyers nationally, and 14% in Dublin, said that they found their mortgage payments difficult to handle. (Recent IIB Bank / ESRI Consumer Sentiment Surveys yield somewhat higher figures for recent first time buyers.)

Fahey (2004) points out that data from the 2001-2002 Irish National Survey of Housing Quality corroborate these findings. 28% of private tenants versus 11% of recent first time buyers spend more than one third of their net income on housing. In addition, 20% of private tenants versus 11% of first time buyers perceived housing costs to be a heavy burden. It is not the case that the tenants were better off than first time buyers. Using a non-monetary deprivation scale, Fahey (2004) shows that they were worse off on average⁶.

Using data from various HBS's, Fahey, Nolan and Maître (2004) examine the share of housing expenditure in reported total household expenditure by tenure group. The main change has been for private tenants where the share of expenditure on rents rose from 12½% in 1987 to 21% in 1999-2000. Fahey (2004) concludes that the real affordability problem is in the private rented sector.

(c) Mortgage Arrears

The Central Bank and Financial Services Authority of Ireland do not currently

⁶ Local authority tenants had even higher deprivation measures and more of them perceived housing to be heavy burden, even though their costs were much lower on average.

publish regular data on mortgage arrears. This gap should be rectified. Kearns (2004) contains a chart showing that, for the main lenders, the sum of commercial and residential mortgage arrears as a percentage of outstanding mortgages fell from just below 0.8% in 1995 to under 0.3% in 2001.

Kearns (2003, 2004) looks at the incidence of mortgage arrears in Ireland in the 1990's using data from two household surveys - the CSO Household Budget Surveys (HBS) in 1994/1995 and 1999/2000 and Eurostat's European Community Household Panel Survey (ECHP) data for years 1994 to 1998. The HBS collects data on outstanding mortgages and mortgage repayments while the ECHP collects data on mortgage repayment burdens and mortgage arrears. The HBS data suggest that the incidence of high mortgage repayment to disposable income ratios fell slightly between 1994/1995 and 1999/2000 for all mortgage holders but rose significantly for new mortgage holders. The ECHP data show that the incidence of mortgage arrears fell from over 9% in 1994 to under 5% in 1998 (as interest rates fell)⁷.

(d) Homelessness and Housing Waiting Lists

Finally, the most recent data for the number of homeless people and the number of households on housing waiting lists and homeless people are set out below. The rise in the numbers on housing waiting lists is clear evidence of the affordability gap faced by many.

⁷Kearns (2003) modelled the factors contributing to the incidence of mortgage arrears. Kearns (2004) combines these incidence estimates with estimates of the distribution of the mortgage debt across various types of households in order to estimate mortgage debt at risk from falling into arrears. He suggests that mortgage debt at risk fell from about 5.6% in 1994 to 5.0% in 1998.

Unfortunately, more recent data are not available to repeat his analysis and see if these conclusions are still valid. A priori, they may not hold since the financial debt has risen relative to household income.

Table 2.2
Homelessness and Housing Waiting Lists

Year	No of Homeless People	No of Households on Housing Waiting Lists
1993	2,172	28,626
1996	2,501	27,427
1999	5,224	39,176
2002	5,581	48,413

Source: Housing Statistic Bulletin. Department of Environment, Heritage and Local Government .

2.4 International Comparisons

The average house price to income ratio in Ireland is very high by international standards, as noted by the IMF (2000, 2003, 2004) and the Economist magazine (2003, 2004).

Table 2.3
House Price / Income Ratios in Various Countries
Ratio of House Prices to Disposable Income per Worker (1985 = 100)

Country	1970	1980	1990	2003
United States	100.34	113.36	107.14	113.66
Germany	129.41	114.45	94.81	79.71
France	122.75	124.70	118.64	124.56
Italy	na	134.72	129.89	130.66
Spain	146.83	127.32	198.92	288.78
Netherlands	136.69	151.42	111.43	243.14
Ireland	na	135.63	110.47	200.81
Japan	107.96	91.21	121.72	79.26
United Kingdom	97.21	108.58	137.00	155.83
Canada	112.51	124.23	138.47	155.54
Australia	107.31	101.00	122.90	183.12

Source: IMF, World Economic Outlook, September 2004. Table 2.1.

2.5 Summary

The various measures of affordability suggest three conclusions. The first is that, as a result of low interest rates and rising incomes, the affordability of mortgage repayments has stabilised in the past couple of years. The second is that there is an affordability gap for many individuals or couples who would like to purchase their own home. Many people on moderate incomes have difficulty saving up the deposit. The third is that affordability is a major problem for many, who by choice or necessity, end up as private renters.

3. Explaining Irish House Prices - Fundamental and Non-Fundamental Influences

3.1 Introduction

There is widespread agreement on the reasons for the boom in Irish house prices in the 1990's. For example, Bacon et. al. (1998) explain the boom in terms of rising demand - due to rising incomes, falling interest rates and a bulge in house buying population cohort, *inter alia* - and a sluggish supply response - partly associated with planning restrictions and a shortage of zoned and serviced land.

There is considerably less agreement about the reasons for the continuing strength of house prices and the outlook for house prices in the next few years. In particular, there is no consensus about the impact of fundamental and other, non-fundamental influences on house prices. This issue is important for policy. If house prices are above fundamentals, then we are likely to see some form of correction / return to fundamentals in any case, without any new policy initiatives.

3.2 Explaining House Prices

At the theoretical level, there is only one widely accepted, standard or textbook model of the aggregate housing market. This textbook two / three equation model is set out and analysed in a wide range of papers including Irvine (1984), Poterba (1984), Muth (1989), Muellbauer and Murphy (1997), Duffy (2002) and Duffy et. al. (2003), *inter alia*. Murphy (1998) using this model to estimate housing supply and demand equations in the first Bacon report (Bacon et. al. 1998). A formal version of the model is set out and discussed in the Appendix.

The model looks at the demand for and supply of housing services, which is assumed to be proportional to the stock of housing. You derive a flow of housing services from owning or renting a house. When you rent a house, you purchase these services for a specific period of time. Similarly, if you purchase a house, you are able to consume the entire future flow of services from the stock (house) as long

as you continue to own the house and the house is still standing. At the same time, you have to pay any costs associated with ownership such as maintenance, mortgage payments, property taxes etc. In addition, your capital is tied up in the house, so there is an opportunity cost associated with this. However, if house prices rise, you benefit from the capital gain. The user cost of housing variable, which picks up all of these effects, is discussed below.

— **Figure 3.1 Here** —

Although, the underlying model looks at the demand for and supply for housing services, it may be illustrated using supply and demand curves with house prices on the vertical axis and the housing stock on the horizontal axis. In the short-run supply of housing is relatively fixed so the supply curve is almost vertical. See Figure 3.1. The short run supply is inelastic (relatively unresponsive to price) since the stock of houses is largely given at a point in time. Increases in the demand for housing, as a result of rising incomes, employment, lower interest rates etc., shift the demand curve out. As a result, house prices have to rise sharply to match the relatively fixed supply of houses to the rising demand for housing.

— **Figure 3.2 Here** —

In the medium to long term, the supply of houses is fairly elastic (responsive to prices) since additional new houses will be constructed when prices rise. See Figure 3.2. This is represented by a flatter supply curve. The supply of new houses depends (positively) on the anticipated prices which they will fetch when sold and (negatively) on construction costs. In the medium term, following the rise in demand, the housing stock rises as new houses are completed so the supply of houses increases and prices fall back from their initial high.

This model, although simple, has some important implications which are relevant to Ireland. In the short run, house prices (measured relative to income, for example) tend to overshoot their long run values in a boom. This results holds even in the absence of any speculation or frenzy. In the short run, additional tax breaks, grants and subsidies to home buyers will mainly be capitalised in higher house

prices.

In the model, the relevant price of housing in the demand equation is the price of a house times the user cost of housing (expressed in terms of the price of a house) rather than, say, the price of a house or mortgage repayments. In its simplest form, the user cost of housing (expressed as a percentage of the price of a house) is:

$$(1) \quad \begin{array}{rcl} \% \text{ User Cost} & = & \% \text{ Tax Adjusted Mortgage Rate} \\ & + & \% \text{ Property Taxes} \\ & + & \% \text{ Maintenance} \\ & - & \% \text{ Expected Capital Gain.} \end{array}$$

The user cost of housing, probably the most important concept in housing economics, is the appropriate “price” of housing because housing is both an asset as well as a durable good yielding housing services.

Explanations of house prices that concentrate solely on house price to income ratios and measures of affordability (or demographics) are not that relevant. The view that there is some unique long-run house price to income ratio to which the economy returns, irrespective to what happens to interest rates etc., is a poor rule of thumb.

3.3 House Prices and the Capitalization of Taxes and Amenities

In an efficient market, the price of a house equals the present (discounted) value of the anticipated net rents i.e. the value of the service flow net of costs. The proper interest rate to use when discounting reflects the opportunity costs of funds, in terms of their use in alternative investment projects or in the production of present consumption, and includes a risk premium. If some news occurs which changes the value of present or future net rents, the news will be quickly “capitalized” into the price since:

$$(2) \quad p_h \approx r n_h / r$$

where p_h is the price of a house, m_h is the *net* rental (after maintenance costs and property taxes etc.) and r is the appropriate real interest rate for discounting the rental⁸.

Inter alia, this approach has been used to analyse the effect on new house prices of introducing the first time buyers grant in Ireland, (Irvine, 1984), the switch from domestic rates to the community charge in Scotland (Hughes, 1989), local taxes in Britain (Rosenthal, 1999), property taxes in California (Quang and Simons, 1994) and development impact fees in Florida (Ihlanfeldt and Shaughnessy, 2004). This approach could be used to estimate the likely effect on house prices of introducing some non-regressive form of property taxation in Ireland. All the evidence is that housing and land markets are efficient at capitalising taxes and the like.

This approach also illustrates the futility of policies that attempt to make housing more affordable by subsidising mortgage payments or increasing mortgage interest rate tax relief. The short term effect of these policies is simply to raise house prices. Well targeted subsidies might work better but even these will generate deadweight and efficiency losses. It is always possible to make some individuals better off at the expense of others.

3.4 Stocks and Flows

The standard model of the aggregate housing market focuses on the demand for and supply of housing services, which is assumed to be proportional to the housing stock. Many non-economists and some economists find this strange. They believe that one should focus on housing flows, especially the demand for and supply of new houses.

⁸The formula assumes that real rents and interest rates are approximately constant and that the house is held for a long time. The proper interest rate to use for discounting the rental is the rate that reflects the opportunity cost of the funds in terms of their use either in alternative investments projects or in the production of present consumption. The risk associated with the level of future rents is part of the opportunity costs.

However, behind the scenes as it were, the flow of new housing interacts with, and in equilibrium must accord with, the stock of housing services (Witte, 1963). To see how stocks and flows interact, consider the effect of a fall in the real interest rate. We use three diagrams. Figure 3.3(a) shows the demand and supply for the flow of housing services, Figure 3.3(b) shows the supply and demand for the stock of housing while Figure 3.3(c) shows the supply and demand for new houses. We assume that new and existing houses are perfect substitutes and that the housing market is in a steady state, so the output of new houses matches the number of houses being demolished etc.

— Figure 3.3 Here —

The supply curve in Figure 3.3(a) is drawn vertically since the housing stock is very large and does not change much in the short run. We assume that the supply and demand for housing services curves are largely unaffected by changes in the interest rate⁹. When the real interest rate falls, the present discounted value of the rental rises so the demand for the stock of houses rises. This shows up as an outward shift in the demand curve in Figure 3.3(b) from D_0^s to D_1^s . In the short run, this leads to a rise in the price of existing houses from P_{h0} to P_{h1} .

The fall in the interest rate also raises the demand for new houses. The demand curve for new houses in Figure 3.3(c) shifts out from D_0^n to D_1^n . New house prices also rise from P_{h0} to P_{h1} (since new and existing house prices are perfect substitutes) and more new houses are completed. The housing stock will begin to rise above its previous level, increasing the supply of housing services and thereby lowering rentals. In the long run, if the fall in the real interest rate is permanent, the new steady state stock of housing and supply of new houses will both be larger. In terms of the housing stock, the analysis is the same as that underlying Figures 3.1 and 3.2.

⁹ A fall in the real interest rate lowers the price of future consumption relative to present consumption. The mix of present consumption should be largely unaffected. Future consumption is now more highly valued. Therefore, any asset such as a house that generates future income is now more highly valued.

3.5 A Review of Some House Price Models - What They Say About Fundamentals and Recent House Price Movements

(a) Murphy (1998)

Murphy(1998) estimated the elasticities of housing supply and demand using data from annual data from 1974 to 1997. The econometric results suggested that:

- Most of the rises in Irish and Dublin house prices up to 1977 could be explained by “fundamentals” using the model outlined above.
- The key driving factors were rising incomes, rising employment, lower interest rates and a growing proportion of the population in the key house buying age group¹⁰.
- Housing supply responds with a long lag. These lags are consistent with the flowcharts of the time delays in the planning process set out in the report.
- Housing supply is far less elastic or responsive to prices in Dublin than elsewhere, probably as a result of operation of the planning / zoning system.

These results are consistent with prior expectations and the results for other countries, particularly the UK.

(b) Kenny (1999)

Kenny (1999) uses a cointegrating regression (vector error correction model) approach to model quarterly data from 1975 Q1 to 1997 Q1. The end of his data period precedes the recent boom in house prices. He identifies two long run

¹⁰ In the US the effect of demography on house prices has been controversial. See Mankiw and Weil (1989), Poterba (1991) and Green and Hendershott (1996).

equilibrium relationships which capture housing demand and supply:

$$\ln p_h = \ln y - \ln(\text{HS}/\text{pop}) - 0.084r$$

$$\ln p_h = \ln \text{BCL} + 0.340r$$

where p_h represents real house prices, HS/pop is the per capita housing stock, y is real aggregate GNP, r is the nominal mortgage interest rate, BCL is a composite measure of building costs including land and \ln denotes a natural log. Unfortunately, there are no comprehensive housing land price data in Ireland so the land prices are derived from the house price data on the basis of guess-estimates. Kenny explicitly excludes demographic variables from the model, suggesting that the use of aggregate, as opposed to per capita, GNP captures the relevant demographic effects.

The first equation may be interpreted as an approximate inverted demand equation. See equation (5) in the Appendix. However the imposed unit elasticities on income and the per capita housing stock are not consistent with the values found in the international literature. The second equation is a markup pricing equation. It is not really a supply equation since it does not explain new house completions, which are not included in Kenny's model. Some calculations suggest that current house prices are far higher than the long run or fundamental values implied by Kenny's inverted demand equation.

(c) Harmon and Hogan (2000)

Harmon and Hogan (2003) estimate an approximation to an inverted demand equation and a new house completions equation. The inverted demand equation explains house prices in terms of the housing stock, real incomes, mortgage interest rates and demographics. Unfortunately, the housing stock (quantity) is statistically insignificant in their demand equation so it is difficult to interpret it as a inverted demand equation. Their supply equation is standard.

Harmon and Hogan find some evidence of instability in the demand and

supply equations. Both the supply and demand elasticities appear to be falling in the mid to late 1990's. However, it is very difficult to reproduce their estimated equations.

(d) Murphy and Brereton (2001)

Murphy and Brereton (2001) update the estimated inverted demand and new house completions equations in Murphy (1998) using an extra three years annual data for 1997 to 1999. They also used the equations estimated over the period 1974 to 1996, when house prices were close to fundamental values, to forecast house prices and new house completions in the period 1997 to 1999. The forecast errors should capture deviations from fundamentals and the effects of policy interventions.

Murphy and Brereton (2001) concluded that the house price / inverted demand equation was rather unstable in the late 1990's. The house price equation under predicts demand. This may be due to mis-specification (omitted explanatory variables or lags etc.) or, more likely, be due to speculative frenzy etc. If speculative frenzy is the main reason why the demand equation under predicts, house prices appear to be 20% or so higher than fundamentals.

The new house completions / supply equations, which fit less well, are reasonably stable over time. The housing supply elasticities are somewhat lower than in Murphy (1998). Overall, the forecasting results suggested that government action to curb housing demand and increase housing supply had not yet taken effect in 1999.

Some further econometric research was carried out for this report. I re-estimated the demand and supply equations using data up to 2003 and obtained similar results to those in Brereton and Murphy (2001). The results continue to suggest that housing demand is 20% or more above fundamental values whilst new house completions / supply has responded to higher prices in much the same way as in the past. This is quite an achievement given that supply has reached record levels.

(e) International Monetary Fund (2003)

In an annex to their Ireland report (IMF, 2003), the IMF ask whether or not fundamentals can explain the growth in Irish house prices. They looked at house price to income and house price to rent ratios. They estimate what they term a “reduced form”, error correction model using income y , mortgage interest rates r and share of the population aged 25 to 34 pop_{2534} to explain house prices. Unfortunately, this equation is difficult to interpret. It is not a reduced form equation since it does not include the housing stock. As Means (2002) notes, this biases the estimated income elasticity downwards. Using annual data from 1977 to 2002, their long-run equilibrium relationship or cointegrating vector for house prices is:

$$\ln ph \propto 0.92 \ln y - 0.02r + 5.40 \text{ pop}_{2534}$$

The income elasticity is very low as predicted.

Based on the models results, the IMF suggest that actual house prices in 2002 were 16½% above their long run equilibrium values, but only 3% above the fitted value allowing for short run dynamics. However, if the model is estimated for the period 1976 to 1979, the implied deviation of house prices from their long run equilibrium value is over 50%. This result is clearly wrong and stems from their incorrect model for house prices. As a result, the IMF suggest that “no one can know the equilibrium value of an asset with any degree of certainty” and that

“In the case of Irish house prices, the empirical evidence suggests, that as long as the change in demand behaviour that seemed to have occurred in the late 1990's is permanent, the sustained rise is quite consistent with strong fundamentals.” (IMF,2003,p. 29)

Unfortunately, this statement is not very informative. It is almost a tautology since permanent rises in demand and strong fundamentals are one and the same thing!

(f) Stephenson (2003b)

Stephenson (2003b), *inter alia*, estimates two different housing demand equations for the period 1978 to 2001. One equation (Model I) is an inverted demand equation. This equation is similar to the demand equations in Murphy (1998) and Murphy and Brereton (2001). Stephenson adds employment and consumer confidence to the list of explanatory variables and uses population rather than the proportion of the population aged 26-34 as his demographic variable. The other equation (Model II) is an ad hoc equation, since the housing stock is incorrectly signed and insignificant. Chow tests suggest that both equations are somewhat unstable.

To see whether fundamentals explain house prices over the period 1996 to 2001, Stephenson (2003b) generates the one period ahead forecast errors from a series of rolling regressions. He initially estimates a regression for the period 1978 to 1995, then he estimates a regression for 1979 to 1996 and so on. Stephenson suggests that the one period ahead forecasts represent fundamentals or long run equilibrium values and, therefore, the forecast errors are capturing deviations from fundamentals due to speculation, frenzy etc. In the case of Model II, but not Model I, the one period ahead forecast errors are small which, according to Stephenson, suggests that house prices in the period 1996 to 2001 were close to fundamentals.

However, there is no necessary correspondence between the predictions of a rolling regression and fundamental values. Moreover, it is very difficult to interpret an ad hoc model (Model II) in terms of fundamental and other factors. Finally, a model with a lagged dependent variable (Model II) will almost always forecast better than a model without one (Model I), when house prices are booming.

(g) Roche (2003)

In a series of papers, Roche (1999, 2001 and 2003) examines the likelihood of a crash in Irish and Dublin house prices. A similar approach is used in all three papers so we focus on the most recent one. Roche (2003) estimates a regime switching model of house prices. Special cases of this model are a fads model and a

partial collapsing (speculative) bubble model¹¹. Regime switching models can be difficult to estimate since the models are highly non-linear. Ideally, one should estimate the models using long runs of data.

The regime switching model is estimated in two stage. In the first stage, the non-fundamental component of house prices is estimated. In the second stage, the actual regime switching model is estimated using last period's estimated non-fundamental prices as the only explanatory variable explaining the change in house prices this period. This means that the regime switching model results are crucially dependent on the model used to estimate the fundamental and non-fundamental components of house prices. If the first stage, estimated, non-fundamental component of house prices is small, then the chances of finding a fad or speculative bubble in the second stage are low.

Roche (2003) uses quarterly data from 1979 Q1 to 2003 Q1 to estimate a "reduced form" model for new house prices. House prices are regressed on a trend, supply side factors (building costs and land costs) and demand side factors (net immigration, the average mortgage, the user cost and per capita disposable income). The net immigration and average mortgage variables capture demographic and financial liberalization effects.

The model is an ad-hoc one rather than a reduced form model since land costs, the average mortgage and user costs are all endogenous variables. Residential land prices, house prices and the average mortgage loan are clearly driven by much the same factors. For example, the average new house price and average mortgage loan are cointegrated at the annual frequency i.e. they move together over time. In addition, the land price data are very poor¹².

¹¹ In both the fads and collapsing bubbles models, houses prices may systematically differ from fundamentals over a number of years. In the fads model, the non-fundamental component of house prices is mean reverting. However, in the collapsing bubbles market, there is a period when the non-fundamental or speculative component of house prices grows along with the probability of a collapse in this component.

¹²As noted above, the land price data, which come from the Construction Industry Review and Outlook prepared for the Department of Environment, Heritage

At a theoretical level, there are problems with using the model to estimate the non-fundamental component in Irish house prices. Suppose house prices are over valued and rising because of a speculative bubble. This will generate rising land prices, rising average mortgage loans and lower user costs. Therefore, the chances of picking up this speculative bubble by regressing house prices on land prices, the average mortgage loan and user costs are very slim.

In view of this, it is not surprising that Roche's estimated house price equation fits the data well. For example, the difference between the (higher) actual and (lower) estimated house prices in 2002 is only 4.6%. Roche (2003) suggests that this 4.6% figure is an appropriate measure of the over-valuation of Irish house prices in 2002. However, for the reasons given above, this is not the case. Roche's choice of explanatory variables in the house price equation will invariably suggest that house prices are close to their fundamental values, even if they are not.

(h) Central Bank and Financial Services Authority of Ireland (2004) and McQuinn (2004)

In Section 2 of the recently published Financial Stability Report 2004, the Central Bank and Financial Services Authority of Ireland (CBFSAI) examined fundamental and non fundamental influences on Irish house prices. Inter alia, they looked at the house price to rents ratio and the discounted house price to rents ratio (CBFSAI, 2004, p. 56 to 59). The former ratio suggests that house prices are overvalued by about 63%. This an excessive figure. In an efficient market, house prices are approximately equal to the discounted present value of net rents See equation (2) above. Since interest rates are much lower now than in the past, the ratio of house prices to rents should be higher now. After the change in interest rates is taken account of, the discounted house price to rent ratio suggest that house prices are overvalued by about 30%.

At this point, the CBFSAI appear to backtrack from this finding. They suggest that:

and Local Government, are guess-estimates based on the published house price data.

“... [T]he real interest rate that is relevant here is not the economy-wide interest rate but rather the own rate of interest in the housing market. This is the nominal mortgage rate less the expected house price inflation rate. In Ireland house price inflation has been well in excess of overall inflation over the past 10 years. Since this is almost certainly the case for their respective expected values, it follows that the own real rate of interest for the housing market has been much lower than the (already very low) real interest rate of interest for the overall economy.”

This “bootstrap” type argument is flawed and does not appear in the finance literature. With uncertainty, it is true that the appropriate discount rate is a risk adjusted interest rate, which is higher than the risk free interest rate, but the adjustment is not equal to difference between expected house price inflation and general inflation.¹³

The CBFSAI then consider a range of supply and demand factors that influence fundamental house prices. The analysis is based largely on McQuinn (2004a, 2004b) so we focus on that paper. McQuinn (2004b) uses a cointegrating regression approach and quarterly data from 1980 Q1 to 2002 Q4 to estimate long run housing supply (completions) and demand (house price) equations. He estimates two versions of an inverted housing demand equation, since the housing stocks is one of the explanatory variables. The other explanatory variables include income, the rental/user cost or real interest rate, net migration and the average mortgage loan. McCain follows Roche (2003) in using net migration as his demographic variable and the average mortgage loan as a proxy for financial liberalization.

The inclusion of the average mortgage loan as an explanatory variable creates problems, as discussed already when reviewing Roche (2003). Firstly, the average mortgage loan is not independent of house prices. Secondly, the results of

¹³ Since house prices, rents and consumption are generally positively correlated, the risk adjustment is likely to be negative. Thus, the price of a house should be lower than the discounted present value of the net rentals using the risk free real interest rate. See Cochrane (2000, p.15-16).

estimating the housing demand equation including the average mortgage loan as an explanatory variable is extremely unlikely to tell you whether or not house prices are overvalued relative to fundamentals. Thirdly, the estimated demand elasticities of house prices with respect to income and the housing stock (approximately $-\frac{1}{2}$ and $\frac{1}{4}$) are orders of magnitude lower than the consensus estimates in the international literature¹⁴. As a result, it is not obvious that the estimated house prices equations in McCain (2004b) represent inverted demand equations and their interpretation

¹⁴ The results in Tables 1 or 3 and Table 4 of McCain (2004b) are also surprisingly different. A priori, they should be similar.

house prices tend to overshoot their long run / fundamental values in the short to medium term.

There is some confusion over which factors determine fundamental values. The evidence suggests that Irish house prices are some way above their fundamental values. Over time, house prices should revert to their fundamental values given the record levels of supply in recent years.

Figure 3.1: Short Run Equilibrium - Effect of a Rise in Demand

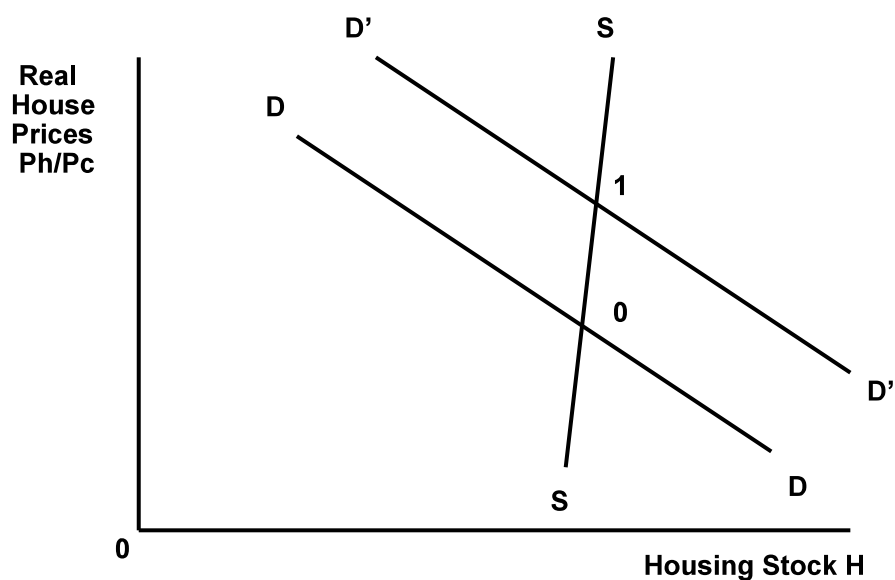


Figure 3.2 : Long Run Equilibrium - Effect of a Rise in Demand

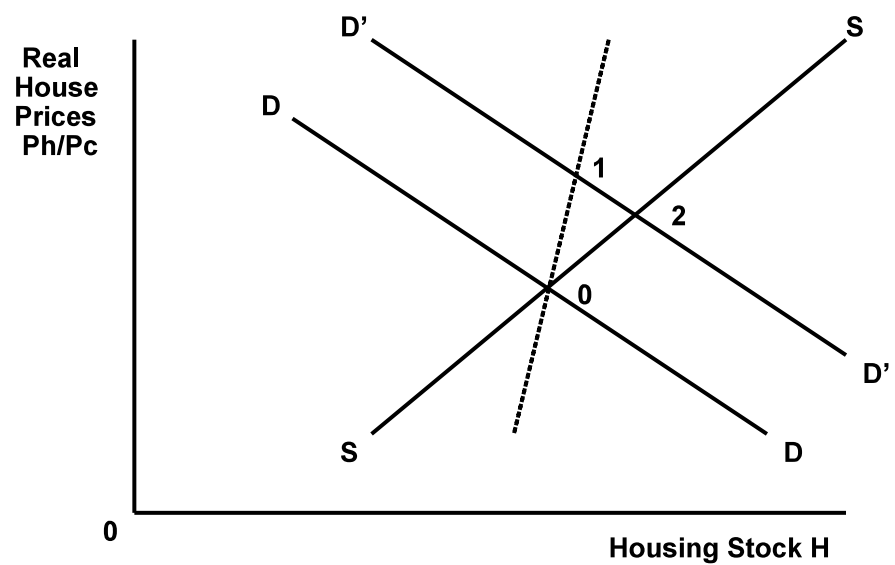
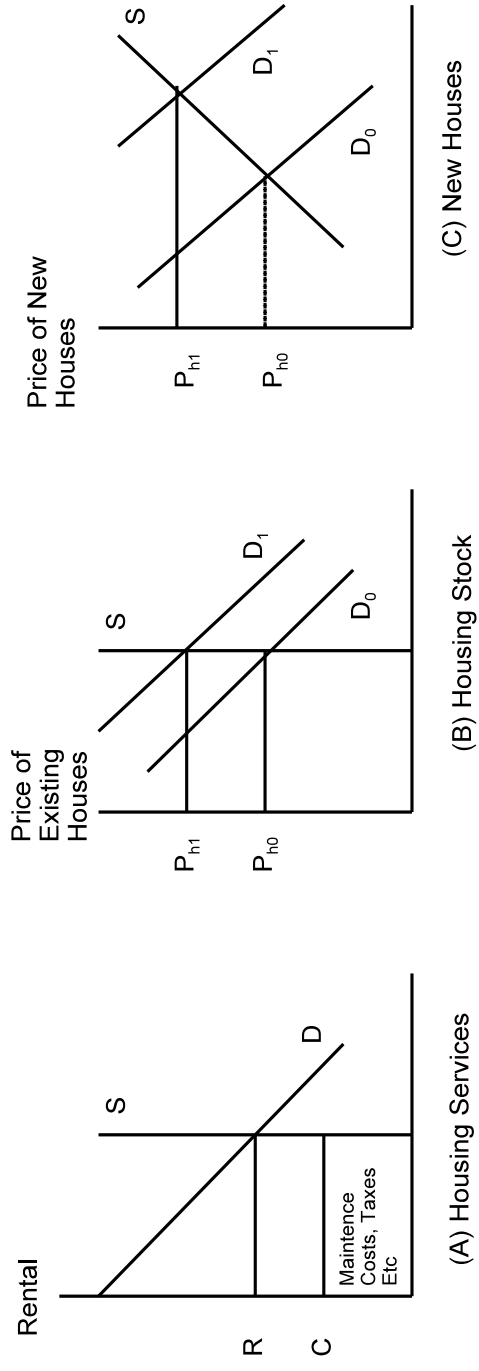


Figure 3.3 - Housing Stocks And Flows



Appendix - A Model of the House Prices

(a) Outline of Standard Model

The standard, textbook model of the housing market consists of three equations:

- A demand equation which, given the housing stock, real incomes, interest rates etc. largely determines house prices in the short run;
- A supply equation which determines the supply of new houses (new house completions) in the short run;
- An equation showing how the stock of houses changes over time as new houses are completed.

This model, or versions of it, have been employed by Buckley and Ermisch (1982), Irvine (1984), Mankiw and Weil (1989), Meen (1990, 1996 and 2000), Muellbauer and Murphy (1997), Murphy (1998), Muth (1989) and Poterba (1984, 1991) inter alia.

The model is concerned with explaining the demand for and supply of housing services, which are assumed proportional to the housing stock. House prices are derived from the demand for housing services by inverting and rearranging the demand equation, so that the dependent variable is house prices as opposed to the quantity of housing services.

(b) Modelling House Prices

In the international literature, especially the UK literature, most estimated house price equations are best viewed as an actual, or approximate, inverted housing demand equations (see equations (4) and (5) below). The advantages of using this approach that your findings may be compared with and evaluated using widely accepted, international research findings in the literature. The international findings provide one with strong priors for the size of various elasticities such as the price and income elasticities of the demand for housing services¹⁵. Meen (1996) and

¹⁵There are no good reasons to believe that the elasticities of demand for housing in Ireland are very different from those in the UK or US.

Meen and Andrews (1998), inter alia, survey the UK and US literature and present central estimates of the key elasticities in these models.

If the housing stock and new house completions equations are substituted into the demand equation, a semi-reduced form house price equation may be obtained and estimated. The explanatory variables that drive both demand and supply should appear in this semi-reduced form (see equation (9) below). A semi-reduced form equation has theoretical foundations but is a rather indirect way of explaining house prices. Alternatively, one could estimate an ad-hoc house price equation with no theoretical foundations.

(c) The Demand Equation

A simplified version of the textbook model of house prices that most researchers use is as follows. The demand for housing services, which is assumed proportional to the housing stock h , is often specified as:

$$(1) \quad h/\text{pop} = y^\alpha r_h^{-\beta} d$$

where pop is population, y is real income, r_h is the real rental and d represents other factors, such as demography, which shift the demand for housing curve. The α and β coefficients are the income and price elasticities of the demand for housing services. The consensus view in the literature is that the income elasticity α is about $1\frac{1}{2}$ and that the price elasticity β is in the range $\frac{1}{2}$ to 1. (Meen, 1996; Meen and Andrews, 1998).

In Ireland and the UK, at least, the rental r_h is difficult to measure since the private rented sector is small and not representative of the overall housing stock. However, in equilibrium, the rental r_h equals the real user cost of housing uc_h which, in principle, may be calculated. Hence, r_h may be replaced by a suitable expression for the user cost. In the simplest case, the user cost may be defined as:

$$(2) \quad uc_h = p_h (r^a + m + t_h - \dot{p}_h/p_h) \equiv p_h v_h$$

where p_h = real price of houses;
 r^a = tax adjusted real interest rate;
 m = rate of expenditure on maintenance and repair etc;
 t_h = net rate of tax on housing;
 \dot{p}_h^e/p_h = expected rate of appreciation of real house prices;

and v_h is the user cost of housing expressed as a proportion of the price of the house. See Irvine (1984), Muellbauer and Murphy (1997) and Barham (2004) *inter alia*, for more details of how to calculate the user cost of housing in practise¹⁶.

The inverted demand curve, obtained by substituting the expression for the user cost uc_h , equation (2) into equation (1) is then:

$$(3) \quad p_h = y^{\alpha/\beta} (h/pop)^{-\beta} v_h^{-1} d^{1/\beta}$$

House prices are positively related to real incomes y , negatively related to the per capita housing stock h/pop and the percentage user cost of capital v_h and positively related to other variables that increase the demand for housing. A priori, the coefficients on income and the per capita housing stock are greater than one and possibly as high as 2 or $2\frac{1}{2}$.

(d) Estimated Versions of the Inverted Demand Equation

The simplest log-linear version of this equation may be written as:

$$(4) \quad \ln p_{ht} = \beta_0 + \beta_1 \ln y_t - \beta_2 \ln (h_t/pop_t) - \beta_3 v_{ht} + \beta_4 \ln d_t + u_t$$

where $v_t = r_t^a + m_t + t_{ht} - (\ln p_{ht}^e - \ln p_{ht-1})$ is the user cost rate and \ln denotes natural logs. Estimated versions of this equation, which condition on the housing stock h , tend to be more complicated¹⁷. Many of the modelling choices, such as the choice of

¹⁶ The complications include transaction costs including stamp duty, gearing and the opportunity cost of funds, new house grants, mortgage subsidies, and limits on mortgage interest tax relief.

¹⁷ Estimated versions of (4) are invariably dynamic - they include lagged house prices and lagged explanatory variables on the right hand side of (4) and may

proxies or selection of lag lengths, are largely data determined.

Equations similar to (4) may also be derived from an explicit multi-period utility maximization problem. Income y is then a measure of permanent income or some combination of physical and financial wealth and current and future real income.

Quite often, equation (4) is approximated by an equation like:

$$(5) \quad \ln p_{ht} = \beta_0' + \beta_1' \ln y_t - \beta_2' \ln(h_t / \text{pop}_t) - \beta_3' r_t^a + \beta_4' \ln d_t + u_t'$$

where the user cost variable has been replaced by the real interest rate (Meen, 2002). Under certain conditions (4) and (5) are related, albeit in the long run.¹⁸ However, the coefficients are not the same. Moreover, the capital gain term, and not the adjusted real interest rate term, is the major, time varying component in the user cost variable. Therefore, it is not obvious why one would prefer to estimate equation (5) rather than equation (4).

(e) The Supply Equations

include an error correction term. They often include proxies for credit / mortgage rationing. The unobserved p_{ht}^e variable in the user cost variable may be proxied in some fashion. It may be replaced by p_{ht} which is then instrumented or expected capital gains $\ln p_{ht}^e - \ln p_{ht-1}$ may be proxied by lagged capital gains. The interest rate and capital gains components in the user cost variable may appear in the equation separately. In almost all cases, the choice of proxies and lags are largely data determined.

¹⁸ Consider a dynamic version of equation (4):

$$\Delta \ln p_{ht} = \beta_0 + \beta_1 \ln y_t - \beta_2 \ln(h_t / \text{pop}_t) - \beta_3 v_{ht} + \beta_4 \ln d_t - \beta_5 \ln p_{ht-1} + u_t$$

In the long run, $\Delta \ln p_{ht}^e = \Delta \ln p_{ht} = \text{constant}$ and, assuming that maintenance m_t and t_{ht} are also constant:

$$\ln p_{ht} = (\beta_0 + \beta_1 \ln y_t - \beta_2 \ln(h_t / \text{pop}_t) - \beta_3 r_t^a + \beta_4 \ln d_t + u_t) / \beta_5$$

which is equation (5).

The model of house price is completed by adding an equation for the supply of new house completions hc and the evolution of the stock of housing h :

$$(6) \quad \ln hc_t = \gamma_0 + \gamma_1 \ln p_{nt} - \gamma_2 \ln cc_t + v_t$$

$$(7) \quad h_t = (1 - \delta)h_{t-1} + hc_t$$

where cc represent construction costs and δ may be interpreted as the housing stock “depreciation rate”. Equation (6) says that new house completions depend positively on house prices and negatively on construction costs. Equation (7) is almost an identity. Equation (6) may, of course, be substituted into (7) to yield, along with (4), an two equation system explaining house prices and the housing stock. See Poterba (1984) for example, who assumes that individuals have rational expectations.

Estimated versions of (6) are dynamic. In principle, construction costs include materials costs, earnings, land prices and the cost of capital. In practise, land prices are rarely included in econometric housing supply equations. A potential omitted variable is a measure of planning restrictions. Surprisingly, construction costs are very often insignificant (Murphy, 1998, DiPasquale, 1999).

The available evidence suggests that, although house prices are a cyclical markup on costs, land prices and house prices move together over time and that land prices are move volatile than house prices over the cycle (Evans 2004b). Studies for the UK produce very low (inelastic) estimates of the price elasticities of new housing supply. The estimates are always lowest for the South East. US studies suggest that new housing supply is highly elastic, although lower estimates are obtained for urban areas on the east and west coast where planning constraints bite.

(f) A Reduced Form House Price Equation

For the record, a semi-reduced form house price equation may be obtained by approximating (6) and (7) by:

$$(8) \quad \ln h_t = \alpha_0 + \alpha_1 \ln h_{t-1} + \alpha_2 \ln p_{ht} - \alpha_3 \ln cc_t + e_t$$

and substituting this into the approximate demand equation (4) yielding:

$$(9) \quad \ln p_{ht} = \pi_0 + \pi_1 \ln y_t - \pi_2 \ln h_{t-1} + \pi_3 \ln pop_t - \pi_4 r_t^a + \pi_5 \ln d_t + \pi_6 \ln cc_t + v_t'$$

In the semi-reduced form equation (9), house prices depend on real incomes, the lagged housing stock, population, the real after tax mortgage interest rate, other demand shifters and construction costs.

4. Land Prices, House Prices and Hoarding

4.1 Planning Restrictions, Land Prices and House Prices - Theory

(a) Do House Prices Drive Land Prices?

The widespread view, dating back to Ricardo, is that high house prices cause or “drive” high housing land prices, since the demand for housing land is a derived demand and the supply of housing land is fixed. In this view, causation runs from house prices to land prices and not vice versa. If this view is correct, does it necessarily follow that any attempt to moderate the rise in house prices by regulating the price of housing land is doomed to failure?

The neo-Ricardian view of how housing land prices are determined may be illustrated by looking at the effect of a rise in the demand for houses. Since the demand for houses has risen, the demand for housing land must rise¹⁹. In Figure 4.1 the demand curve for housing land shifts outwards from D_0D_0 to D_1D_1 while the vertical supply curve S_0S_0 remains fixed and the price of housing land rises from P_{h0} to P_{h1} .

— Figure 4.1 Here ---

An increase in housing densities has the same effect on land prices as an increase in the demand for houses. *Ceteris paribus*, land prices will rise (and house prices should fall as capital is substituted for land).

Thus, the assertion that house prices drive land prices is correct in the short run when the supply of housing land is relatively fixed. It is also true in the medium run and long run if the amount of housing land is fixed and housing or other land

¹⁹Formally, the demand for housing land may be determined using the residual valuation approach familiar to practitioners. The residual value, or maximum amount that housebuilders are willing to pay for housing land, is equal to the expected revenues from house sales minus the expected costs of all inputs other than land.

may not be used for any other purposes. However these are rather extreme assumptions.

Although, house prices drive land prices in the short run, this does not mean that the supply of zoned and serviced land does not matter. If the supply of residential land increases then house prices will fall, *ceteris paribus*.

(b) The Supply of Housing Land

Assuming a fixed amount of available housing land is reasonable when considering a very restrictive planning system. In general, however, although the total amount of land is fixed, the amount of housing land varies for two reasons - and may be switched from other uses and additional housing land may be zoned.

There are a number of ways that land may be switched from other uses in response to changes in house prices, commercial rents, taxes etc. Land zoned for mixed use or commercial use may, subject to permission, be switched to residential housing as commercial rents fall relative to house prices. In addition, land zoned for housing which may have been left idle or used for agriculture, for a variety of reasons²⁰, may be released to the market as housing land prices rise.

--- Figure 4.2 Here ---

This sort of situation is illustrated in Figure 4.2 where we assume land may be used for housing or agriculture. The total amount of land is given by $O_h O_a$. The vertical line $S_0 S_0$ represents the fixed supply of zoned land so the horizontal distance $O_h X$ represents the amount of land zoned for housing and $O_a X$ represents the amount of land used in agriculture. The price of housing land is shown on the left hand vertical axis and the price of agricultural land on the right hand vertical axis.

²⁰The owners may speculate that a higher price may be obtained in the future than is available now. They may also be uncertain about the future and prefer to hold on to the land for the same reason that an investor holds onto an option. Alternatively they may simply enjoy the amenity aspect of the undeveloped land.

For simplicity, the demand for agricultural land is assumed to be perfectly elastic at the price P_a (because, for example, it is determined by world or EC prices). It is represented by the horizontal line D_aD_a . The demand for housing land is given by the downward sloping demand curve D_hD_h . Higher demand would be represented by a demand curve which is further out from housing land origin O_h . The effective supply of housing land is represented by the upward sloping curve S_hS_h , which captures the fact that not all land zoned for housing is released to the market.

Initially, the price of housing land is P_h , corresponding to the intersection of the demand and effective supply curves for housing land. The price of agricultural land is P_a , corresponding to the intersection of the horizontal demand and vertical supply curves for agricultural land. The differential between the prices of agricultural and housing land is represented by the vertical distance between P_{h0} and P_a . Some land zoned for housing, represented by the horizontal distance XY is kept back from the market. When the demand for housing rises, the price of housing land will rise and the differential between the price of housing land and agricultural land will widen.

(c) Re-Zoning and the Supply of Housing Land

The supply of housing land rises when land is re-zoned. Similarly, the effective supply rises when zoned land is serviced. The evidence in both Ireland and in UK, albeit to a much lesser extent, is that the planning system responds over time to market signals such as rising house prices and widening differentials between agricultural and housing land. Of course, many house builders and others argue that the size of this response is insufficient.

The effect of an increase in the supply of zoned (and serviced) land is shown in Figure 4.3. Re-zoning shifts the housing land supply curve from S_0S_0 to S_1S_1 . The effective housing supply curve also shift outwards. If demand rises at the same time from $D_{h0}D_{h0}$ to $D_{h1}D_{h1}$, the new price of housing land P_{h1} may be either higher or lower than the initial price P_{h0} . A priori, we cannot predict this since the outcome depends on the relative size of the shifts in the supply and demand curves. As drawn, Figure 4.3 shows the price of housing land falling.

— Figure 4.3 Here —

Other things being equal, if the supply of zoned and serviced housing land increases then the price of housing land will fall and, in turn, house prices will fall. The extent of the fall in house prices will obviously depend on the size of the change in supply. Equally importantly, it will also depend on the location of the changes in supply and the extent of competition amongst developers in those locations. If demand is strong and there is little competition amongst developers and / or markets are quite segmented, large developers with market power can afford to hoard land and there may be little impact on house prices.

To conclude, this analysis shows that, in the medium to long run, the price of housing land and the price of houses depend upon both the demand for housing, as determined by incomes, interest rates, demographics etc. and the supply of zoned and serviced land as determined by the planning system and investment in infrastructure.

4.2 Land Prices and House Prices

There is controversy over the share of land prices in Irish house prices. Casey (2003a,b) points out that land costs accounted for between 10% and 15% of the price of a new house before the current boom. These figures are, he suggests, close to the European norm. According to Casey, land costs now account for over 40% of the price of a house nationally and possibly as much as 50% in parts of Dublin. These findings are often quoted to justify a policy of capping the price of housing land.

Various bodies have disputed these figures but have produced little hard evidence to the contrary. The problem is that there are no official data on the price of housing land. The methodology appendix to the Review of the Construction Industry 2003 and Outlook 2004-2006 (DKM, 2004, p.67), produced for the Department of Environment, Heritage and Local Government (DoEHLG), discusses the share of land costs in house prices:

“Land acquisition costs are assumed to increase from 13% of the average house price in 1995 to 24% in 2000. While there is no official data on land prices in 2001, we understand - following discussions with industry representatives - that development land prices weakened during 2001, declining to around 23% of the average house price in that year. We have assumed that site costs remain at around 23% of the average price since 2001”

The assumed figures appear to be based on very little evidence. Earlier reports note that “given the absence of information on average site costs, the estimated site acquisition costs are extremely tentative” and the “figures reflect anecdotal evidence”.

The auctioneers Hooke and MacDonald, in a submission to the Oireachtas All Party Committee on the Constitution (2003), suggest that land / site costs accounted for about 27% of the cost of new house. This figure was based on a sample of 15 plots of land sold in Dublin over the previous 18 months. They suggest that the 27% figure is only marginally higher the 25% figure that applied in the 1970's and 1980's. Of course, these figures could be consistent with Casey's figures if the builders / developers had large land banks and the land prices used in the calculations were historic purchase prices.

Some calculations, based on the prices of new houses and the costs of rebuilding houses quoted by insurance companies, suggest that land costs account for at least 35%, and probably well over 40%, of the price of a new house in Dublin. Other things being equal, higher residential densities should lead to a fall in the share of land costs in house prices in the long run.

There are no good reasons for the absence of official data on the price of housing land in Ireland. The Valuation Office in England and Wales have produced a series of housing land prices by region and by type of development since 1983. National housing land price data are also available back to the 1930's. Something similar could be produced by the Valuation Office in Ireland using land registry and stamp duty returns. The costs of compiling and analysing housing (and other) land

data are likely to be small and far outweighed by the benefits.

4.3 Hoarding

The issue of land hoarding has generated a lot of attention. Many commentators believe that hoarding of housing land by a number of large builders / developers contributed to the recent boom in house prices. McDonald (2000), quotes a Business and Finance article, dated 13 January 2000, which showed that small number of developers owned huge amounts of housing land. Casey (2003) looked at the ownership of land zoned for housing in the Fingal County Council area. He examined 30 folios of large land holdings in the Land Registry and found that at least 40%, and possibly 50%, of the total land zoned for housing at the time was controlled by 19 or so parties, mostly large developers. He suggested that, while these developers did not operate as a cartel, a “quasi-gentleman’s club exists, which outsiders have difficulty in penetrating”. Casey’s data show that different developers concentrated in different areas.

The All-Party Oireachtas Committee on the Constitution (2004, pp 85-87) considered the question of whether the hoarding of large land banks at the edge of urban areas by developers kept prices artificially high. They did not come to any conclusions about the extent of this problem. The Committee took the view that the planning system as it currently operated served to facilitate “those with the resources to buy up development land and hold on to it”. The Committee argued that the problem could be dealt with by tax changes encouraging early use of zoned land and penalising failure to use it expeditiously.

The issue of land banking and land hoarding were considered in Chapter 5 of the interim Barker Review of Housing Supply in the UK (Barker, 2003). There was some concern that options and land banking allowed house builders to erect barriers to entry into the market. However, the Review found “little evidence for this, at any rate across the country as a whole”. However, the Review noted that, once land acquisition is complete, competitive pressures in the house building industry reduced. In some localities, a single builder appeared to have significant market power. Many house builders appeared to “trickle out” new houses, especially from

large developments thereby ensuring that they did not adversely influence prices in the local housing market. Given, the ongoing shortage of houses and residential land in the UK, “house builders are primarily rewarded for obtaining valuable land rather than responding to consumer needs”.

In her final report, Barker (2004) recommends that, in order to encourage faster build-out (rate of production) of new houses on large housing sites, planning authorities should use their discretion in setting time limits on planning permissions and seek to agree an expected build-out rate as part of the planning permission. She also suggested that, if the rate of build-out had not increased appreciably by 2007 and subject to conditions in the housing market, “the Government should review all available policy options to address this issue”.

4.4 The Goodbody Report on Land Hoarding

(a) Good and Bad Hoarding?

The Government commissioned a report from Goodbody Economic Consultants (hereafter Goodbody) to look at the issue of hoarding and setting time limits on planning permissions *inter alia*. Goodbody (2003) suggested that builders / developers hoarded land for three reasons:

- Commercial hoarding - holding “normal” land banks to smooth the production of new houses over time, thus reducing “stop-go” cycles.
- Speculative hoarding - holding above-normal land banks in anticipation of future price rises.
- Oligopolistic hoarding - holding above-normal land banks in order exercise some market power.

They suggest that oligopolistic hoarding is of the more concern than speculative hoarding. However, from an economic welfare point of view, there is little to choose between the two forms of speculation. Moreover, from a practical point of view, the two motives are extremely hard to distinguish with the available data, especially when examining the behaviour of a relatively small number of large

developers in boom times. Goodbody (2003) conclude that the evidence does not suggest that oligopolistic hoarding of zoned land is occurring.

This conclusion is rather surprising for a number of reasons. The geographical level of their analysis is too broad. In addition, the observed trickle-out of new houses in many developments and the amount of long term zoned and serviced land with inactive planning status suggest that hoarding was and, to some extent, is still a problem. These issues are discussed below.

(b) Data Limitations

Goodbody (2003), and Casey (2003) before them, point out how difficult and tedious it is to identify the ownership of zoned housing land. Given the importance of transparency in this area, the recommendation of the All-Party Oireachtas Committee on the Constitution (2003) regarding information of property transactions - “transactions details should be gathered and published by the State” and “all lands and titles should be registered by a specified date” - should be implemented forthwith. If nothing else they would help reduce planning corruption (McCarthy, 2003).

The Department of Environment, Heritage and Local Government have published consistent zoned and serviced land data for Ireland since 2000. The data are collected at the city or county council level. However, more spatially disaggregated data (and for longer time periods) are required when it comes to the issue of land holdings, land speculation and market power. The reason being that similar houses in different parts of the same council area are not necessarily close substitutes for each other e.g. houses in Baldoyle and Balbriggan.

(c) Land Banks, Land Hoarding and the Supply of Zoned and Serviced Land

Goodbody (2003) looked at the land banks of two publicly quoted Irish builders which are on a par those held by UK builders. No information is available showing the land holdings of other large builders / developers so it is difficult to draw any general conclusions from this.

They also looked at the Department of Environment, Heritage and Local Government (DoEHLG) data on the supply of zoned and serviced land in the Dun-Laoghaire Rathdown and Fingal county council areas of Dublin, as well in the Ennis urban district council area where hoarding was never believed to have been a problem. The Dun-Laoghaire Rathdown and Fingal data are summarised in Table 4.1(a) and 4.1(b) along with some house price data for Dublin in Table 4.2.

— **Tables 4.1(a) and Tables 4.1(b) Here** —

Unfortunately, consistent housing land supply data have only been compiled for the past few years. However, the data clearly show that (i) the aggregate availability of zoned and serviced land has not been a constraint in recent years in either the Dun Laoghaire Rathdown or Fingal county council areas. The data also show that (ii) planning permission has not been sought for a large proportion of this zoned and serviced land, despite the high levels of demand and resulting high house prices.

— **Table 4.2 Here** —

Zoned and serviced land data for 2004 are not available at present but, the indications are that the amount of zoned and serviced land has continued to increase. Given the amount of rezoning in the new Dun Laoghaire Rathdown Development Plan 2004-2010 and the draft Fingal Development Plan 2005-2011, the amount of zoned and serviced land in these two areas will increase significantly over the next few years²¹.

²¹In February 2004, the Minister for Environment, Heritage and Local Government directed Dun Laoghaire Rathdown County Council to rezone more residential land to meet the requirements of the Council's Housing Strategy. The Strategy suggested that, on average, 2,350 new dwellings p.a. needed to be built between 2003 and 2010, as opposed to the next few years. Thus there appeared to be a shortfall of 40 hectares of residential land. The projected demand for new houses is based on the household projections in the Strategic Planning Guidelines Review 2000. These projections, which are based on 1996 Census data, are rather crude since there is no feedback from house prices to migration or household numbers. They are also outdated at this stage. The other contentious assumption is that all new dwellings will be on greenfield land (land which is currently zoned non-residential) and not on land within the existing built up areas.

Even allowing for the inevitable delays in planning and construction, it is clear that hoarding of land cannot be ruled out on the basis of the data in Tables 4.1(a) and 4.1(b). In fact, the data are consistent with land hoarding, slow build-out rates and the trickle-out of new houses. Land hoarding and slow build rates have very similar economic effects.

Anyone who took an interest in the housing market in the Dun Laoghaire Rathdown or Fingal areas is aware of the slow build-out rates in many large developments during the late 1990's and early 2000's. In addition, those with more detailed knowledge can identify prime zoned and serviced land which is or was lying idle. For example, Goodbody (2003) note that one area accounted for a significant proportion of the undeveloped land in the Dun Laoghaire Rathdown area. Five builders were active in this area but one builder, who owned 50% of this land, had not built any significant number of houses.

(d) Counter Arguments

Many builders, developers, auctioneers, valuers and others associated with the house building industry adopt a rather Panglossian view and assert that there is no evidence at all of land hoarding and slow build rates.²² They argue that the house building market in Dublin is highly competitive and / or contestable.

Housing markets are locally segmented to various degrees, so a lack of supply in one area need not be offset by greater supply in another area (Monk et. al., 1996, Monk and Whitehead, 1999).²³ The fact that many people commute long distances, from where they live to where they work, does not change this. There are many local housing markets in the Dun Laoghaire Rathdown and Fingal county council areas so developers with large land holdings had some market power.

²² "It is proved that things cannot be other than they are, for since everything is made for a purpose, it follows that everything is made for the best purpose." Dr. Pangloss in Voltaire's *Candide*.

²³For example, areas differ in terms of social mix, house type, school quality, shops and other amenities, transport links, open spaces etc. Poor transport links reduce the substitutability of houses in different areas and adds to overall mismatch.

However, this market power has been eroded over time as more zoned and serviced land has come on stream.

Goodbody (1993) referred to Casey's (2003) finding that nineteen or so parties owned 40% to 50% of the zoned housing land in Fingal. They suggest that many markets with this level of concentration or competitors would be considered competitive. However, this argument is not really relevant. It does not take account of the nature of housing demand or the structure of the house building industry. Houses in different areas are not necessarily close substitutes and the industry consists of relatively few large firms and a great many small firms. Moreover, many firms concentrate on particular localities.

4.5 Summary

In the short run, house prices drive land prices. In the medium to long run, a greater supply of zoned and serviced housing land will reduce house prices, other things being equal. The limited available evidence suggest that neither a lack of zoned and serviced land nor planning delays fully account for the poor response in the supply of new houses in Dublin during the housing boom. Land hoarding and slow build-out rates are probably important factors explaining the trickle out of new housing.

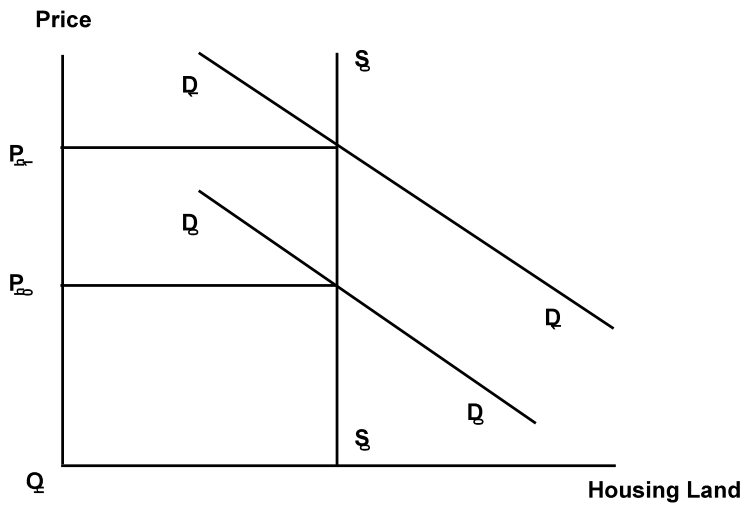


Figure 4.1: The Effect of a Rise in Demand for Housing Land When Supply is Fixed

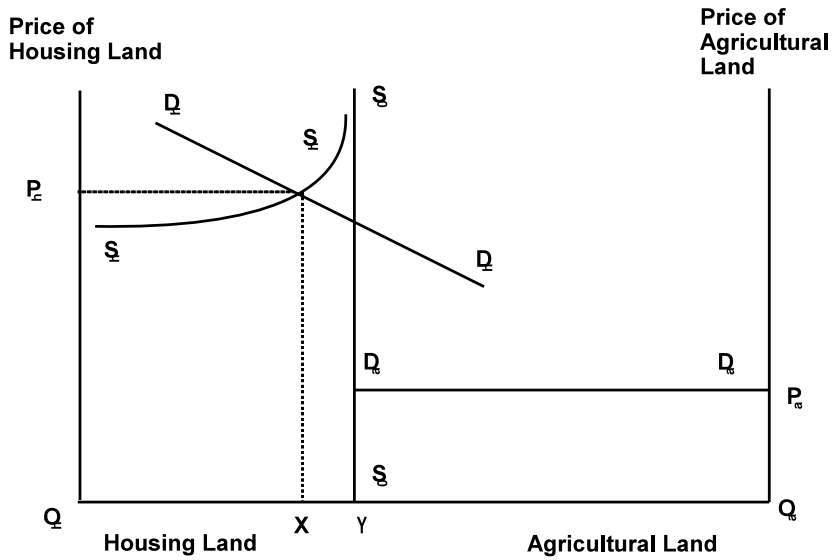


Figure 4.2: The Price of Housing Land When There Are Alternative Uses for Land

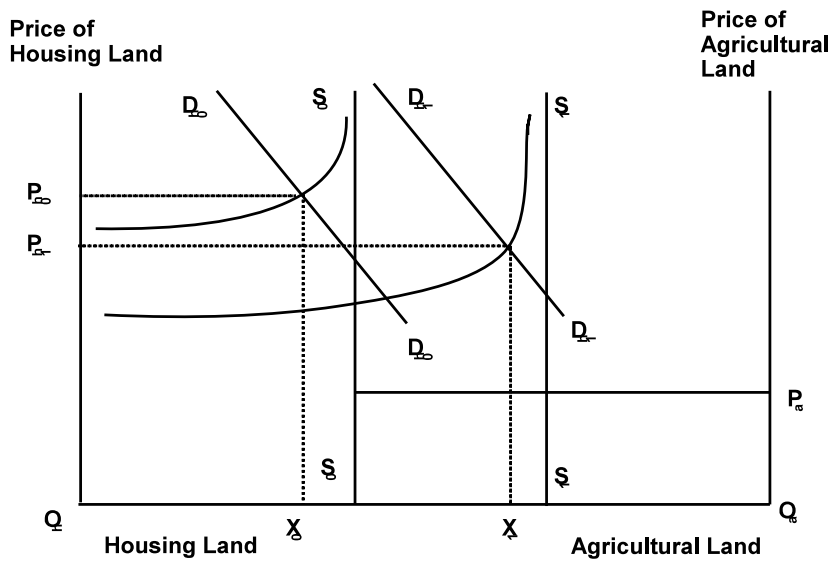


Figure 4.3: The Effect of a Rise in Demand and an Increase in the Supply of Housing Land

Table 4.1(a) - Dun Laoghaire Rathdown County Council

Date/ Year	Potential No. of Housing Units on Zoned and Serviced Land								Planning Permissions (No. Of Units)	House Completions
	Under Construction	Awaiting Construction	Awaiting Planning Decision	On Appeal	Pre-Planning Discussion	Inactive Planning Status	Total			
Jan 1998	-	-	-	-	-	-	4005	964	549	
Dec 1999	1381 20.2%	496 7.2%	1273 18.6%	141 2.0%	2000 29.2%	1559 22.8%	6850 100.0%	884	886	
June 2000	780 10.9%	406 5.7%	852 11.9%	104 1.4%	2129 29.8%	2875 40.2%	7146 100.0%	994e	860	
June 2001	589 6.2%	1702 17.9%	1618 17.0%	1629 17.1%	852 8.9%	3136 32.9%	9526 100.0%	2441	1166	
June 2002	1645 16.3%	2748 27.2%	540 5.4%	957 9.5%	870 8.6%	3311 32.6%	10071 100.0%	2478	785	
June 2003	3063 25.1%	1455 11.9%	1427 11.7%	706 5.8%	1600 13.1%	3940 32.2%	12191 100.0%	2123	1871	

Sources: Jan 1998 figures from Bacon et. al. (1998), Dec 1999 figures from Bacon and McCabe (2000). Other housing land data from DoEHLG Housing Land Availability Returns. The house completion data are from the DoEHLG Housing Statistics Bulletins and the planning permission data are from the CSO. Planning permissions in 2000 are estimated since the third quarter data are not available.

Table 4.1(b) - Fingal County Council

Date / Year	Potential No. of Housing Units on Zoned and Serviced Land								Planning Permissions (No. Of Units)	House Completions
	Under Construction	Awaiting Construction	Awaiting Planning Decision	On Appeal	Pre-Planning Discussion	Inactive Planning Status	Total			
Jan 1998	-	-	-	-	-	-	-	9052	2334	2618
Dec 1999	1927 10.4%	4322 23.4%	5052 27.3%	1852 10.0%	5329 28.9%	5329 28.9%	18482 100.0%	18482 100.0%	5858	4296
June 2000	1206 3.5%	8710 25.1%	2784 8.1%	2587 7.4%	19434 56.0%	19434 56.0%	34721 100.0%	34721 100.0%	7793e	4044
June 2001	9150 21.5%	4018 9.4%	3626 8.5%	2773 6.5%	3655 8.6%	19330 45.4%	42552 100.0%	42552 100.0%	5170	3602
June 2002	10258 27.6%	5509 14.8%	463 1.2%	757 2.0%	5814 15.7%	14314 38.6%	37115 100.0%	37115 100.0%	6819	4308
June 2003	13228 29.7%	4466 10.0%	1055 2.4%	3200 7.2%	5046 11.3%	17595 34.4%	44590 100.0%	44590 100.0%	8609	7019

See notes to Table 1(a).

Table 4.2 - Dublin House Prices

Year	New House Prices (€000's)			Second Hand Prices €000's
	Houses	Apartments	All	
1995	-	-	86.7 +5.7%	88.9 +7.4%
1996	-	-	95.1 +12.0%	104.4 +17.4%
1997	-	-	122.0 +25.7%	131.3 +25.7%
1998	159.6	166.7	160.7 +31.7%	176.4 +34.4%
1999	191.9	201.7	193.5 +20.4%	210.6 +19.4%
2000	216.4	243.3	221.7 +14.6%	247.0 +17.3%
2001	252.2	224.5	243.1 +9.6%	267.9 +8.5%
2002	259.4	249.2	256.1 +5.4%	297.4 +11.0
2003	302.3	274.3	291.6 +13.9%	355.4 +19.5%

Source: DoEHLG Housing Statistics Bulletins.

5. Planning Restrictions and the Prices of Land and Housing - Some International Research

5.1 Relevance to Ireland

In Ireland, residential land prices have risen sharply for a variety of demand and supply reasons. On the supply side, the relative shortage of zoned and serviced land was probably more important than planning restrictions (e.g. density or green belt restrictions). However, from the economic point of view, *continuing* infrastructure deficits and planning restrictions have the same effects on land prices, house prices and housing supply, by and large.

Even though a great many commentators and academics discuss the effects of planning / zoning restrictions on the price of land and housing, the direct academic research on the topic is not very large. For example, White and Allmendinger (2003) survey the UK and US literature and cite less than 40 articles. Cheshire and Sheppard (2004) stress that the economic analysis of land use regulation is, compared to regulation in other contexts, significantly neglected.

5.2 Planning Systems in Other Countries

Some of the literature on the effects of land use zoning may not appear to be directly relevant to Ireland. The reason being that the Irish planning system, in terms of legislation and structure was, and is to some extent, closest to the UK system which, in turn, is very different to the zoning system in the US or the systems in the rest of Europe or Asia²⁴. However, this literature is relevant since restrictive zoning and planning have the same economic effects (Dawkins and Nelson, 2002; Evans, 2004a,b).

²⁴ For details of the planning/zoning systems in various European countries, see the EU Compendium of Spatial Planning Systems and Policies: Comparative Review (European Union, 1997). Individual country volumes of the Compendium have also been published.

developments (Duncan, 1986; Barlow and King,1992; Golland and Boelhouwer, 2002, Ball 2003).

5.3 The Benefits and Costs of Land Use Planning

Planning / zoning has clearly significant social benefits - limiting sprawl or ribbon development, maximising the use of scarce transport resources, preserving the countryside, reducing uncertainty etc²⁶. Cheshire and Sheppard (2002) point out that land use planning produces benefits of considerable value. It serves a variety of purposes including reducing the costs of providing some local public goods, isolating land uses which are likely to generate costly externalities, providing valued public goods such as neighbourhood quality and amenities such as open spaces by fiat rather than through taxes and direct public sector provision.

However, the absence of taxes does not imply the absence of costs. Land use planning and zoning also have significant private and social costs. These include raising house and land prices, reducing housing supply, increasing density and reducing choice in, for example, the UK but not the US (Monk et. al. 1996; Cheshire and Sheppard, 1989 and 2002; White and Allmendiger, 2003). Both international and national studies show that house prices are structurally higher and more volatile in areas with rigid planning / zoning regimes than in other areas with responsive regimes and which are similar in terms of incomes, growth etc.

Qualitatively, everyone agrees on these effects. Quantitatively, these effects are harder to pin down, mainly because of data requirements and more research would be helpful.

5.4 The Price Elasticity of Housing Supply

One key, albeit indirect, indicator of the effects of planning restrictions, based

²⁶Poor planning may result in high land and house prices, high commuting costs, sprawl and expensive infrastructure.

on macroeconomic data, is the price elasticity of housing supply. Post war estimates suggest a value for the long run elasticity of between 0 and 1 for the UK, where planning restrictions are generally tight, and 6 to 13 for the US, where planning restrictions are generally loose (Meen, 1996; Malpezzi and MacLennan, 2001; White and Allmendiger, 2003). The corresponding Irish figures are in the range 1 to 2. (Murphy and Brereton, 2001; McQuinn 2004a,b). As expected, the long run supply elasticity for Dublin is lower.

Stephen Mayo notes that, other things such as incomes and growth rates being equal, house prices are both higher and more volatile in areas with more rigid supply regimes²⁷. According to Mayo, such regimes are characterised by (i) bad infrastructure supply policies; (ii) rigid, time consuming and unpredictable regulatory regimes and / or (iii) high degrees of concentration in the land development and building industries.

5.5 Research Findings from the UK

Turning now to more micro research for Britain, Bramley's research has been very influential. For example, the Joseph Rowntree Foundation (JRF), using studies by Bramley (1993a,b), controversially argued that large land releases are an ineffective and environmentally damaging way of reducing house prices. Of course, no one disagrees with the view that housing supply elasticities in Britain are low or that the planning system is restrictive. However, the JRF conclusions are questionable (Evans, 1996).

Bramley (1993a,b) studied the elasticity of supply of new housing in 1988 using highly dis-aggregated, cross-section data for 90 local authorities in a wedge shaped area, stretching from the West Midlands to the eastern part of the South West. His model is based around (i) a demand equation explaining new house

²⁷ Discussion dated 25 November 1998 posted on World Bank development discussion forum on Land, Real Estate and the Economy. Available online at www2.worldbank.org/hm/landecon/0169.htm.

prices, (ii) a supply equation for new houses which, inter alia, depends on the stock for land with outstanding planning permissions, and (iii) an equation explaining the flow of planning permissions which depends on the local structural plan “provision” or planning policy target.

The estimated price elasticity of supply of new houses varies with the availability of land with planning permission averages is about one. The simulated effect of a 75% increase in the land targeted are as follows:

	Year 1 Effect	Year 3 Effect
Planning Permissions	+16%	+7% to 8%
New Houses Completions	+23%	+8%
Second Hand House Prices	-1%	-11%

These effects are measured relative to a “no change” scenario. The change in house prices falls back to -5% five years after the increase in plan provision.

Evans (1996) and Bramley (1996) engaged in a lively debate over these results. Evans (1996) argues that the supply responses were understated This partly due to the use of cross-section data to reveal responses over time but, more importantly, because of the “implementation gap” between the planned release of land and the resulting flow of permissions to use the land. Evans suggests that the reason for this is the that model was estimated (mainly) using data for 1988, when the housing market had peaked, so there was not a great incentive for builders to expand their output. Pryce(1999), using data provided by Bramley, found that the estimated price elasticity of supply varied between 0.6 in 1988 and 1 in 1992.

Bramley and Watkins (1996) updated the earlier work of Bramley (1993a,b) and re-emphasised the “implementation gap” - the lack of correspondence between targets and actual supply. They show that local plan allocations are twice as effective as structural plan allocations. They also suggested that large concentrated land releases could have significant local/regional house price effects. Bramley

(1999) extended this research.

In a new departure, Bramley (2003) and Bramley and Leishman (2002) constructed and estimated a panel data model of the housing market for the 90 former health authority areas in England. The use of panel data, overcomes some of the problems in using cross-section data to look at dynamic responses to changes in the supply of land. Somewhat surprisingly, using a similar model to that in Bramley(1993a,b), Bramley (2003) obtains lower supply elasticities than in his earlier papers.

In a series of papers, Cheshire and Sheppard (1989,1993,1998 and 2002) estimate a series of hedonic regressions explaining house prices in Reading and Darlington in mid 1980's. Reading, in the South East, was an area of "strong planning" whilst planning controls were "weak" in Darlington, in the North East. In their 1989 paper, Cheshire and Sheppard estimate that local planning regimes imposed price differentials of between 2% to 12%, depending on house type, between Reading and Darlington. If the constraining effect of the green belt was taken into account, the price differences ranged from 3% to 17%.

Cheshire and Sheppard (2002) showed how one could try to estimate the welfare effects - both costs and benefits - of the land use planning system in Reading in the mid 1980's. Their estimates suggest that the welfare effects were large and negative - about ½% of income on average - and distributed in a way that favours those who already have high incomes²⁸.

Monk, Pearce and Whitehead (1996) adopt a more qualitative approach to

²⁸ The aggregate welfare effect is obtained by summing the difference in each household's welfare under the status quo planning system and an alternative involving the absence of planning. Household welfare is derived from a standard expenditure function $e(p,r,u)$, where r is the price/rental of land, p is a vector of prices of other goods including hedonic prices for amenities, u is utility and expenditure refers to after tax income net of transport costs. Transport costs depend upon distance and direction from the centre. The effects of planning restrictions show up in the prices of land r , which is endogenous, the prices of amenities p and transport costs.

examining the effect of land use planning on land supply and house prices in the 1970's and 1980's in Britain. They studied four areas, two in the South East and two in Yorkshire and Humberside which reflected the full spectrum from high demand or high planning constraints and low demand or constraint. They take the difference between the price of housing land and the price of agricultural land as a measure of the constraints imposed by the planning system together with other factors such as the cost of infrastructure.

Monk et. al. (1996) also studied market segmentation at the local level in Cambridgeshire in 1980's. They were interested in the extent to which increased land allocations in one area can compensate for constraints in another area. The evidence from the two studies suggest that, although local housing markets were fairly open and, in the planner's terms, constraints were small in certain, often undesirable, areas, the land use system did impose significant costs, which included the exacerbation of price increases in periods of economic growth, without being able to generate higher housing output during recessions. In addition, it tended to foster a narrower range of housing types and densities that would be expected in its absence, and so restricted the choices available to consumers. Monk and Whitehead (1999) draw out some of the implications of this research. In particular they suggest that the current UK planning system is structural incapable of providing an effective (i.e. in terms of house prices) supply of land for housing.

5.6 Some US Research

It is not possible to summarize all of the disparate US literature on the effects of zoning so I review three recent, representative papers - one qualitative, one based on hedonic regressions and the last using an econometric, vector error correction model. Dawkins and Nelson (2002) compare the US with other countries with regard to urban containment policies, designed to prevent sprawl. Within the US they examined Oregon and California. In the case of Oregon, the urban containment policies did not bite much since the local authorities wanted to facilitate economic growth and provide enough land for housing. Within California, the impact of urban containment policies on house prices was not uniform. House and land prices rose

in areas with tight urban containment boundaries.

Malpezzi et. al. (1998) estimated hedonic house price regression models for 272 metropolitan areas, including a composite measure of the land use regulatory environment as an explanatory variable. Using the model results, they simulated the effect of moving from the first quartile of the values of the regulation measure in the sample to the third quartile. Their results ranged from a 31% to a 46% increase in house prices, depending on the exact model used. Their results show that land use regulation can drive up house prices by large amounts.

Finally, Harter-Dreimann (2004) used a panel data set of 76 metropolitan areas to examine the responsiveness of supply to income shocks. Her results suggests that long-run housing supply is quite elastic, confirming the accepted wisdom. However, the adjustment to demand shocks is relatively slow. Surprisingly she only finds minor differences in the supply responses across different groupings of the metropolitan areas - the highest and lowest population densities, the most supply constrained and the least supply constrained.

5.7 Summary

Land use planning produces benefits and costs. The costs of restrictive planning include higher house and land prices, reduced housing supply, increased densities and reduced choice. Infrastructure delays have similar effects in the short to medium term.

Zoning systems, which are widely used through out the world including the US, would free up planning resources. Typically, under a zoning system, all residential development satisfying certain requirements are automatically allowed and do not require specific permission. A good case could be made for introducing something similar in Ireland for small scale residential developments.

6. The Planning System in Ireland

6.1 Introduction

In recent years, the planning system in Ireland has become more complex with more layers and often competing objectives e.g. building communities and ensuring good quality of life versus higher densities and clustering developments close to transport links. In addition to the traditional city/county development plans, we now have Regional Planning Guidelines, local area plans, Strategic Development Zones, the National Spatial Strategy and local authority Housing Strategies as well as the Residential Density (1999) and Retail Planning (2000) Guidelines issued by the Department of Environment Heritage and Local Government²⁹.

6.2 A Brief Outline of the Current Irish Planning System³⁰

At the local level, the planning system is largely administered through the local government system. The planning authorities consist of the city and county councils and urban district councils. At the regional level, eight regional authorities prepare statutory Regional Planning Guidelines (RPGs). RPGs are seen as one of the main methods of delivering the National Spatial Strategy and co-ordinating planning activities within the region. The first RPG to be adopted was the Strategic Planning Guidelines for the Greater Dublin Area 1999. At the national level, the main players are the Department of Environment, Heritage and Local Government and An Bord Pleanála. The Department is responsible for a wide range of functions including planning policy and legislation. The Department also issues policy

²⁹Inter alia, the 2000 Planning and Development Act brought in Housing Strategies, Regional Planning Guidelines, Strategic Planning Zones and Part V social and affordable housing provisions.

³⁰The current planning system is described in chapter 3 of the report of All Party Oireachtas Committee on the Constitution (APOCC, 2004) on private property. The planning process in Ireland, before the 2000 Planning and Development Act, is briefly described in section 5.3 of Bacon et. al. (1998).

guidelines to planning authorities. These guidelines now have a statutory basis. Recently issued guidelines include those on residential densities (1999) and retail planning (2000).

Under the Planning and Development Act 2000, the timescale for the preparation and adoption of development plans is very strict. Development plans must be prepared / reviewed every six years. Prior to the preparation of the Draft Development Plan, planning authorities must engage in consultations with the public and with other statutory bodies. The Development Plan must be adopted within two years of the initial public consultations.

Under the 2000 Act , planning authorities may make local plans for any part of their area, although the preparation of local plans is mandatory for all towns with a population of 2,000 or more. Local plans should enhance flexibility in the planning system. The procedures for making local plans are simpler and more straightforward than for making Development Plans. However, the local plan must be consistent with the development plan, which in turn must be consistent with national plans, policies and strategies relating to proper planning and sustainable development.

The actual process for the zoning / rezoning of land in Ireland is far from transparent as noted by All Party Oireachtas Committee on the Constitution. The adoption of the Development Plan is a reserved function of the elected members of the planning authority, who may issue directives to the manager regarding the preparation of the Draft Development Plan.

In many ways the planning system in Ireland resembles that in the UK³¹. However, the Irish system is far more flexible and responsive, especially in relation to housing. In the UK, the 2000 planning policy guidelines relating to housing (the so called PPG3 guidelines) emphasized the availability of an adequate and sustainable supply of housing land; making effective use of urban land, whilst protecting

³¹The UK planning system is outlined in appendix A of the Kate Barker's interim report on housing supply in the UK (Barker, 2003).

open/green spaces; ensuring that housing is available where jobs are created etc. However, no mechanism is provided to ensure that either an adequate supply of housing land or an adequate supply of affordable housing will be provided. In addition, the government's target for using "brownfield" sites in preference to "greenfield" sites makes housing more, rather than less, expensive³². In Ireland there are few genuine "brownfield" sites.

6.3 Resources and Risks

Although the demands on the planning system have risen - the volume of planning applications has shot up whilst the system has become more complex - the resources available to the planners have not always risen accordingly. The imbalance in resources between large private developers and the planning authorities increases the risk of "regulatory capture" by these developers. This risk is increased given that the system of long term planning is far from transparent and little attempt is made to involve the general public³³. In addition, some local authorities are heavily involved in commercial developments, on their own or in partnership with private developers. There is a danger that commercial interests will take precedence over planning matters.

The requirements that local authorities (i) prepare regular Housing Strategies which take account of social and affordable housing needs in their area and (ii) publish and review their Development plans on a regular basis (every six years) are

³² The target is that at 60% of new housing in the UK will be built on high density brownfield sites. There are two major problems with this target. Brownfield sites are a good deal more expensive to develop. There are also a good deal more brownfield sites outside the South East of England in areas of low demand and few planning restrictions. In the South East, where demand is high and planning restrictions really bite, brownfield sites are relatively scarce.

³³ For example, the public involvement in preparing the Strategic Planning Guidelines, later the Regional Planning Guidelines, for the Greater Dublin Area was minimal. Little effort was or is being made to involve the public in the process. The small number of submissions received on the 2003 guidelines and the lack of a public office are clear indicators of this.

useful developments³⁴. However, additional resources are required for these activities. Planning delays, both at the planning authority and An Bord Pleanála levels, were commonplace. Happily, the incidence of delays has fallen sharply in the past few years.

In practise, the level of coordination between adjoining local authorities in preparing housing strategies and development plans is unclear. In terms of commercial, industrial and retail developments, all of which generate business rates, local authorities appear to compete with each other in something akin to a zero sum game.

6.4 Higher Densities and Redevelopment of Urban Areas

As discussed elsewhere, local authorities appear to have zoned and serviced sufficient land for housing. The 1999 DoEHLG guidelines on residential housing densities are taking effect. They are not at all restrictive, especially for developments close to public transport links. In fact, there seems to be an over-optimistic view that, on its own, proximity to a public transport link means that the majority of people will actually use public rather than private transport.

In the medium term, it will be interesting to see the effect of locating a lot of high density housing on the fringes of Dublin, where there is little social infrastructure (schools, libraries, sports grounds, community and health centres etc) and often poor transport links, as opposed to closer to the centre where densities are quite low. Of course, unlike parts of Britain, there are relatively few brown-field sites in Dublin which can be redeveloped. It can also be slow and costly to accumulate sites in inner city areas. However, Dublin City Councils' scheme for redeveloping Cherry Orchard is a good example of what is possible.

³⁴From the financial point of view, commercial and industrial developments are a good deal more attractive to local authorities than residential developments, since there are no rates on domestic properties, service charges are small and development levies are one off charges.

Unfortunately good redevelopment schemes, such as the Ballymun Regeneration Area and Cherry Orchard schemes, are marred by attempts to engage in social engineering. For example, no social housing will be provided in the Cherry Orchard scheme and rent supplements will not be paid to applicants wishing to live in the Ballymun Regeneration Area. Attempts at social engineering along these lines are, in my opinion, misguided and unacceptable. Segregation of different tenure groups is not part of the stated housing policy of the government.

6.5 Planning Delays

Many developers complain about the delays in the planning system. The slow pace of progress on Strategic Development Zones (SDZ's) is cited³⁵. Given the size and complexity of these developments, equivalent in scale to a medium sized town outside Dublin, and the resources available to planning departments, it was almost inevitable that SDZ's would proceed slowly. For example, the SDZ at Adamstown involves 8 to 10 thousand dwellings and 125 thousand m² of non-residential development.

By default, planning permission is granted eight weeks after an application is lodged. The Planning and Development Act 2000 addressed the time taken to deal with requests for additional information by the planning authority. Once a notice seeking further information is complied with, the planning authority must its decision within four weeks (provided the total decision period is at least eight weeks). If the original application was accompanied by an Environmental Impact Statement or involved a material contravention of the Development Plan, the four week period becomes an eight week period.

— Table 6.1 Here —

³⁵The objective of Strategic Development Zones is to streamline the planning process in respect of specific sites designated for specific developments considered to be of social or economic significance to the state. The government selects these sites.

The latest DoEHLG Planning Statistics and the 2003 An Bord Pleanala Annual Report show how the workload of the Board has risen over time. The number of appeals has risen in line with the number of planning applications. Table 6.2 shows that the average time taken to dispose of planning appeals rose from 15 weeks in 1996 to 25 weeks in 2001. It then fell back to 23 weeks in 2002 and a very reasonable 16 weeks in 2003. The percentage of appeals dealt with within the statutory 4 month or 18 week “objective period” (or target period) fell sharply since the mid 1990's until 2001 when it reached it 29%. It then rose to 36% in 2002 and 74% in 2003. According to the 2002 annual report, the main reason for the delays in disposing of appeal cases were the backlog of cases over a prolonged period of years and the difficulties in recruiting and retaining qualified planners and other staff. Other reasons that gave rise to delay included the submission of Environmental Impact Statements, holding oral hearings/ public inquiries, the number of large or complex cases and cases requiring further submissions, observations or documents.

Table 6.2
Performance of An Bord Pleanala

Year	No. of Cases Disposed Of	Average Time Taken to Dispose of Cases (Weeks)	Cases Determined Within 18 Week / 4 Month Period	Outstanding Cases at End of Year
1996	3237	15	93%	1085
1997	3563	16	85%	1387
1998	4057	18	63%	1878
1999	4623	21	47%	1945
2000	4833	21	47%	2431
2001	5105	25	29%	2753
2002	5892	23	36%	1425
2003	4815	16	74%	1353

Source: Annual Report of An Bord Pleanala 2003

Note: The An Bord Pleanala and DoEHLG Planning Statistics are not directly comparable.

Third party appeals to An Bord Pleanala are often mentioned when discussing planning delays. Many people do not realize that the appeal system has been considerably tightened up since 2000³⁶. In addition, as Table 6.2 shows, most appeals are upheld to some extent by An Bord Pleanala, in the sense that the Board either refused permission or granted permission with revised conditions.

Table 6.3
Third Party Appeals to An Bord Pleanala

Year	No. of Decisions	Third Party Only Appeals	Decision of Planning Authority		
			Confirmed	Varied	Reversed
1996	915	36%	6.1%	65.4%	28.5%
1997	1125	39%	6.0%	62.3%	31.6%
1998	3154	39%	2.8%	66.4%	30.8%
1999	3697	40%	3.1%	59.4%	37.5%
2000	3801	42%	1.6%	56.7%	41.7%
2001	3829	42%	1.3%	53.0%	45.7%
2002	4276	46%	1.4%	53.2%	45.4%
2003	3074	47%	0.7%	58.6%	40.7%

Source: Annual Report of An Bord Pleanala 2003, Further Statistical Analysis

Third party appeals, as such, may not be allowed in other countries such as the United Kingdom. However, there is always a mechanism for outside, interested parties to have a say in the planning process. There is no strong evidence that the

³⁶Under the Planning and Development Act 2000, third party appellants to An Bord Pleanala, other than prescribed bodies or people with an interest in adjoining land, must have made a written submission to the planning authority in relation to the planning application. Appeals to the Board must be made in writing within four weeks beginning on the date of the decision by the planning authority (not the date the decision is sent or received). The appeal must be complete and accompanied by a fee of €300.

The Board can only consider planning issues and can dismiss an appeal where it is satisfied that it is vexatious, frivolous or without substance or foundation or where the appeal is made with the sole intention of delaying development or of securing the payment of money, gifts, considerations or other inducements by any persons.

planning systems in other countries reach decisions quicker. Overall it may well be better to have a somewhat slow planning system rather than bad planning decisions. The effects of poor planning can last a very long time.

6.5 Summary

The planning system in Ireland has become more become more complex with more layers and competing objectives. In many ways it resembles that in the UK. However, the Irish system is far more flexible and responsive, especially in relation to housing. Unfortunately, it is not clear that the resources available to the planners have risen in line with the demands on the system.

The planning authorities appear to have zoned sufficient housing land and the DoEHLG guidelines on residential housing densities are taking effect. The incidence of planning delays has fallen in the past few years. Some planning delays are inevitable, especially when dealing with large developments. On balance, a somewhat slow planning system may be better than having to live with bad planning decisions.

Table 6.1
Appeals to An Bord Pleanala

Year	Planning Authority Decisions and Appeals			No. of An Bord Pleanala Decisions	Decision of Planning Authority		
	No. of Planning Decisions	No. of Appeals	Appeal Rate		Reversed	Varied	Confirmed
1996	46015	3319	7.2%	2540	23%	38%	41%
1997	50427	3845	7.6%	2902	23%	34%	42%
1998	58634	4533	7.7%	3154	22%	37%	41%
1999	69869	4706	6.7%	3697	25%	33%	42%
2000	77320	5306	6.9%	3801	27%	31%	42%
2001	71890	5219	7.3%	3829	29%	30%	40%
2002	60378	4324	7.2%	4276	33%	34%	34%
2003	64456	4643	7.2%	4716	30%	36%	34%
2004 Jan-Jun	36892	2521	6.8%	2397	na	na	na

Source: DoEHLG Planning Statistics 2002 and Quarterly Planning Statistics and the Annual Report of An Bord Pleanala 2003 for the data on decisions made within 4 month/18 week period. The 2004 data are for the first half of the year only.

Note: The figures for decision made within 18 week / 4 month periods are not directly comparable with other data in the Table.

7. Infrastructure Deficits and Delays

7.1 The Boom in House Prices and the Infrastructure Deficit

If the supply of new housing had responded faster to rising house prices in the mid to late 1990's, Ireland would still have experienced a house price boom. However, the boom would have been on a much smaller scale. Much of the boom can be attributed to deficits in infrastructure rather than to binding planning restrictions.

7.2 Serviced Land - Water and Sewerage

Many of the infrastructure deficits - in water, sewerage, roads and public transport - which were revealed in the mid to late 1990's, when the housing market began to boom, have been addressed. The serviced land and other initiatives of the Department of Environment, Heritage and Local Government have worked well and had the desired effect. The amount of available zoned and serviced land, especially in Dublin, has increased and the number of new house completions has more than doubled.

7.3 Transport Problems

However, roads and public transport in the Greater Dublin area are a bit of a mess. Some recent examples include:

- The poor design of the M50 (inadequate junctions, proximity of junctions on the South Eastern Motorway stretch encouraging local traffic etc.); the failure to buy out the Westlink toll operators; the delays resulting from the mysterious rerouting of the M50 through the Carrickmines castle site;
- The controversy regarding the height of the Port Tunnel;
- The poor state of the N7 Naas road, the busiest road in the country; the routing of the Tallaght Luas line across the Red Cow roundabout at the junction of the M50 and the Naas Road;

- The dubious economics of the Luas and the ongoing failure to sort out the Dart / suburban rail / mainline rail time tabling and capacity issues on the main Belfast-Dublin-Wexford rail line;
- The lack of demand management policies (including congestion charges) and dearth of park and ride facilities.

A lot of money has been spent on roads and public transport but it is not clear that the public is getting value for money. Planning delays and the high cost of land are only part of the problem. Poor initial planning, competing agencies, political interference and poor management are important factors behind the transport deficit in Dublin.

7.4 Why Transport Matters

The transport issue is important since Dublin house prices drive Irish house prices. Better transport links, which increase the substitutability of houses in different areas, both between Dublin and its hinterland and within Dublin will reduce housing demand in Dublin. Of course, regional policy could shift demand away from Dublin, at least in principle, but there are few policy levers available even if the political will was there³⁷.

7.5 The Planning System and Infrastructure Deficits

As the All Party Oireachtas Committee on the Constitution (2003) point out, delays in infrastructure projects occur for a variety of reasons arising from the complexity of the issues involved. They suggest that the delivery of key projects would be assisted by, *inter alia*, formal public consultations prior to seeking planning, improved compulsory purchase procedures, greater cooperation and coordination between departments and agencies, adequate and continuing resourcing of An Bord Pleanála and planning authorities, independent preparation of Environmental Impact Statements and adoption of a single procedure for the

³⁷ A property tax related to the value of house or land would also shift demand away from Dublin.

approval of large, key infrastructure projects. These suggestions are eminently sensible.

7.6 Summary

Much of the house price boom can be attributed to deficits in infrastructure rather than to binding planning restrictions. Many of the infrastructure deficits have been addressed. The serviced land and other initiatives of the Department of Environment, Heritage and Local Government have worked well.

A lot of money has been spent on roads and public transport but it is not clear that the public is getting value for money. Planning delays and the high cost of land are only part of the problem. The suggestions of the All Party Oireachtas Committee on the Constitution (2003) for avoiding unnecessary delays in key infrastructure projects should be adopted.

8. Private Renting, Social Housing and Affordable Housing

8.1 Introduction

Housing policy in Ireland appears to be focussed on maximizing the level of owner occupation³⁸. The 2002 Census suggests that the rate of owner occupation is about 80%, which is very high by international standards. From an economic point of view, maximizing the level of owner occupation is not optimal³⁹. More tenure neutral housing policies are required. For example, there is no good reason to favour a local authority tenant or an owner occupier over a tenant in the private rented sector in similar circumstances.

8.2 Local Authority and Voluntary Sector Housing

New local authority and voluntary sector houses have generally accounted for between 6% and 8% of overall new house completions in recent years. Between 1% and 2% of the local authority housing stock are sold to tenants every year. The policy of selling local authority houses to existing tenants at prices far below the going rate is not an efficient use of resources and should be reviewed.

Local authorities administer quite a few schemes designed to help local authority and some other tenants buy their own house. The coverage of the various schemes is rather confusing whilst the output of many schemes is small. Presumably, these schemes are costly to administer. Outdated and unproductive schemes should be dropped and common, tenure neutral eligibility criteria introduced for the remaining schemes.

³⁸ Norris and Winston (2004) is a good review of housing policies in the period 1990 to 2002. In particular, they provide a useful guide to the rather confusing range of policies and schemes that have been introduced since 1990's. For example, six new schemes to enable low income households to purchase a dwelling have been introduced since 1990.

³⁹ Inter alia, as discussed in Section 1.2, it reduces mobility and is inefficient. It diverts resources from where they would be better used. Moreover, it is a costly policy.

Table 7.1
Local Authority and Voluntary Sector New House Completions
Local Authority House Sales

Year	Local Authority New House Completions	Voluntary Sector New House Completions	Sales of Local Authority Houses
1996	2676	917	1844
1997	2632	756	2139
1998	2771	485	2006
1999	2909	579	2256
2000	2204	951	1844
2001	3622	1253	1411
2002	4403	1360	1195
2003	4516	1617	1567

Source: DoEHLG Housing Statistics Bulletin

The affordable housing and shared ownership schemes are popular⁴⁰. The amount of affordable housing provided to date is relatively small, albeit rising over time. However, in reality, affordable houses are not really that affordable. Allowing purchasers of affordable homes to take out 90% plus mortgages is not a riskless strategy (especially if interest rates were to rise) and is a very indirect way of tackling the problem of affordability. The shared ownership scheme is a more affordable option for many people and should be expanded.

At some point in the future, the role of the social (local authority and voluntary) housing sector needs to be reviewed. Whitehead (1998, 2003) discusses many of the issues that should be considered in such a review.

- Should social housing needs be provided by public or private provision? In

⁴⁰ There are two affordable housing schemes - the 1999 scheme and the a scheme based on Part V of the Planning and Development Act 2000. The shared ownership scheme was introduced in 1991.

many countries such as Germany and Switzerland social housing needs are effectively met through private provision.

- Does the provision of social housing necessarily imply public ownership? Independent social landlords play a major role in countries such as France, the Netherlands and Sweden.
- Does the existence of a social housing sector imply below-market rents? In the Netherlands and Sweden social sector rents are on a par with private rents.
- Should social housing be allocated administratively or should there be consumer choice between sectors?

Table 8.2
Social and Affordable Housing

Year	Shared Ownership	Affordable Housing (1999 Scheme)	Part V Housing
1996	1166	-	-
1997	1042	-	-
1998	805	-	-
1999	1314	40	-
2000	1190	86	-
2001	1611	272	-
2002	1686	882	0
2003	998	1524	163
2004 Jan-Jun	438	427	106

Source: DoEHLG Housing Statistics Bulletin

8.3 Part V Social and Affordable Housing

To date, the additional social and affordable housing resulting from the Section V requirement is very low, even taking account of the time lags in drawing

up Housing Strategies and completing large developments. It is not obvious that local authorities are actually getting the required percentage of the *ex post* value of the land. It is strange to still see advertisements in the commercial property pages for housing development with no social or affordable housing requirement.

In order to increase transparency and ensure value for money, local authorities should publish comprehensive details of all Part V agreements as well as the use of the associated land, sites, houses and / or money. These are all meant to be ring fenced for social and affordable housing. The allocation of social and affordable housing also needs to be more transparent and accountable.

8.4 The Private Rented Sector

The private rented sector is relatively neglected when it comes to housing policy (O'Sullivan, 1998). Many private renters cannot afford to buy a house, are not eligible for local authority housing and pay relatively high rents. Housing costs are still a problem for many private renters, despite the fact that rents have fallen relative to house prices (Downey, 2003; Fahey 2004a; Fahey et. al., 2004). In particular, households with a full-time employee cannot avail of the Supplementary Welfare Allowance rent supplement.

The changes to the rent supplement scheme, which were introduced at the end of January 2004, as well as the recently announced changes are restrictive and constrain the choices that households can make⁴¹. Under the new measures, the rent supplement scheme will now be refocused on meeting short-term income maintenance needs while local authorities will assume responsibility for meeting

⁴¹ Inter alia, the January 2004 changes include the requirement to be in rented accommodation for six months; the exclusion of a spouse/ partner of a person in full time employment from receipt of rent supplement; new applicants to be referred to the Local Authority and rent supplement not payable to those who refuse a second offer of local authority accommodation.

long-term housing needs. Tenants will not be able to choose their accommodation. Instead, the local authority will decide what is best for them! Restricting choice seldom increases household welfare.

There is widespread agreement that the rent supplement scheme is outdated and needs to be replaced. Originally it was designed to be a short-term income support and not a housing support. It is not at all obvious that the new measures are superior to some form of housing benefit which is tenure neutral.

8.5 Summary

Housing policy in Ireland appears to be focussed on maximizing the level of owner occupation. This is not the optimal policy. More tenure neutral housing policies are required.

The range of schemes designed to help local authority and other tenants buy their own homes need to be rationalized. The role of the social housing sector needs to be reviewed. Details of all Part V agreements should be published and the allocation of all new social and affordable made more transparent.

The recent changes to the rent supplement scheme are restrictive and constrain the choices that households can make. It is not at all obvious that the new measures are superior to some form of tenure neutral housing benefit.

9. Taxation of Housing and Development Land

9.1 Introduction

The government both raises a lot of tax revenue from housing and spends a lot on tax exemptions, reliefs and subsidies. Overall the favourable tax treatment of housing has added to, rather than reduced, housing demand and contributed to the house price boom. From the economic point of view, the fiscal treatment of housing is not well thought out and has large efficiency costs.

9.2 Taxation of the Housing Stock

The taxation of the housing stock / existing houses in Ireland is generally very favourable. For example, there is:-

- No residential property taxes (rates, community charges etc.) on either principal residences, vacant homes or second homes;
- No capital gains tax on principal residences (on less than one acre etc.);
- Limited tax relief on mortgage interest payments.

In addition, local authority service charges are quite low by international standards.

The favourable tax treatment of the housing stock is not economically efficient and so comes at the price of over-investment in housing (including holiday and/or second homes), reduced relocation from higher to lower priced houses and reduced trading down from larger to smaller houses over the life cycle. Quantitatively the estimated effects tend to be large. The international, mainly US, literature is unanimous about these effects. See Berkover and Fullerton (1992), Bruce and Holt-Eakin (1999), Gervais (2002), Pines et. al. (1985) and Skinner (1996) *inter alia*.

Historically, there have been problems with domestic property taxes in Ireland. The problems were mainly administrative, to do with ensuring that the tax base was fair and accurate. Nowadays, it is relatively straight forward to estimate the current values of most houses using data on the prices and characteristics of similar

houses which have sold recently⁴². Certainly there are no good reasons for not having some form of property tax (at a rate of say half a percent of the value of the house) on second homes and long term vacant homes. This would make houses more affordable since taxes are capitalized in house prices. The ESRI, in their Mid-Term Evaluation of the National Development Plan and Community Support Framework (Fitzgerald et. al., 2003) have also highlighted the issue of second homes.

9.3 Taxation of Housing Transactions

Taxation of housing *flows* / transactions - stamp duties, development levies etc. - is generally quite high. For example it is difficult to reconcile 9% stamp duty on sales of a good deal of residential property with 20% capital gains tax on sales of development land⁴³. Stamp duty on residential properties is a good revenue source for the government but tinkering around with different rates for new versus second hand homes, first time buyers versus investors etc. is not very effective in terms of social engineering. In addition, as Oswald (2000) points out, it is not very efficient to tax people for moving.

Many well intentioned policies in the past few years have had unintended negative effects elsewhere, because the different sectors of the housing market are all interrelated. Very often, the less well off have been the main losers. See Murphy (1998), Berry et. al. (2001), Murphy and Brereton (2001) and Ball (2004). In addition, the evidence suggests that the tax changes in 1998, 2000 and 2002 significantly impacted on house prices. See IMF(2004b,pp 32-33) inter alia.

There is no good case for the retention of the myriad of special incentives and

⁴²For example, one could use hedonic regressions to relate the prices of recently sold houses to the characteristics of the houses such as the location, number of bedrooms, number of bathrooms etc. Some hedonic regressions are presented in Appendix C of Bacon et. al. (1998).

⁴³ Over the lifespan of a typical house, the capital gains tax will be paid once whereas stamp duty will be paid multiple times.

reliefs (section 23 reliefs etc.) for investment in residential properties and holiday homes⁴⁴. These incentives and reliefs merely add to the already high level of housing demand and have large deadweight and displacement effects⁴⁵. The actual or supposed market failures, used to justify these incentives, no longer exist.

9.4 CGT on Development Land

In 1998 the government announced a temporary reduction in capital gains tax (CGT) on development land from 40% to 20% for three years, to be followed by a rise to 60% afterwards. The change in CGT was designed to bring forward additional supply. However, the proposed rise to 60% was dropped a couple of years later so CGT on development land sales remains at 20%, an extremely low rate. The justification for the current 20% rate of CGT on development land should be reviewed.

Developers argue that the Section or Part V provisions of the 2000 Planning and Development Act, along with recently introduced local authority development levies, means that the current tax situation is effectively the same as when CGT was 40%. The original Part V requirement was basically that up to 20% of land (or the monetary equivalent in sites or houses) in most developments be set aside for social and affordable housing⁴⁶.

Even ignoring issues of tax incidence, this argument is not correct. The 2002

⁴⁴ For example, the Urban Renewal Scheme, which was due to be phased out on at the end of December 2004, has been extended to the end of July 2006. Few would argue that the scheme is necessary any longer.

⁴⁵ Deadweight refers to an activity that would have occurred regardless of the policy. Displacement occurs if, for example, the main reason an activity is located in a particular area, rather than another area with greater demand / need, is to benefit from tax relief. Displacement also occurs if the activity uses locally scarce factors of production (e.g. skilled builders or residential land) bidding up their prices.

⁴⁶ Crook and Whitehead (2002) look at whether section 106 agreements, which are similar to Part V agreements, are the appropriate way of providing affordable housing in the UK.

Planning & Development Act allows for a great deal of flexibility in dealing with the Part V requirement. Thus, social and affordable housing may be provided in a completely different and far less expensive location than the main development. The value of the land at Part V agreement stage may also be very different from the value of the land two to three years on in the later stages of a development, given the appreciation in house prices. In addition, local authorities have always looked for development contributions. Admittedly, the scale of development levies are somewhat higher than in the past but then so is the expenditure on necessary infrastructure.

9.5 Proposals for Capturing Planning Gain

Many proposals for capturing a larger share of the planning gain or betterment value of development land in Ireland have been discussed. There are good social and economics reasons for wanting to do so. However, experience in the UK and elsewhere, shows that many schemes for taxing planning gains can be rather ineffective and may have the unintended effects of reducing the supply of development land (Evans, 2004a, Chap 17; Litchfield et. al., 2003)

If hoarding is an issue, taxing the value of the undeveloped sites rather than the value of the eventual planning gain is a much better option. Site value taxation of undeveloped zoned and serviced land, possibly at increasing rates, would certainly reduce hoarding⁴⁷. In any case, there are good economic reasons for some form of site value or property taxation.

Kenny type proposals - compulsory purchase of development land with a payment of 25% above existing use value - are unfair because they discriminate between the owners of development land which is compulsorily purchased and adjoining development land which is not. Moreover, there is the issue of how to

⁴⁷Agreed time limits and build-out rates for planning permissions for large development sites, as proposed by Barker (2004) in the UK, would also help. Planning permissions in Ireland generally last for five years.

efficiently allocate such land.

In principle, auctioning compulsorily purchased land will generally maximise the revenue raised and result in an efficient allocation of the land. In practise, as the 3G mobile phone auctions in Europe showed, it is important to ensure that as many bidders as possible enter the auctions and that they do not collude (Klemper, 2003). This may be difficult. Large developers with deep pockets may frighten off small developers, especially if large plots of land are auctioned. In addition, since these auctions would be regular events, there is a risk that developers may learn to collude. Auctions of compulsorily purchased development land would need to be carefully designed.

9.6 Summary

Overall the favorable tax treatment of housing has added to rather than reduced housing demand and contributed to the house price boom. From the economic point of view, the fiscal treatment of housing is inconsistent and has large efficiency costs, including overinvestment in housing. The system should move away from taxing housing flows to taxing the housing stock, thereby reducing housing demand and house prices.

Unnecessary tinkering with stamp duty rates etc. should be avoided. Very often, well intended policies have had unforeseen, negative effects elsewhere. In many cases, the less well off were those adversely affected.

Section 23 type reliefs for residential property add to demand and have large deadweight and displacement effects. The current rate of CGT on development land is very low and should be reviewed. Some form of site value taxation would reduce land hoarding. There are good social and economics reasons for wanting to capture a greater share of planning gains for the public. However, proposals for capturing part of the planning gain need to be considered carefully, to ensure that they are fair and cannot be manipulated.

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