FINANCIAL AND FISCAL MEASURES TO SUPPORT THE HOUSING MARKET

BUDGET 2017

OCTOBER 2016

An Roinn Airgeadais
Department of Finance

Contents

Executive Summary

- A key priority for this Government is to tackle the barriers impeding the development of a fully functioning housing market where supply responds in a stable, predictable and adequate manner to changes in demand.
- In this regard, the Government launched its *Rebuilding Ireland - Action Plan for Housing and Homelessness* in July. This comprehensive Plan takes a holistic approach in addressing the many interacting structural constraints affecting the housing market in areas such as planning and land use, regulation, and skills deficits in the construction sector.
- To further support the Action Plan careful consideration was given to the introduction of new, and the enhancement of existing, financial and fiscal measures. In this regard, the potential role fiscal incentives, particularly those effected through the taxation system, can play in addressing these constraints is inherently limited. Moreover, historical experience has demonstrated that property related tax incentives which are poorly targeted or left unchecked can have very distortionary and adverse impacts.
- With this in mind, it is clear that fiscal supports should only play a supporting and time-bound role in addressing the current problems in the housing sector. Well-designed fiscal incentives can be of assistance but they are not a substitute for addressing the structural factors that are impeding the housing sector.
- Budget 2017 includes a package of fiscal measures, valued at approximately €100 million to complement the structural measures contained in the Action Plan as they are rolled-out and before those actions start to yield results in terms of improving the functioning of the housing market. In other words, fiscal measures will play a supplementary and primarily time-bound role in getting the market moving.
- Building on the structural actions included in the Action Plan, the Government is committed to putting in place the following ten supporting measures:
    1. Help-to-Buy Incentive
    2. Rent a Room Relief extension
    3. Increased mortgage interest deductibility for landlords
    4. ISIF supported fund for housing
    5. ISIF enabling infrastructure fund
    6. Student accommodation investment funding support
    7. Enhancement of the Living City Initiative
    8. Mortgage interest relief extension
    9. CAT tax-free threshold increase
    10. Home renovation incentive extension

2017 BUDGET

SUPPORTING THE HOUSING MARKET

#Budget17

SUPPORTING FIRST TIME BUYERS AND HOME OWNERS

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Tax rebate of up to €20,000 to assist first-time buyers with the deposit for a new home

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Rebuilding Ireland
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1. Introduction

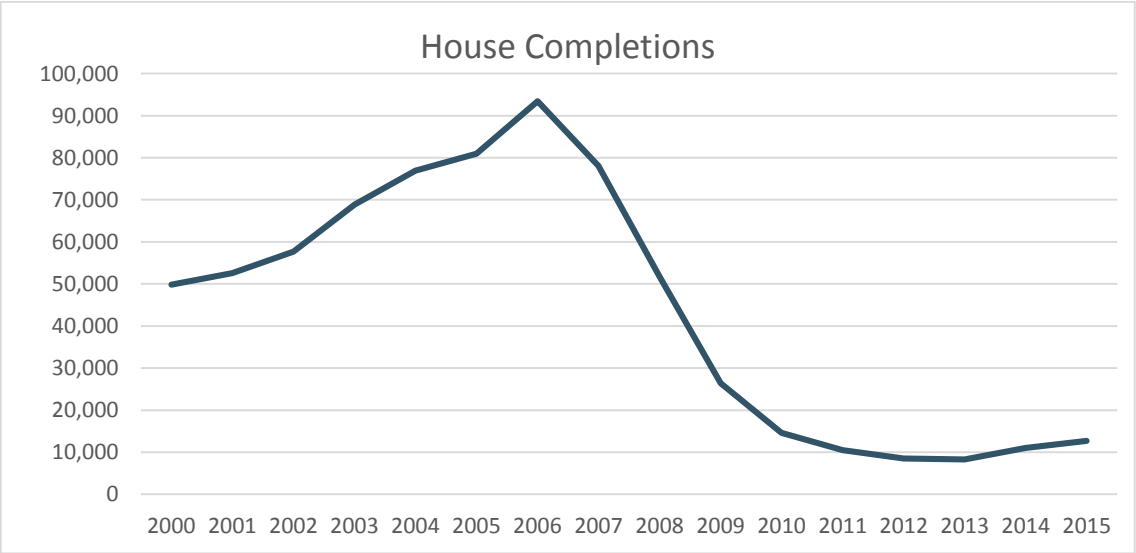
1. One of the key economic and social challenges that this Government has set out to address is the development of a fully functioning housing market that meets the needs of our citizens - one where supply responds in a stable, predictable and adequate manner to changes in demand.

2. Ireland is in the midst of a significant housing shortage where the present sluggish supply response in the face of higher demand for new housing has contributed to rising house purchase prices and rental costs. These developments are giving rise to major social problems including rising homelessness driven by pressures in the private rental market.

3. Furthermore, the housing shortage represents a threat to the economy's competitiveness and long term growth performance. Excessive housing costs pose a serious challenge to attracting skilled immigrants and additional FDI. Mobility of labour within the economy may also be affected giving rise to skill mismatches which are damaging to productivity.

4. National residential construction activity currently is running at just over half of demographic demand. Over 12,600 units were built nationally in 2015 while 14,500 units are forecast for completion in 2016. However, demographic demand models forecast that housing demand over the medium term is for c.25,000 units per annum. The shortfall in new supply in Dublin is expected to be even more pronounced falling far short of the estimated 7,500 units annual requirement.

5. As has been diagnosed by the ESRI and other experts, this unresponsive or inelastic supply reflects the influence of a number of interacting structural constraints in areas such as planning and land use, regulation and skills deficits in the construction sector.



Source: DHPCLG

6. These considerations were very much to the fore in the development of *Rebuilding Ireland, The Action Plan for Housing and Homelessness,* launched in July, which sets out detailed actions that the Government will pursue to tackle the bottlenecks in the sector in order to increase building activity and supply, as well as addressing the problems of homelessness.

7. This Action Plan was developed in close collaboration with key Government Departments, including the Department of Finance, and relevant agencies. The Plan is comprehensive and addresses all aspects of the housing system under five Pillars:

    - Address Homelessness,
    - Accelerate Social Housing,
    - Build More Homes,
    - Improve the Rental Sector, and
    - Utilise Existing Housing.

8. Key measures contained in the Plan intended to accelerate the supply of housing include the allocation of an additional €2.2 billion in capital for investment in social housing up to 2021 and the creation of an Infrastructure Fund of €200m which will be used to open up large sites in areas where people need homes.

9. The Action Plan builds on the previous policy initiatives that have assisted the housing market recovery including *Construction 2020*, the *Social Housing Strategy* (SHS) and more recently the *Stabilising Rent and Boosting Housing Supply* package.

10. The Minister for Finance and his Department have actively engaged with and contributed to the formulation of the Government's response to the housing crisis. As part of this response, Budget 2017 contains a number of additional measures to support the property market. However, before outlining these, it is useful to review some of the key fiscal and financial policy measures that have been introduced to support the housing market over recent years.

11. In reviewing these interventions it is important to bear in mind that the potential role that fiscal incentives, particularly those effected through the taxation system, can play in addressing the difficulties we face in the housing market is inherently limited. Nonetheless, fiscal measures can play a time-bound role in getting the market moving.

12. Ireland's past experience with tax-based interventions in the housing sector also underscores the imperative of adopting a cautious stance towards fiscal incentives in current circumstances. In particular, previous experience with investor-led tax incentives targeted at particular areas or sectors strongly suggests that these types of interventions should be avoided. Indeed, the contribution of tax reliefs to the property bubble of the 2000s and the erosion of the tax base have been highlighted in a number of important reports on Ireland's banking and economic crisis (Honohan, 2010;

Regling-Watson, 2010; Oireachtas Banking Inquiry, 2015)[1]. The key lessons are that property market investments must be inherently viable and that Government fiscal intervention can have very distortionary impacts.

13. Fiscal supports should only play a supporting and time-bound role in addressing the current problems in the housing sector. Well-designed fiscal incentives can be of assistance but they are not a substitute for addressing the structural factors that are impeding the housing sector. Many of these factors are being addressed in the Action Plan for Housing. The role of the measures outlined here is to complement those actions particularly in the short term as the structural measures are rolled-out and before those actions start to yield results in terms of improving the functioning of the housing market.

14. It is also important that policy intervention in the housing market is viewed as being definitive so as to avoid creating uncertainty amongst market participants and volatility. Accordingly, the measures announced in Budget 2017 should be seen as final and the Government will not be considering further tax based housing market incentives over the period of the Action Plan for Housing.

[1] Regling, K. and Watson, M. (2010), 'A Preliminary Report on the Sources of Ireland's Banking Crisis'. Dublin; Honohan, Patrick (2010). The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008. Report to the Irish Minister for Finance by the Governor of the Central Bank; Report of the Joint Committee of Inquiry into the Banking Crisis (2015), Houses of the Oireachtas

2. Measures taken to date

15. The policy supports included in Budget 2017 build upon a number of targeted measures introduced in recent years, which have helped stabilise the property sector and kick-start its recovery. These are listed below:

Social Housing Tenancies Incentive

16. As part of the *Stabilising Rents, Boosting Supply Package* announced in November 2015, a measure was included to provide for an increase in the deduction available to landlords for mortgage interest from 75 to 100 per cent where they let to tenants in receipt of social housing supports. The purpose of the incentive is to encourage landlords to commit to renting their property for a period of three years to tenants in receipt of social housing supports, thereby improving security of supply of rental property to such tenants. By mid-September 2016, 1,260 commitments in respect of qualifying social housing tenancies were registered with the Private Residential Tenancies Board (PRTB), with qualifying tenancies registered in each of the 26 counties.

Ireland Strategic Investment Fund

17. The mandate and structure of the Ireland Strategic Investment Fund (ISIF) allows its funds to leverage additional private sector finance so as to achieve higher levels of housing output than Government could achieve alone. In the past year, ISIF has invested €350 million in two commercial housing ventures, Activate Capital and Ardstone. The total investment, both Government and private sector, is kept off balance sheet, thus freeing up Government resources for other priority investments. The Activate Capital fund (€500 million in total) will provide funding for 11,000 units and be recycled for further investment. The Ardstone Equity Investment (€25 million) will fund the delivery of over 1,500 units.

18. In addition to these residential investments, the ISIF has also partnered with the European Investment Bank and other private investors in providing €54 million (ISIF element) of funding to build six accommodation blocks in Dublin City University. This investment will free up existing rental stock in the surrounding locations.

Living City Initiative

19. The Living City Initiative, launched in 2015, aims to assist in urban development and the restoration of heritage properties. The initiative offers a tax relief for qualifying expenditure incurred on the refurbishment or conversion of certain pre 1915 buildings. The scheme which is run in conjunction with City Councils applies to certain "special regeneration areas" in the centres of Dublin, Cork, Limerick, Galway, Waterford and Kilkenny.

Home Renovation Incentive

20. The Home Renovation Incentive came into operation in 2013. The incentive supports activity in the construction sector, by providing a tax relief for homeowners and

landlords in the form of a tax credit at 13.5 per cent of qualifying expenditure incurred on repair, renovation or improvement work carried out on a principal private residence. By the end of September 2016, 68,453 works were registered under the incentive. This amounts to a cumulative total of €75 million in tax credits available to be claimed by those who have completed works with a value of €1,080 million under the incentive.

Improving the rental market

21. The attraction of investment into professionally managed residential property helps to professionalise the private rental sector and better serve tenants. This was the objective behind the introduction of the Real Estate Investment Trust (REIT) tax regime in 2013. The acquisition of properties by REITs contributes to a more sustainable, long-term property rental market for both investors and property tenants. A number of REITs have since launched, including Hibernia REIT, Green REIT and iRes REIT. The Irish Residential Properties REIT, which launched in April 2014, was the first Irish REIT with a residential property investment focus and has a property portfolio consisting of over 2,000 apartments. The professionalisation of the build-to-rent sector is a way of ensuring that the mistakes of the Section 23 type amateur investments are not repeated.

3. Budget 2017 Measures to Support *Rebuilding Ireland*

22. Building on the initiatives introduced over recent years and as complements to the structural actions included in *Rebuilding Ireland*, Budget 2017 includes a number of supporting fiscal and financial measures as outlined below.

Helping FTBs and Homeowners

I. Help-to-Buy Incentive

23. The Help-to-Buy incentive is designed to assist first-time buyers with the deposit required to purchase a home while complying with the Central Bank's macro prudential rules. It will apply in respect of newly built houses only.

24. The incentive will take the form of a rebate of income tax paid over the previous four tax years up to a maximum of 5 per cent of the purchase price of a new home up to a value of €400,000. Where new homes are valued between €400,000 and €600,000 the maximum relief (i.e. €20,000) will continue to be available. No relief will be available for new builds costing over €600,000.

25. Depending on the approval of the Oireachtas, eligibility for the incentive will be back-dated to take effect from 19th July 2016. This was the date of the publication of *Rebuilding Ireland* and the backdating was announced at that time with a view to avoid any interruption in property sales by potential purchasers deciding to defer purchases, pending the commencement of the incentive. The incentive will run until the end of 2019.

II. Extension of mortgage interest relief

26. Mortgage Interest Relief is intended to improve the affordability of mortgage repayments on the capital borrowed to purchase a home. The gradual phasing out of Mortgage Interest Relief (MIR) has been under way since 2009. No new mortgages taken out since January 2013 have qualified for MIR, and the relief has ceased for qualifying mortgages taken out prior to 2004. The remaining recipients receive relief at a rate of between 15 and 30 per cent of qualifying interest paid – the highest rate of 30 per cent applies to those who purchased between 2004 and 2008 when house prices were at their peak.

27. MIR for all remaining recipients is due to expire at the end of 2017 and, as the relief is administered at source, existing recipients could face a significant net increase in their mortgage payments (all other factors being equal). The Programme for a Partnership Government contains a commitment to retain MIR beyond the current December 2017 end date on a tapered basis and Minister Noonan has confirmed that he will bring forward such an extension in Budget 2018.

Improving the rental market and tackling supply constraints

28. A well-functioning rental market is crucial in supporting the performance of the wider economy. Though the provision of private and social accommodation, the rental market can moderate the property cycle and reduce household and the economy's

exposure to house price fluctuations. The key aim is to professionalise the sector and make it fit-for-purpose.

29. The focus of Government action will be to further develop the market by directly investing in new housing, as set out in *Rebuilding Ireland -The Action Plan for Housing and Homelessness*, but also by continuing to attract investment in the sector by maintaining certain existing tax incentives for landlords and by introducing a number of new measures.

III. Mortgage interest deductibility for landlords

30. Mortgage interest deductibility for landlords of residential property was restricted to 75 per cent of qualifying interest in supplementary Budget 2009, in the context of the fiscal crisis and the need to broaden the income tax base. Interest deductibility for borrowings relating to commercial rental property remained at 100 per cent.

31. Reduced interest deductibility has limited the attractiveness of the residential rental market for private landlords and significant progress has been made since 2009 on the broadening of the income tax base in other areas.

32. Accordingly, to further support the provision of accommodation by landlords, a phased unwinding of the restriction on interest deductibility for residential landlords has been announced in Budget 2017. An increase in interest deductibility from 75 per cent to 80 per cent will take effect from January 2017. It is intended to further increase the allowable deduction on a phased basis in future years, subject to having the available fiscal resources.

IV. Rent-a-room relief

33. The ceiling for income under the Rent-a-Room relief will be increased from €12,000 to €14,000. This increase would, for example, allow a homeowner to rent out two separate single rooms in Dublin at current average prices but still remain within the scope of the incentive. This change is aimed at encouraging homeowners to rent out vacant rooms and could lead to an overall increase in the availability of rental accommodation.

V. Living City Initiative

34. The Programme for Partnership in Government states: *"We will review the Living City Initiative and the conditions that apply to the size of properties in order to boost the attractiveness of the scheme, which will contribute to both built heritage and urban regeneration"*.

35. The Department of Finance has engaged with the relevant City Councils and the Department of Arts, Heritage, Regional, Rural and Gaeltacht Affairs and undertook a review of the Living City Initiative, which is published today as part of the *Report on Tax Expenditures 2016*. The review has identified specific aspects of the Initiative which could be amended to encourage participation and ensure the Initiative can achieve the socio-economic objectives that it is targeted at.

36. The scheme will be opened up to landlords to invest in heritage properties for subsequent rental. In addition other changes are being made to improve the functioning of the incentive and to make it more attractive. These include amending the residential element of the scheme to remove the limitation on the maximum floor size of a property, removing the requirement that the property must have been previously used as a dwelling, and reducing the minimum amount of expenditure needed to qualify for the incentive.

VI. Home Renovation Incentive extension

37. The HRI provides tax relief for homeowners and landlords by way of a tax credit at 13.5 per cent of qualifying expenditure incurred on repair, renovation or improvement work carried out on a residence. In order to assist homeowners and landlords in repairing and renovating their properties, this incentive is extended for a further two years until the end of 2018.

VII. ISIF supported fund for housing

38. The Ireland Strategic Investment Fund (ISIF) and the wider National Treasury Management Agency (NTMA) is examining the feasibility of establishing a new funding vehicle, in conjunction with the private sector, that is capable of funding the delivery of new mixed-tenure residential developments, with a strong focus on social housing, in a way that is both off-balance sheet and is commercially viable. It is envisaged that whilst social housing delivery is a key focus, a substantial portion of the overall supply of new units from such a funding vehicle, would also include private housing to meet the commerciality test and to satisfy the requirements of an off-balance sheet investment model. As outlined in *Rebuilding Ireland*, such a funding vehicle has the potential, if the challenges of establishing commerciality and off-balance sheet treatment can be satisfactorily met, to provide in the order of 5,000 additional units over a five-year period for social housing and could also play an important role in helping to activate residential construction for the broader build-to-rent sector.

VIII. ISIF enabling infrastructure fund

39. The Ireland Strategic Investment Fund (ISIF) will support the delivery of housing-related enabling infrastructure in large scale priority development areas through the provision of upfront capital to developers with repayments made either as sites or completed housing units are sold. The eligible infrastructure includes non-income producing assets such as roads, drainage, water supply pipelines, and specific works included in conditions of planning permission. ISIF's flexible approach to funding, its ability to look at innovative financing structures, its view on risk, and potential longer tenures mean that it can provide funding in areas that are not currently suited to more traditional debt providers or developer equity. Initial ISIF engagement with local authorities and private sector developers indicates that infrastructure financing requirements will be in the order of €250 million.

IX. Student accommodation

40. ISIF has already made a substantial investment in student accommodation through its €54 million investment in Dublin City University's overall €230 million campus

redevelopment. Given the commercial returns that are available from the rental income on student accommodation, ISIF (in tandem with third party investors) is open to further investment opportunities in the sector. The primary benefit of ISIF's investment in this sector is the freeing up of significant rental accommodation in the vicinity of third level institutions. There are additional significant benefits from ISIF's commercial investment focus, including; the leveraging of third party funds which keep the investments off the State's balance sheet, and also timely project delivery as opposed to using alternative funding mechanisms that may require lengthy state aid clearance processes.

X. CAT tax-free thresholds

41. One of the commitments in the Programme for Partnership in Government is to raise the Band A Capital Acquisitions Tax Threshold (including all gifts and inheritances from parents to their children) to €500,000. A first step towards meeting this objective is to increase this CAT tax-free threshold to €310,000 in Budget 2017. This will help reduce the tax burden faced by individuals who inherit a property from their parents, the value of which would have exceeded the previous threshold of €280,000.

42. In addition both the Band B and C CAT tax-free thresholds will be increased by 7.8 per cent. The new Band B CAT tax-free threshold will be €32,500 while the Band C threshold will increase to €16,250. All three new thresholds will apply to gifts and inheritances taken on or after 12 October 2016.

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