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By Alan Ahearn

Should the budget contain measures to boost the property market? **Ronan O'Driscoll** argues 'Yes', that by encouraging the sale of 30,000 unoccupied homes, the Government could inject €10 billion into the ailing economy, while **Alan Ahearne** says 'No', that a fall in property prices and a smaller construction sector are the tough medicine this economy needs.

YES: CONSIDER THE impact of the sale of one single new apartment. It triggers a series of activities spanning numerous industries and creates work and income for many different people, from banks to furniture suppliers to insurance companies to carpet fitters. Hundreds of thousands of people in Ireland in recent years have become directly or indirectly reliant on activity in the house-building industry, writes Ronan O'Driscoll

This sector has been at a virtual standstill for the past 18 months and there are few signs of recovery. This lack of activity is contributing in a very significant way to the dramatic shortfalls in exchequer returns.

Immediately after the announcement of the early budget, speculation started on what the Government could do to assist the market. Recently, the Minister for Finance indicated that the budget "was not all about property" and of course he is correct in the sense that Ireland has become far too reliant on house building and property development.

It is also true however, that if the housing sector cannot be ignited soon, the pattern of job losses in hundreds of related industries will continue as more companies downsize or close. I wonder if the Government is aware of or is willing to face up to the extent of the problem.

We find ourselves in a very strange and unprecedented situation today in Ireland. There are up to 30,000 new homes built and unsold in the Republic right now and several thousand more at varying degrees of completion.

That equates to a ghost town the size of Galway city. If all of these homes could be sold, up to €10 billion would be injected into the economy. This massive injection of money would be spread throughout the country and would impact positively on a huge variety of industries.

Given the extent of oversupply, it is unrealistic that all of these units can be sold in the short term - there are simply not enough people to fill them in many parts of the country. But for those in the major cities and towns, a short, sharp, aggressive initiative can deliver significant sales, activity and economic benefits quickly.

The vast majority of unsold completed homes are well finished, well built and well located. If a significant proportion of these homes can be sold, the money will circulate again and jobs will be created rather than lost. Furthermore, and critically, banks will be repaid and more money will be available for lending.

The sluggish market has been dragging on now almost two years and during this period first-time buyers and traders-up have been waiting for the market to bottom out. So far, the perceived bottom has not yet been reached.

Most developers, however, are now offering excellent value, yet demand has not been stirred. A positive move by the Government next month could release demand but only if these moves are aggressive enough. Tinkering with stamp duty, for example, would be ineffective.

The Government must be radical in its approach to the problem. The reintroduction of a first-time buyer's grant of, say, €5,000 would only have a token effect.

What is required now is much more significant and it needs to be in the magnitude of €20,000 to €25,000 to have a meaningful impact.

Today in Ireland, we pay a massive 13.5 per cent of the price of a new home in VAT. In the UK, there is a zero VAT rate applicable. On an average new home, almost €40,000 is paid directly in VAT and a third of the price of a new home is made up of taxes in some form or other. The Government, more than any other entity, including the developer, benefits most from the sale of every new home.

I propose that, for a specific nominated and non-extendable period of time, and with the objective of getting this massive oversupply sold, purchasers should be permitted to reclaim a significant portion (75 per cent in my view) of the VAT on their new home. This will work if it is applied for a specific period of time, such as 12 months. It is my belief that this will yield as many as 15,000 sales in that period, generating €150 million or more in VAT and many millions more in other forms of taxation. Furthermore, many jobs will be retained and there will be a significant knock-on saving in unemployment benefit payments.

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Another major benefit will be to ease the pressure on the banking sector which will in turn be in a position to release funds back into the market. It will most certainly boost confidence generally and numerous sectors - not just property-related ones - would benefit. It is also not a costly initiative from the Government's point of view. Vat returns from property are negligible at present.

Stamp duty, the old chestnut, has been spoken about for long enough and tinkered with recently. The reality is that the 7 per cent and 9 per cent rates are too high and hinder movement in the market. Stamp duty here remains the highest in Europe and should be reduced. This too will result in more activity and ultimately more, not less, in exchequer returns.

Ronan O'Driscoll is director of new homes at Savills Hamilton Osborne King.

NO: A fall in property prices and a smaller construction sector are the tough medicine this economy needs, says Alan Ahearne

AMID TURMOIL in global financial markets, it might be tempting to put the blame for Ireland's recession on the international credit crisis. That would be the wrong conclusion. Our economic problems stem to a significant degree from the speculative bubble in property prices that inflated over the period 1999-2006. That bubble was associated with an extraordinary expansion in new homebuilding and construction of commercial property. As a result, economic growth and public finances became dangerously over-reliant on construction activity.

It follows that the proper treatment for what ails our economy is a drop in property prices and a shrinking of the construction sector. The necessity for the bubble to deflate cautions against measures to stimulate the property market.

For starters, it would be a mistake to try to stimulate new homebuilding. Residential investment has been running at levels well above estimates of medium-term housing needs for many years. The resulting large surplus can only be worked off if new-home building remains at low levels, say, 20,000 units annually, for a prolonged period of time. The Government should avoid actions that would add to the excess supply.

It would also be wrong for the Government to try to shore up property prices. Although house prices have fallen significantly over the past two years, they remain elevated relative to rents and disposable incomes. Further declines are therefore necessary to bring house prices in line with other parts of the economy. The resulting improvement in affordability will boost demand.

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Vested interests are lobbying the Government to use taxpayers' money to provide incentives to first-time buyers. They argue that these schemes may be self-financing, because a large amount of unclaimed VAT is tied up in the unsold housing stock. This is nonsense. The Government will receive this unclaimed VAT in any event, because the unsold houses will eventually sell when prices have corrected. The incentive to buyers should take the form of lower asking prices, not taxpayers' funds.

One question is whether developers can cut house prices any further without incurring significant losses. The answer largely depends on when the development land was purchased. Developers who bought land in recent years could probably slash prices and still turn a profit. Developers who bought more recently may have to sell at well below cost price, because that cost includes the inflated price of land that the developer mistakenly paid.

Many of the schemes proposed by vested interests are supposedly aimed at increasing the availability of mortgage credit. The argument for these proposals seems to be that first-time buyers are unable to take advantage of falling house prices because banks are demanding unreasonably large deposits.

However, this argument seems to confuse the asking price for a house with its true market value. Lenders correctly believe that the market-clearing values are well below current asking prices and have therefore reduced the amount they are willing to lend.

Moreover, lenders are requiring larger deposits from buyers whose employment prospects have become more uncertain, such as workers in the construction industry. Requiring larger deposits from more risky borrowers is perfectly sensible banking practice. The Government should not be encouraging financially vulnerable people to purchase property in the current economic environment, especially since prices are almost certain to continue to decline.

Vested interests complain that lenders will currently only offer mortgages of 80 per cent or less of the asking price. However, those complaints are not consistent with guidelines for first-time buyers that banks have provided recently to mortgage brokers. Most lenders no longer offer loans with loan-to-value ratios of above 95 per cent. This is no bad thing, as 100 per cent mortgage products should never have been offered. Most lenders, however, continue to advertise 90-92 per cent mortgages.

Requiring a deposit of 8-10 per cent of the price is not an unreasonable lending practice. Banks' internal criteria may be stricter and not all buyers will qualify for such products. However, this doesn't point to a failing mortgage market. Assessing buyers on a case-by-case basis is hardly inappropriate.

In addition, banks can be expected to demand smaller deposits when house prices have moved down closer to market-clearing levels, since the risk of prices falling further will have diminished. Moreover, for a given loan-to-price ratio, lower house prices mean lower deposits.

Neither is there a strong case for expanding existing State-subsidised programmes such as affordable housing schemes. Falling house prices will make houses affordable again.

There is a case for subsidies to energy-efficiency investments in houses. Insulation investments in houses have long been recognised as an economically attractive way to reduce carbon dioxide emissions. Subsidies for such insulations might give rise to a double dividend of environmental benefits plus a cushioning of the necessary but painful contraction of the construction sector.

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