Submission to the Public Consultation on Tax and Fiscal Treatment of Landlords

'Toward a housing system that serves society'

Focus Ireland is one of the leading providers of support services to individuals and families experiencing or at risk of homelessness and to vulnerable young people leaving care. In the course of our work we have day-to-day exposure to the faults and weaknesses within our housing system.

Since 2012 Focus Ireland has been designated by the Dublin Region Homeless Executive (DRHE) as the Family Homeless Action Team (HAT) in the Dublin area. During that period of time we have seen the number of families newly presenting as homeless in the Dublin area and allocated to this team grow from 15 a month in 2013 to 75 a month in 2016.

A large majority of these families had their last secure home in the private rental sector and the most significant driver of these families becoming homeless has been the increasing cost of rental accommodation.

Given that a very high proportion of people facing homelessness previously resided in the private rented sector, the failings of the private rental system feature strongly in the experience of the over 5,000 customers who used our Advice and Information services in 2015.

The private rented sector will continue to play a significant role in the Irish housing market into the future. This is particularly true of households leaving emergency accommodation, who are reliant on the sector due to the shortfall in social housing. In 2016 Focus Ireland helped to support 320 families out of emergency accommodation. Of these, 161 moved into the private rented sector. We must continue to develop the sector to ensure it can provide stable and secure homes.

Focus Ireland welcomes the fact that Rebuilding Ireland is being considered and seen to be taken ownership of by departments other than the Department of Housing Planning and Local Government. That the Department of Finance is taking the time to have such an open consultation is equally welcome.

Background/Context

The paper issued for the consultation setting out context, background and the objectives that the Department is seeking to meet is instructive. The document properly notes the intrinsic link between the rental housing market and the owner-occupier housing market and sets out that fiscal policy must take account of the needs of a broader housing market.

However Focus Ireland believes that the Department needs to take a broader view of the housing 'system' if we are to ensure a successful long-term strategic policy for the provision of housing.

In particular the interrelatedness of the provision of housing support in Ireland needs to be given more consideration. Fiscal policy set with a focus on a binary choice between private rental and home ownership will not foster a housing system that serves Irish society and the Irish economy.

To move beyond the binary position set out in the consultation paper it useful to interrogate some of the premises regarding the private rental market that are asserted there.

Analysis

In the public consultation paper released by the Department, it is stated that: "The current shortage of supply of residential rental properties is driving upward pressure on rental prices and making it difficult for prospective tenants to find affordable homes.

At the same time, increases in house prices might be facilitating some individuals who may not wish to be landlords to exit the market and may be prompting some multi-property landlords to reduce their property holdings, thereby further constricting the supply of residential rental property."

The vista that is projected is one of a rental sector that is too small with landlords exiting or preparing to exit at a significant rate.

Figures from Daft on the availability of accommodation to rent nationally and on the increased cost of rents and data from the RTB rent index confirm that demand is outstripping supply and the cost of renting particularly in the Dublin area is rising to previously unseen highs seeming to support this analysis.

In addition Focus Ireland is seeing some 20 families a month becoming newly homeless in the Dublin region due to landlords selling up to take advantage of a buoyant housing market or being encouraged to sell up by lenders due to mortgage arrears again supporting the premises set out in the paper.

However, Residential Tenancy Board records, set out in table 1 below, suggest that while the number of landlords reduced 2012 to 2014 the number is again increasing and the number of properties being let continue to increase.

Recent CSO figures show that the majority of rental property is in the urban areas with the private rental market now at 25% of the total market in the Dublin area.[1]

There are also reports of significant development in the Dublin area of properties to go directly to the rental market so called ‘build to rent’. However these developments are particularly aimed at the high end of the market. So what we are likely seeing is a rental market that is slowly consolidating with rental properties concentrating at the ‘high cost’ end. This will obviously exacerbate the issues for families that can lead to homelessness without significant government intervention.

Table 1 taken from RTB annual reports outlining tenancy and landlord information

Year	Tenancies registered	Total Tenancies	No. Landlords	Ratio Tenancies to Landlords
2010	101,888	231,818	145,021	1.60
2011	99,914	260,144	182,800	1.42
2012	97,181	264,434	212,306	1.25
2013	114,405	282,918	179,026	1.58
2014	112,873	303,574	160,160	1.90
2015	105,566	319,609	170,282	1.88
2016	106,075	325,372*	175,250	1.86

*From April 2016 Approved housing bodies (AHB’s) have been registering with the RTB 5129 were registered in 2016.

Reviewing current indicators such as the Daft report for the 3rd quarter of 2016 which found market rent in Dublin is ‘14% higher than their previous peak at the start of 2008’ and yields as

[1] https://www.irishtimes.com/business/economy/home-ownership-in-dublin-falls-to-record-low-1.3008896?mode=amp

high as 11% in some areas[2] for investors there is a strong incentive for landlords to stay in the market and to continue to invest.

In addition the Department of Finance and the Government will have to take account of projections by the ERSI that the current growth in the economy holds out the possibility of overheating.

'The *expected* increase in construction related activity will contribute to a consistent fall in unemployment over the next two years. We expect the unemployment rate to fall to 6.4 and 5.6 per cent by the end of 2017 and 2018. Any fall below 5.5 per cent would almost certainly indicate that the domestic economy is beginning to overheat.'[3](*Emphasis added*)

Market Disruption

The short review outlined so far suggests that the private rental market is in a growth phase with strong investor returns. It might well be assumed that growth in the private rental market, if it is desirable, is hampered not by the tax treatment of landlords but by the shortage of supply of housing more generally.

However there are a number of other factors that might have a disruptive effect on the private rental market and indeed could contribute to homelessness.

Some landlords argue that the tax treatments of income from rental properties mean that many landlords are operating at a loss but having purchased at a point that they remain in negative equity they are unable to exit the market. With the current growth the prices of housing the tipping point for these landlords who bought in the 2005-2008 period and have continued to make repayments if it has not already arrived might be approaching.

One of the first and most significant interventions of the last government was the introduction of a capital gains tax exemption on properties that were bought between 7th December 2011 and 31st December 2014. It is only possible to benefit from the exemption if the property is held for 7years or more and then a proportion of the gains tax is applied after that period. So if the property is held for 10years the CGT exemption is 7/10.

The question that arises is, as the CGT exemption matures in December 2018 to December 2020 what is the likelihood that we will see mass exits of investor landlords from the private rental market?

[2] http://www.daft.ie/report/2016-q4-rental-daft-report.pdf
[3] http://www.esri.ie/pubs/QEC2017SPR.pdf

This is difficult to gauge as there are a number of unknowns including how many properties were bought as investments in this timeframe and were let out. The table above shows the growth in registered tenancies over the period as 43,430 so there is very clear significant potential for disruption in the private rental market. In addition we do not know how many of the untenanted properties that are in urban areas may have taken advantage of CGT exemption and are now waiting for the investment to mature at which point they may release these properties into the market.

To aid our consideration of investor landlord responses we have modelled two scenarios the first being a cash investor landlord who purchase a property outright in a desirable Dublin central location. The second model is an investor landlord who purchased the same property mortgaging 60% of the cost of the investment. The full details of these are provided as appendix. We do not know how common the investor landlord scenarios outlined are so there is no claim here as to their representativeness however the models bring up some interesting considerations for investors who are in a position to avail of the exemptions.

In particular in order for the CGT 7 year exemption to retain its monetary value (€46,200 in this case) past year 7 they would have to secure a year on year increase in house price of 5%. If the year on year increase after year 7 is reduced to 3% then the value of the CGT break in the model is reduced to just under €40,000. However the capital in the property continues to increase so the investor who exits at year 10 still has a 3% year on year capital gain on the property (an additional €14,600 in the model). This capital gain is only one part of the equation as the rental income also has to be factored in. We modelled rental income based on the daft reports for the Dublin 7 area for a 2bed property and allowed deductible cost of 1.5months rent per year taxed at the top rate of income tax and PRSI. In the three years past the maturation of the CGT exemption the net rental income received by the investor landlord is projected as €24,000.

In the second instance the investor landlord has taken out a loan in respect of 60% of the cost of the property at 4.85% over 20 years so the return in terms of the capital on the home from the base price remain constant in this example but we have to take account of the mortgage costs. Over the course of the 7 years the investor landlord would have to contribute an additional €24,034 to meet the borrowing cost however over the 7 years they will have paid down €39,518 capital from the loan.

Table 2. Investor Landlord Return on capital investment.

Landlord Investor 1			Landlord Investor 2	
(a) initial investment	€200,000.00		(a) initial investment	€40,000.00
(b) net rental income	€43,680.00		(b) net rental income	-€25,747.69
(c) capital accrued	€140,000.00		(c) capital accrued	€140,000.00

(d) loan capital paid down	N/A	(d) loan capital paid down	€39,518.00
(e) profit (b+c+d)	€183,680.00	Total capital accrued (c+d)	€179,518.00
Return (e/a)	92%	Return (c+d/a-b)	255%

The maturation of the 7 year tax exemption creates a natural interval to evaluate the investment and the models set out above and in the appendix look beyond the 7 years to the 10th year.

As stated above the first landlord investor will require 5% year on year property price growth to maintain the full benefit of the CGT exemption but even at a more modest 3% overall capital return is €5,000 a year and €8,000 in net rental income. The capital investment at this point of evaluation is €340,000 of which €13,000 amounts to 3.8%.

The second landlord investor will see the same capital growth in the property but this will have to be offset by the estimated €2,000 a year that they will have to contribute to the cost of the mortgage which in turn is offset by the €7,000 capital accrued through payment of the mortgage. So at a 3% capital return for years 8-10 the total is €10,000 per year with a capital investment at this point of 219,518 which amounts to 4.6%.

However if house prices level out increasing at just over 1% for the years 8-10 then the CGT exemption has a built in claw back which means that the capital return to the investor landlord will fall by just over €3,000 over years 8-10.

Taken together the scenarios that are outlined suggest that there is a strong possibility that there will be significant disruption in the private rental market. What the models illustrate clearly is that the provision of a home to a family or individual from a financial perspective is an investment where the return is significantly held within the capital accrued within the property.

Trajectory

Above we have set out a short review of the current market situation. This includes an examination of the most significant recent fiscal interventions in the property market by the state.

Taken together and in the context of the current examination of tax treatment of landlords it highlights the need to answer the question of where we want to go in the future.

Focus Ireland have previously called for tax treatment of residential landlords to be given consideration and for the provision of a social dividend through taxation policy to encourage landlords to support those in need of social housing. This was in part to offset the cost of rental accommodation that rent supplement and housing assistance payments did not meet. Recent increases in rent supplement payments and homeless housing assistance payments make this less urgent.

Michelle Norris has shown the effect of policy on housing provision and even influencing how we think about housing. Norris's work highlights that the perceived obsession with home ownership is a consequence of state intervention[4]. Currently the private rental market is dominated by investor landlords who resist tenant security as it impinges on their ability to realise that investment at a time of their choosing.

Focus Ireland believes we need the private rental market to move toward a market designed to secure a return for the provision of homes to those who are not eligible for the support of the state. We have set out in other submissions that we believe there should be greater state intervention to secure a public housing system including innovative solutions such as cost rental model but in the private rental market we need to change the structure of the market from one of an investment to one of provision of a service.

As noted in the first section of this submission the private rental market now accounts for 25% of housing provision in Dublin. Focus Ireland does not believe that the proper course of action is to provide greater fiscal incentives to see the current system or levels of privately rented accommodation expanded.

Focus Ireland does note that it is difficult to identify any other investment that suffered such retrospective negative tax treatment in the years following the financial crash. However Focus Ireland does not believe that it is constructive or timely to look at marginal rates of taxation on rental income or expenditure particularly in the context of the economic projections that the ERSI set out.

In short in the context of the current market tax breaks for Investor landlords would appear to be an excessive transfer of state funds to private investors already making significant returns.

However using the tax and private rental regulatory system to encourage a wholesale restructuring of the private rental market from a capital investor market to one of business investors would be constructive in the short-term. It also may have long-term benefits beyond the housing system into the broader economic system helping to ameliorate boom bust trends by providing greater stability.

Recommendation or actions for consideration

[4] Norris, M. (2016) *Property, Family and the Irish Welfare State*, Cham, Palgrave MacMillan.

Focus Ireland does not support policy approaches which introduce new tax breaks in an attempt to to ‘incentivise’ landlords or particular sections of the private rented sector.

Focus Ireland does propose that landlords be treated as a business for tax purposes. However, the business in question must be ‘providing homes’ with all the commitment to security and quality standards implied by this. The treatment of landlords as a business gives the State the authority to establish clear requirements and obligations concerning how the business is carried out.

Focus Ireland is proposing that tax on income for those renting a property that is designated as a ‘rental business’ is reduced but a higher rate of capital tax be set to encourage retention as a business and to offset some of the loss to the exchequer.

Issues that would have to be looked at are loopholes in the context of so many landlords with only 1 or 2 properties so there would have to be consideration given to a clause preventing a designation of the property as a principle private residence for the purposes of tax avoidance. If this were to be an opt-in system the implications of a two-tier rental system developing would also have to be considered.

The benefits, pitfalls and structure of such a substantial alteration of the private rental market are most likely best investigated within a working group such as the one set up by the department of Finance.

Focus Ireland is offering the proposal as an action that would radically alter the relationship of landlords with their properties. Such restructuring as we have set out above should be conducted in the context of an evaluation with the department of housing of the needs of tenants in the private rental sector and a commitment at a minimum to provide greater security. In particular the need, as evidenced by Focus Ireland, for the rights of tenants to have their part IV tenancy respected where a property is sold.

Appendix 1 Capital Gain

Scenario 1 5-6% increase

Year 7						
Purchase Price	% increase	Sale Price	YonY increase	Potential CGT	CGT Exemption	Capital Gain
€	70%	€	%	33%	100%	€
€200,000.00	€140,000.00	€340,000.00	NA	€46,200.00	€46,200.00	€140,000.00

Year 8						
Purchase Price	% increase	Sale Price	YonY increase	Potential CGT	CGT Exemption	Capital Gain
€	80%	€	%	33%	88%	€
€200,000.00	€160,000.00	€360,000.00	5.9%	€52,800.00	€46,200.00	€153,400.00

Year 9						
Purchase Price	% increase	Sale Price	YonY increase	Potential CGT	CGT Exemption	Capital Gain
€	90%	€	%	33%	78%	€
€200,000.00	€180,000.00	€380,000.00	5.6%	€59,400.00	€46,201.32	€166,801.32

Year 10						
Purchase Price	% increase	Sale Price	YonY increase	Potential CGT	CGT Exemption	Capital Gain
€	100%	€	%	33%	70%	€
€200,000.00	€200,000.00	€400,000.00	5.3%	€66,000.00	€46,200.00	€180,200.00

Scenario 2 3% increase

Year 7						
Purchase Price	% increase	Sale Price	YonY increase	Potential CGT	CGT Exemption	Capital Gain
€	70%	€	%	33%	100%	€
€200,000.00	€140,000.00	€340,000.00	NA	€46,200.00	€46,200.00	€140,000.00

Year 8						
Purchase Price	% increase	Sale Price	**YonY increase**	Potential CGT	CGT Exemption	Capital Gain
€	75%	€	**%**	33%	88%	€
€200,000.00	€150,200.00	€350,200.00	**3.00%**	€49,566.00	€43,370.25	€144,004.25

Year 9						
Purchase Price	% increase	Sale Price	**YonY increase**	Potential CGT	CGT Exemption	Capital Gain
€	80%	€	**%**	33%	78%	€
€200,000.00	€160,800.00	€360,800.00	**3.03%**	€53,064.00	€41,273.18	€149,009.18

Year 10						
Purchase Price	% increase	Sale Price	**YonY increase**	Potential CGT	CGT Exemption	Capital Gain
€	86%	€	**%**	33%	70%	€
€200,000.00	€171,600.00	€371,600.00	**2.99%**	€56,628.00	€39,639.60	€154,611.60

Scenario 3. 1% increase

Year 7						
Purchase Price	% increase	Sale Price	YonY increase	Potential CGT	CGT Exemption	Capital Gain
€	70%	€	%	33%	100%	€
€200,000.00	€140,000.00	€340,000.00	NA	€46,200.00	€46,200.00	€140,000.00

Year 8						
Purchase Price	% increase	Sale Price	**YonY increase**	Potential CGT	CGT Exemption	Capital Gain
€	72%	€	**%**	33%	88%	€
€200,000.00	€144,000.00	€344,000.00	**1.18%**	€47,520.00	€41,580.00	€138,060.00

Year 9						
Purchase Price	% increase	Sale Price	**YonY increase**	Potential CGT	CGT Exemption	Capital Gain
€	74%	€	**%**	33%	78%	€
€200,000.00	€148,000.00	€348,000.00	**1.16%**	€48,840.00	€37,987.75	€137,147.75

Year 10						
Purchase Price	% increase	Sale Price	**YonY increase**	Potential CGT	CGT Exemption	Capital Gain
€	76%	€	**%**	33%	70%	€
€200,000.00	€152,000.00	€352,000.00	**1.15%**	€50,160.00	€35,112.00	€136,952.00

Appendix 2

Gross Rent Return

Assumption/Source for rent rates	Rent Set	Monthly Rate	Yearly Gross	Yearly Gross Return (10.5mths)
Daft Rate for D7	q1 2012	€962.00	€11,544.00	€10,101.00
Daft Rate for D7	q1 2013	€1,014.00	€12,168.00	€10,647.00
Daft Rate for D7	q1 2014	€1,171.00	€14,052.00	€12,295.50
Daft Rate for D7	q1 2015	€1,306.00	€15,672.00	€13,713.00
24 Month Regs	q1 2016	€1,306.00	€15,672.00	€13,713.00
Rent Pressure Zone	q1 2017	€1,358.00	€16,296.00	€14,259.00
Rent Pressure Zone	q1 2018	€1,385.00	€16,620.00	€14,542.50
Rent Pressure Zone	q1 2019	€1,412.00	€16,944.00	€14,826.00
4% increase	q1 2020	€1,468.00	€17,616.00	€15,414.00
4% increase	q1 2021	€1,526.00	€18,312.00	€16,023.00

Rental Return for Investor landlord 1

Rent Set	Monthly Rate	Yearly Gross Return (10.5mths)	Income Tax	Net Return
q1 2012	€962.00	€10,101.00	€4,848.48	€5,252.52
q1 2013	€1,014.00	€10,647.00	€5,110.56	€5,536.44
q1 2014	€1,171.00	€12,295.50	€6,393.66	€5,901.84
q1 2015	€1,306.00	€13,713.00	€7,130.76	€6,582.24
q1 2016	€1,306.00	€13,713.00	€7,130.76	€6,582.24
q1 2017	€1,358.00	€14,259.00	€7,414.68	€6,844.32
q1 2018	€1,385.00	€14,542.50	€7,562.10	€6,980.40
q1 2019	€1,412.00	€14,826.00	€7,709.52	€7,116.48
q1 2020	€1,468.00	€15,414.00	€8,015.28	€7,398.72
q1 2021	€1,526.00	€16,023.00	€8,331.96	€7,691.04

Appendix 3

Rental Return for mortgaged Investor landlord 2

20 years	€160,000.00	4.85%	€1,042.71 mth

Mortgage Structure for Investor landlord 2

Year	Opening Balance	Annual Interest Charged	Capital Repayment	Monthly Payment
1	€160,000	€7,653	€4,860	€1,042.71
2	€155,140	€7,412	€5,101	€1,042.71
3	€150,040	€7,159	€5,354	€1,042.71
4	€144,686	€6,893	€5,619	€1,042.71
5	€139,067	€6,615	€5,898	€1,042.71
6	€133,169	€6,322	€6,190	€1,042.71
7	€126,979	€6,015	€6,497	€1,042.71
8	€120,482	€5,693	€6,819	€1,042.71
9	€113,662	€5,355	€7,158	€1,042.71
10	€106,504	€5,000	€7,513	€1,042.71
11	€98,992	€4,627	€7,885	€1,042.71
12	€91,106	€4,236	€8,276	€1,042.71
13	€82,830	€3,826	€8,687	€1,042.71
14	€74,144	€3,395	€9,118	€1,042.71
15	€65,026	€2,943	€9,570	€1,042.71
16	€55,456	€2,468	€10,044	€1,042.71
17	€45,412	€1,970	€10,542	€1,042.71
18	€34,870	€1,447	€11,065	€1,042.71
19	€23,804	€899	€11,614	€1,042.71
20	€12,190	€323	€12,190	€1,042.71

Yearly cash return for Investor landlord 2

Year Begins	Mortgage	Yearly Gross Rent (10.5mths)	Interest on Mortgage	75-100% Mor relief	Liable for Tax	Income Tax	Rent - tax=return	Return-Mortgage
q1 2012	€12,600.00	€10,101.00	€7,653.00	€5,739.75	€4,361.25	€2,093.40	€8,007.60	-€4,592.40
q1 2013	€12,600.00	€10,647.00	€7,412.00	€5,559.00	€5,088.00	€2,442.24	€8,204.76	-€4,395.24
q1 2014	€12,600.00	€12,295.50	€7,159.00	€5,369.25	€6,926.25	€3,601.65	€8,693.85	-€3,906.15
q1 2015	€12,600.00	€13,713.00	€6,893.00	€5,169.75	€8,543.25	€4,442.49	€9,271.71	-€3,329.29
q1 2016	€12,600.00	€13,713.00	€6,615.00	€4,961.25	€8,751.75	€4,550.91	€9,162.09	-€3,437.91
q1 2017	€12,600.00	€14,259.00	€6,322.00	€5,057.60	€9,201.40	€4,784.73	€9,474.27	-€3,125.73
q1 2018	€12,600.00	€14,542.50	€6,015.00	€5,112.75	€9,429.75	€4,903.47	€9,639.03	-€2,960.97
q1 2019	€12,600.00	€14,826.00	€5,693.00	€5,123.70	€9,702.30	€5,045.20	€9,780.80	-€2,819.20
q1 2020	€12,600.00	€15,414.00	€5,355.00	€5,087.25	€10,326.75	€5,369.91	€10,044.09	-€2,555.91
q1 2021	€12,600.00	€16,023.00	€5,000.00	€5,000.00	€11,023.00	€5,731.96	€10,291.04	-€2,308.96