A Right to a Home for All:

Towards a Housing Strategy for Ireland, 2016-2020

Submission to The Oireachtas Committee on Housing and Homelessness

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Vision

The vision for any housing strategy for Ireland over the coming years should be clear and simple: a right for all households, regardless of their income or tenure, to access good quality homes.

In order to make that right meaningful, there are four core strategic policy objectives that must be at the heart of housing policy reform in the lifetime of the new government. These are listed below and explained in more detail in the pages that follow.

Core Strategic Policy Objectives:

1. A Safe Mortgage System
2. An Efficient Construction Industry
3. An Income-based Housing Subsidy
4. A Functioning Market for Land

Summary of key policy measures recommended

- Transparent, government-sponsored **audit of construction costs** for a small number of typical dwellings, and follow-on action plan, in order to reduce the cost of construction where necessary.
- Replacing existing social housing schemes, including Part V and rent supplement, with a **single housing subsidy**, based on the gap between a household's disposable income and the cost of providing that household with accommodation.
- Replacement of industrial and commercial rates, stamp duty and development levies with a **land value tax**, also applicable to publicly-owned land, together with a review of land use restrictions, relating to building height and zoning.
- Maintenance of the **loan-to-value limit** and relaxation of loan-to-income requirement, at least until land use restrictions are addressed.

0. Introduction

0.1 The new government in Ireland has taken office in the context of two important themes. The first is the growing unease, both globally and nationally, at the levels of inequality within developed countries. The second, and somewhat more unique, phenomenon is the acute and growing lack of housing in Ireland.

0.2 Therefore, a Housing Strategy for Ireland must take into account not only the lack of housing supply, which underpins most of the problems faced in the Irish housing sector currently, but also address issues of access. In particular, to make the right to housing meaningful, a system of subsidies for housing for those on lower incomes must be set up in tandem with, and taking account, of other aspects of Ireland's housing system.

0.3 I believe that there are four clear areas where government policy reform is needed, in order to bring about a healthy housing sector and with it a meaningful rise to housing for all. A healthy housing sector can be thought of as having the following two features. Firstly, any increase in demand – for example due to an natural increase in the population or to net migration into the country by those who believe Ireland offers them the opportunities they seek – should bring about a consequent increase in supply that leaves the cost of accommodation, relative to everyday incomes, unchanged.

0.4 Secondly, the provision of market housing and social housing should be complementary. In other words, when the market system fails to provide an adequate number of good quality homes, the social housing system should increase its level of output to compensate. This could either be either temporarily in the case of recession or permanently in the case of those with lower incomes who cannot cover the cost of their accommodation.

0.5 Having stable cost of accommodation and adequate homes, regardless of market conditions, should be the barometer by which the housing sector is judged. The four core strategic policy objectives outlined below aim to holistically address these twin challenges. By implementing these four policy areas in full, the new government can leave as it legacy a healthy and fair housing sector.

0.6 Before outlining each of these four policy areas, it is useful to place the current housing sector in context. To do this, I will outline the path of the price of housing, a popular measure of conditions in the housing sector, both over the last generation and over the last century.

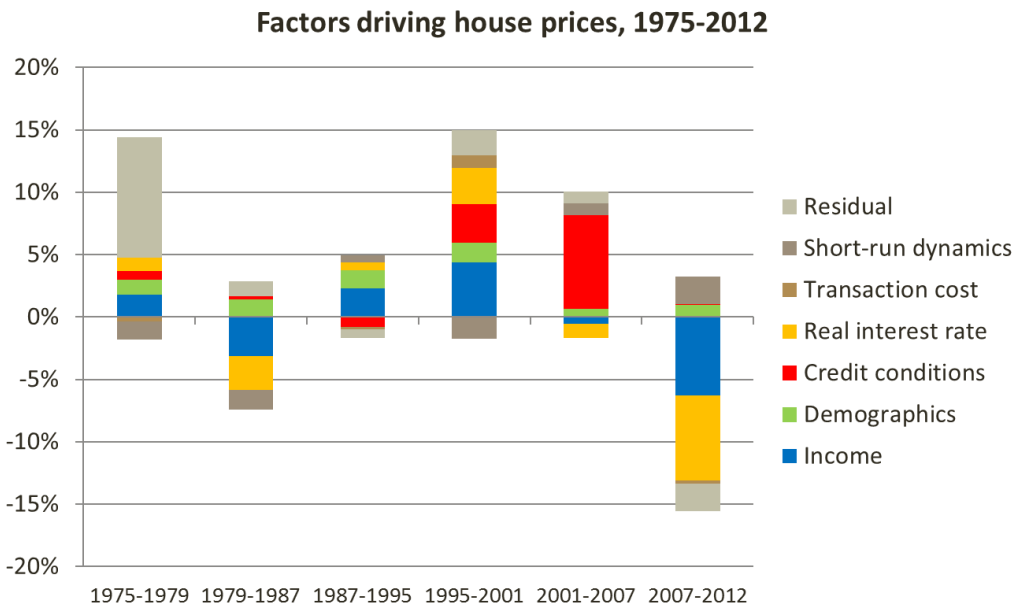
Housing over the last generation

0.7 The figure below, based on some of my doctoral research at Oxford, breaks down the increase in house prices, after inflation, for various market cycles in Irish housing from the 1970s to the bottoming out of house prices in 2012. What it shows, firstly, is that there are a small number of key factors that affect house prices. These include three fundamentals: household income, supply of housing, and average household size, a factor which captures various demographics. The other two factors are what

may be termed asset factors: credit conditions and the real interest rate, or user cost, of housing. Whereas fundamentals such as income and supply typically move slowly, asset factors – which often depend on expectations – can change overnight.

0.8 Secondly, the graph shows a clear distinction between what drove house prices in Ireland in the earlier phase of the Celtic Tiger and drivers of house prices in the later phase. Before 2001, the rapid increase in house prices was driven by a combination of factors, including demand outstripping supply as well as greater confidence, lower interest rates and more generous lending practices by banks. During the later period from 2001 to 2007, it was almost entirely credit conditions – in particular excessive mortgage lending – that drove house prices.

Figure 1: Determinants of house price growth in Ireland, 1975-2012
(Source: Lyons & Muellbauer WIP)

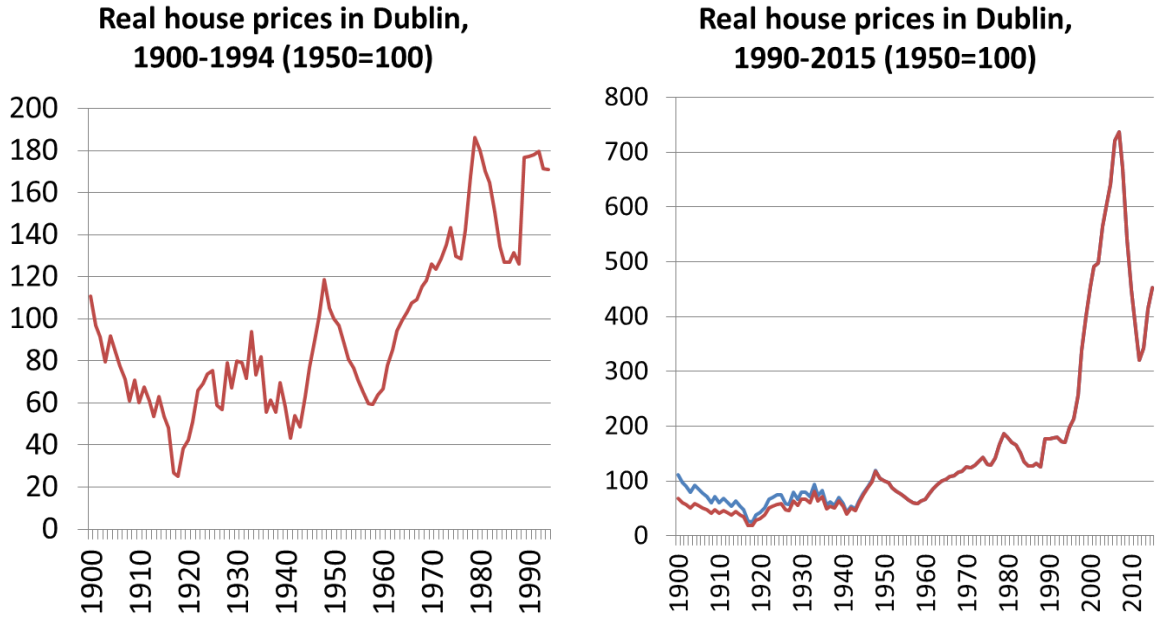


Housing over the last century

0.9 Figure 2, below, shows the path of house prices, again adjusted for inflation, in Dublin from 1900 to today. Again, it is worth noting two things. Firstly, the graph on the right-hand side, which goes to 2015, shows how extreme the recent housing market bubble and crash was, compared to everything that happened in the previous century. This is a theme which underpins the first strategic policy objective outlined, in other words a safe mortgage market.

0.10 The second point to take from the long run path of house prices is that there is no guarantee that house prices increase over the long run. While it may be tempting to think that the growing population and a fixed plot of land would result in upward pressure on house prices decade on decade, this is only through true to the extent that this increase in demand cannot be met through extra supply. This is relevant in particular for the fourth strategic policy objective outlined, reforming how we use land, but also in relation to construction costs, the second policy objective.

Figure 2: Inflation-adjusted house prices in Dublin, since 1990
(Source: Lyons WIP)



1. A Safe Mortgage System

1.1 The first policy objective must be to ensure that the mortgage system is safe; i.e. that credit extended for home purchase is done so at levels consistent with the economic and financial stability of the country. Figures 1 and 2, above, showed just how extreme the recent credit-fuelled housing bubble was. This of course only shows one aspect of the economic and social effects of the housing bubble – others include negative equity, mortgage arrears and default, a trebling of unemployment and a switch from net immigration to net emigration after 2007. While there were other factors that contributed to this range of aspects to Ireland's economic crisis, housing, and by extension housing policy or the lack of it, must be regarded as a primary contributor to the economic distress faced by the Irish people after 2007.

1.2 Economic theory suggests greater credit supply, in other words easier mortgages, primarily affects demand rather than supply of housing. More generous mortgage terms push up housing prices. In the century to the 1990s, the nature of the mortgage market, which was driven by building societies rather than universal banks, meant that it was not in the interest of those providing mortgages to overextend themselves. The switch from a specialised banking system, which included building societies and commercial banks, to a system of universal banks led to increasingly generous terms for mortgages, as these new larger universal banks enjoyed an implicit state guarantee.

1.3 It is in this context that the Central Bank introduced new rules about how much households can borrow for mortgages, relative both to their savings and to their income. These rules differentiate between first-time buyers, investors and others, and also differentiate between more expensive and less expensive housing. They act as an anchor trying the price of housing to the real economy.

1.4 A year after the introduction of these rules, the Central Bank committed to review them and indeed to do so annually. They have also set a high bar for evidence, so that the rules do not become tweaked in response to political conditions. This independence from the political system is key to the credibility of the rules, but that should not stop those involved in policy-making from highlighting areas where reform is needed.

1.5 Most commentators agree that the new rules are broadly right, in that they minimise the risk of the housing sector threatening the financial stability of the country through excessive mortgages. But one of the signs that the rules have worked really well also shows up the limits of the particular system brought in by the Central Bank. That sign is a complete shift in house price inflation away from Dublin to the rest of the country.

1.6 Before the Central Bank rules were brought in, annual inflation in Dublin house prices was nearly 25%, while elsewhere in the country, house prices were growing much slower, if at all. Since the start of 2015, however, Dublin house prices have been more or less stable – and indeed have fallen in some of the most expensive postcodes. Meanwhile, other parts of the country are (as of mid-2016) witnessing house prices increasing at double-digit rates for the first time in a decade.

1.7 It is my opinion that the Central Bank rules respond to the market failure of excess leverage, i.e. too much debt, which constitutes a certain payment in an uncertain world. The solution to excess leverage – whether it be in residential mortgages or elsewhere in the financial system – is to increase what bankers might term the buffer, which in the mortgage market means the deposit. Therefore, the loan to value rules should remain at the heart of Ireland's mortgage regulations into the future.

1.8 However, particularly in the context of a country with stringent land-use restrictions, which are discussed in section 4 below, loan to income ratios are far less appropriate. In simple terms, house prices vary significantly more around the country than incomes do. Therefore, by including a loan to income limit, this effectively introduces a policy that can only be effective in Dublin and is therefore redundant elsewhere.

1.9 Moving to a mortgage regulations system that relies significantly more on loan-to-value than loan-to-income would undo some of the more perverse incentives introduced by the current system. One example relates to commuting. Commuters face not only mortgage costs, but also the cost of fuel and their own time, and potentially other costs including longer childcare. None of this is captured in a system that emphasises gross income relative to gross mortgage debt.

1.10 Thus, the current system – due to its inclusion of loan to income limits – encourages sprawl, particularly when density is limited by policy. There are further environmental costs of the current system. Take the example of a family, considering two homes to buy. The homes are largely similar in terms of location, size and type, but differ in their energy efficiency. The less energy efficient home is cheaper and within the household's loan to income limit, whereas the more energy efficient home is beyond their loan to income limit. From a social perspective, it clearly makes no sense to force this household to buy the less energy efficient home. Even from the

finances of the household itself, it is possible that the more energy efficient home poses less of a financial risk, once energy bills are taken into account.

1.11 Under the current rules, there is no room for manoeuvre to overcome these perverse incentives of the loan to income limits. A switch away from these to loan to value limits would still recognise the slightly greater financial risk involved in a property that is, say, 10% more expensive because it is closer to work because it is more energy efficient. In this case, the household involved would need to save for a larger deposit. But they would not be prevented by the rules from buying a home that better matches their needs.

1.12 A counterargument often raised is that people can be gifted deposits and therefore the loan-to-value says nothing about on-going ability to pay. However, dropping a formal loan-to-income requirement does not mean that you ignore where the deposit came from. An alternative is a requirement for the individual bank to be satisfied that the financial behaviour of the household, including savings behaviour, is consistent with ability to pay. Banks already do this when they look at the fraction of disposable income that would be spent on the mortgage. Tweaked to include energy and time costs, this is a much better measure of ability to pay than the total mortgage amount relative to gross household income.

1.13 Overall, the Irish economy is much safer for having the Central Bank mortgage rules. But the loan-to-income requirement brings with it very serious side-effects. Focusing on the minimum deposit should be the next step in tweaking the mortgage and rules and helping to bring about a stable and fair housing sector.

2. An Efficient Construction Industry

2.1 The second core policy objective must be to bring about an efficient construction industry. To take round numbers, in 1995 the average value of a house was €120,000 and, if this represented some sort of equilibrium, the cost of constructing that house must have been around €100,000. By 2007, the average value of the property in Ireland was €360,000, and in this context, an increase in the cost of building a home to €200,000 would not have been noticed. However, the collapse in property prices has meant the average value of a home in Ireland now is currently around €180,000. Without any significant reduction in costs, this means that building is not viable in large parts the country currently.

2.2 Clearly, one solution to this would be to further increase property prices. This was the solution preferred by some members of the last government. However, as highlighted above, higher property prices relative to the real economy is a clear net negative for society. It means that homes are not affordable for a greater fraction of the population.

2.3 The importance of construction costs is amplified by the strong demand for housing in Ireland currently. Looking at the number of births to first-time mothers with a number of marriages in the country, there are roughly 30,000 new households created each year in this country. Subtracting deaths, but also factoring in declining household size and the obsolescence of older homes, particularly in rural areas, means that between 30,000 and 40,000 new properties need to be built each year in Ireland.

2.4 To focus for a moment on the case of Dublin, it is estimated that 10,000 new homes have been needed in the capital each year since 2011. This means that between 2011 and 2020, roughly 100,000 homes need to be built. More than halfway into the decade, fewer than 15,000 new homes have been built.

2.5 A common misunderstanding is that if demand exceeds supply, the supply will simply respond by building new homes. This is only true if the price to be received is greater than the cost of construction. As outlined above, this threshold is rarely met in the current economic climate – and will almost never be reached when we are talking about those on the lowest incomes in Ireland. Therefore, the lack of new building at a time of rising prices and rents does not at all 'fly in the face' of economic theory, as theory focuses on the gap between prices and costs, not prices alone.

2.6 To see the importance of this, it is worth drawing a parallel between the mortgage regulations and construction costs. Once mortgages are capped, as is now likely to be the case into the future, house prices have effectively been capped, relative to the real economy. In this policy environment, it is incumbent on government to also cap construction costs relative to the real economy.

2.7 One of the key challenges here is that those most likely to make the point that costs are too high those regarded as system insiders, including developers, builders or estate agents. Over the last two years, I have talked to various parties, including developers, quantity surveyors, architects, housing bodies, international finance,

and local policymakers, in order to understand better the current level of construction costs and how that compares to the real economy.

2.8 The best figures I can find suggest that the cost of building a two-bedroom apartment in Ireland currently is roughly €280,000. This figure excludes any land costs but does include a range of other soft costs, including VAT, local authority levies and the 12.5% profit margin. Assuming that the ultimate landlord would like a rental income of 5% a year, this up-front cost of €280,000 converts into a monthly rent of €1,400. Bearing in mind that this excludes land, a realistic actual monthly rent for a newly built two-bedroom apartment is probably closer to €1,800. The average rent for a two-bedroom apartment in Dublin currently is €1,300 and in only two parts of the city – Dublin 2 and Dublin 4 – is it above €1,600. Unsurprisingly, any apartment building that is taking place currently is concentrated in these areas.

2.9 And these construction costs do not vary significantly around the country, so the problem is much worse when you look at Ireland's other major cities. Rents for two-bedroom apartments in Cork currently average at €825 while in Waterford they are just €550. Even in the extreme case, where profits were banned, land was decreed to be free and VAT was scrapped fully, we should still not expect to see apartments being built in areas that currently demand significant numbers of new homes, including apartments.

2.10 The maths are less onerous for building houses, rather than apartments, but the overall challenge is still there for most parts the country outside Dublin. And my focus on apartments is not arbitrary: recent reports by the Housing Agency, analysing census figures, suggest that the vast majority of new households being created in Ireland comprise one or two persons. This reflects greater longevity, increasing rates of separation, but also smaller families and greater fraction is people choosing to not have children.

2.11 The overall policy objective here, therefore, is unambiguous: to lower construction costs to a reasonable multiple of household incomes. However, it is not clear at this stage that there is any unanimity on the causes of the higher construction costs. Therefore, the first priority must be to establish an evidence base, similar to the methodology underpinning the World Bank *Doing Business* report, where an overall score can be broken down into its constituent parts and, where necessary, challenged. Such a transparent analysis of construction costs in Ireland now, compared to Ireland 10, 20 or 30 years ago and perhaps more importantly compared to our economic peers, would provide the evidence base necessary to take further policy action. One potential example of how construction costs have been inflated in recent years is outlined below.

2.12 The example, particularly pertinent in the construction of apartments, relates to ancillary facilities in apartment blocks. The installation and maintenance of lifts and the provision of basement car parking spaces are expensive additions to build costs, which understandably are passed through to the end user. In this regard, it is therefore puzzling that some Irish local authorities require more lifts per floor and more basement car parking spaces than most of their European counterparts.

2.13 Again, as indicated above, an independent and government-supported audit of the costs of building homes will identify whether features such as lifts and car parking spaces, or changes in safety certification, which is another area sometimes mentioned, are indeed significant contributors to Ireland's construction costs per square metre being so far out of line with other countries.

2.14 A final point worth mentioning is the efficiency of construction at scale. Those involved in development believe that efficiencies of the order of 15-20% are possible when the number of homes being built per year is 75 more, rather than 10-20. There is an element of a vicious cycle here, as construction costs are high because very little is being built, as well as there being very little built because construction costs are high.

2.15 Another common misunderstanding is that lowering costs may just result in more profits, not lower rents or prices. There is no empirical evidence to back this up – all the evidence from Ireland and elsewhere is that if you build more homes, prices and rents fall – but perhaps the obvious drawback to this argument is simpler: nothing is being built currently so there is nothing to profit from. Yes, if a greater number of units are built, the total amount of profits in the sector will increase but this comes with the significant social benefit of cheaper homes and more of them.

2.16 More importantly, this argument completely misunderstands how modern developers – such as the REITs, Hines and Kennedy Wilson – operate. They look at construction costs and then add in a percentage profit margin on top and see how that compares to prevailing rents. With profits in percentage terms, lower costs actually means lower euro profits per home, the compensation for developers being they build a greater number.

2.17 In summary, with mortgages and house prices capped, we need construction costs to be capped also so that there are no barriers to building all the new homes that Ireland needs each year.

3. An Income-based Housing Subsidy

3.1 As discussed above, over the last few years, Ireland has faced the problem of building far too few new homes, given the growth in the population. Those feeling the effects of this are littered across all sectors of Irish societies. Wealthy elderly households looking to downsize have nowhere to move. First-time buyers similarly complain of too little choice in the market. They and an increasing number of students are having to endure longer and longer commutes as renters.

3.2 But the worst victims of Ireland's chronic and worsening lack of housing are those on low incomes. Rising rents on their own are not a problem for those on low incomes, provided there is somewhere for them to move to. However, currently, there is nowhere to move to for someone who can no longer afford to stay in their current home.

3.3 A call for a ban on evictions or an end to rent increases, however, is not the correct solution, because it misunderstands what is a symptom and what is the underlying cause. In particular, banning evictions would merely leave those who would move into the accommodation after an eviction without a home, i.e. switching the losers, while an end to rent increases would prevent the system from recognising when new supply is needed.

3.4 The two previous actions on mortgages and costs, when combined, would give the following result: mortgage caps mean that house prices do not go so high relative to average incomes that the sector becomes a danger to the Irish economy, while sensible construction costs mean that those on average incomes can afford a new home. But this still leaves to be answered how to provide housing for those on below-average incomes.

3.5 To take a concrete if stylised example, a family that earns €45,000 a year has monthly disposable income of about €3,000. The golden rule of housing affordability is that a household shouldn't spend more than roughly one third of its disposable income on accommodation, so this family shouldn't be spending more than €1,000 a month on housing. In other words, if they are to afford the property that costs €280,000 to build (the two-bedroom apartment described above), they will require need a monthly subsidy of €400 from the rest of society to bridge the gap between the €1,000 they can afford with the €1,400 in break-even rent.

3.6 Hopefully, this example shows just how closely related build costs and social housing are. The more expensive it is to build a home, the more of a top-up those on lower incomes are going to need to find somewhere to live. And just as important, the more expensive it is to build a home, the greater a fraction of society is going to require a subsidy.

3.7 A family earning €45,000 year is actually above the median income, while as noted above, €280,000 is roughly the cost of building a two-bedroom apartment excluding land costs in Ireland currently. So Ireland in 2016 is in the worrying situation were a family in the top half of the income distribution is not able to afford even a two-bedroom apartment, let alone something larger. This is a reminder that it will not be

possible to fix the social housing crisis in Ireland until the very high level of construction costs is addressed.

3.8 To take a second example, and perhaps one more familiar to those involved in social housing, a single person earning €18,000 a year can afford to spend no more than €500 a month on accommodation – one third of their monthly disposable income. However, the maths of construction in Ireland currently means that a 50-square-metre one-bedroom apartment costs roughly €160,000 to build – a monthly break-even rent of €800. This €300 gap between what they can afford and what is needed to see a home for them built is currently an insurmountable obstacle. It is easy to see why both for-profit and not-for-profit housing developers are currently not prepared to build one-bedroom apartments, at a loss of €300 a month per unit.

3.9 Reform of housing policy, in particular housing subsidies, means that this challenge need not be insurmountable. All we need to do is change how we fund social housing, in particular to reflect the gap between what someone with a low income can afford to spend on rent and what the cost of their accommodation is. In the example above, a person on €18,000 has €500 a month to spend on rent but their newly built one-bedroom apartment costs €800 a month. The clear and obvious answer is that this person needs a subsidy of €300 a month.

3.10 Note that under this system, the lower your income, the bigger the subsidy. Those in most need get most help. If your income goes up, you need less of a subsidy and if your income continues to rise, there is a point at which you transition – without any huge change in your circumstances – from receiving a housing subsidy to not receiving one. This has the important positive side-effect that the housing of those on lowest incomes does not turn into a ghetto system, where those on below-average incomes live apart from the rest of society.

3.11 Another important aspect is the role that this would give Approved Housing Bodies. Such a simple income-based housing subsidy would provide AHBs with the collateral they need to expand the production of social housing, when a recession hits. That is to say, the provision of social housing would be decoupled from the provision of market housing. This is the opposite of the case currently, where Part V provisions tie the production of social and affordable housing to the market. AHBs will confirm that international capital is very interested in becoming involved in the funding of social housing in Ireland, but the current constraint is a lack of connection between housing subsidies and the cost of providing homes.

3.12 Three further points are worth making here. The first is that an income-based housing subsidy renders largely irrelevant the debate about who provides the homes, public or private. Every household now has sufficient income to cover the cost of their accommodation, and AHBs have a slight advantage over their for-profit counterparts, in that they do not have a 12.5% profit margin, nor do they face local authority levies. These two differences probably account for €100 per month difference in the breakeven rent. Where local authorities grant AHBs land for free, this further tips the scales in favour of nonprofit housing bodies in providing housing at scale.

3.13 Secondly, the cost of meeting households' accommodation needs clearly depends on the nature of each household. The needs of older persons will vary from those of students and those households starting a family. And within the older persons demographic, there are a number of different levels of care and housing need, from completely independent living to round-the-clock residential care. Therefore, to implement a subsidy of this nature properly, a full taxonomy of housing and care needs and the life-cycle of housing is required. This does not prevent universal design features, where relevant.

3.14 A final point on the subsidy is its flexibility in relation to renting versus owning, particularly for those with incomes close to the average. As mentioned above, when those in receipt of a subsidy receive an increase in their household income, above the level that would justify subsidy, they stay in their accommodation and merely pay the market rent. Alternatively, for a premium similar to the profit margin that would be enjoyed by a for-profit developer, the household can pay a slightly higher rent that would give them an equity share in the house.

3.15 What we have currently is a social housing system very far removed from the goal of topping up inadequate incomes in order to cover accommodation costs. For example, rent supplement is what might be termed a zero-one subsidy. The household either gets the whole thing, or you get nothing. This creates a barrier to taking up employment as well as being inherently unfair, as it gives those just below the threshold far more than those just above the threshold – and the same as those who have no income at all of their own.

3.16 A housing subsidy that varies with income is completely different. Those who need the most help get the biggest top-up, while those who are very close to being able to afford their own place to live are not treated much differently to those whose incomes are just above that cut-off. This subsidy would need to be based off official earnings, both private (Revenue Commissioners) and public (Social Welfare).

3.17 The policy implications are clear. Ireland needs to replace its mishmash of legacy systems and short-term measures that have become mainstays of social housing. Rent supplement merely pits so-called "welfare tenants" and working tenants against each other. A more farcical example is the tragic situation of families living in hotels for more than the cost of their previous rent. Included in systems that are not fit for purpose is Part V, which is noted above bizarrely links the production of social housing to the production of market housing.

3.18 There is a clear link between this objective and the last one. To guarantee a right to housing for all, we need minimum standards that reflect average incomes and subsidies for those who cannot afford the socially agreed 'minimum acceptable home'. The starting point should be the question: "What fraction of income distribution do we believe we should support in providing their housing needs?" If we decide that one third of the income distribution should receive help from the rest of society, what the household one third of the way up the income distribution can sustainably spend on accommodation must be the benchmark for the minimum acceptable home, in terms of size, features, etc.

4. A Functioning Market for Land

4.1 The discussion above, on construction costs and a subsidy based on the gap between those costs and household income, deliberately omitted any discussion of site costs. In a functioning market for land, the value of the site will be based on the gap between all costs of construction for all the bills on that site and the net present value of income from that site. For example, if prevailing monthly rents for two-bedroom apartments in a particular area are €1,500 and construction costs in monthly terms for those in units is €1,200, the most developer will bid for the site on which that apartment will be built would be €300, in monthly and per-unit terms.

4.2 Currently, this is far from how land is valued in Ireland. For example, it suggests that sites even well located party Dublin have values very close to zero – and perhaps even negative – because construction costs are so high relative to breakeven rents. Nonetheless, the asking price of sites in the capital is substantial.

4.3 The importance of land can be seen in a comparison of the housing market in Dublin to elsewhere in the country. As recently as the mid-1980s, there was almost no difference between average house prices in Dublin average house prices in the rest of the country. It is true that what you got for your money was different – in particular, buying in Dublin means you give up space in favour of location – but to give one statistic, the average property price in Dublin in 1987 was €49,000 compared to €46,000 elsewhere. However over the last three decades, the differential between Dublin and elsewhere has grown from less than 10% to more than 60%. Average prices in Dublin now are significantly above elsewhere in the country.

4.4 A common response to this is fatalism: land is scarce so it must be the case that Dublin will become increasingly more expensive than elsewhere. This, however, is inconsistent with the evidence. For example, it is not clear why land suddenly became scarce in Dublin during the last generation. As the graph showing house prices in Dublin from 1900 on shows, once inflation is taken account of, house prices in the capital were not much higher in 1990 than in 1900.

4.5 Not only that, if we look across other cities in Europe and the US, it is clear that major cities need not have significantly higher house prices than elsewhere in the country. Research by Albert Saiz at MIT, for example, shows that any increase in demand for housing can be completely offset, i.e. there is no long-run effect on house prices, provided there are no geographic or policy barriers to new supply. Furthermore, he found evidence that geographic barriers create policy barriers to new supply and in only the largest cities in the US are these binding themselves.

4.6 Connecting this policy area back to the first one, on a safe mortgage market, countrywide loan to income limits only make sense where supply can respond to extra demand and thus prevent the divergence of house prices in some areas convert others. Clearly, the discussion here is about the "sticker price" of housing: as in, if the housing market in Ireland were healthy might be the case that the average sticker price of housing was €250,000 both in Dublin and elsewhere. The €250,000 would probably by a smaller home in Dublin, but the key feature is that the average price paid by the household is the same. They trade location for space.

4.7 In a truly healthy housing market, average house prices in Dublin should be as low as elsewhere in the country. If they are not, the cause is a lack of supply, ultimately coming from how we as a society restrict land use.

4.8 In stylised terms, the expected policy solution to growing demand for housing in and around major cities is to zone yet more land, further away from the urban centre, for another ring of three and four bed semi-detached homes. An alternative solution, adopted by many cities in high-income countries, is to densify rather than sprawl, i.e. to build up rather than build out. This includes 'densifying the suburbs', i.e. putting in place more housing, particularly greater options for downsizers, where people would most like to live.

4.9 Ireland also needs to rethink how it zones and uses land. Perhaps at the risk of oversimplification, land use policy in this country can be summed up as "for current use, see last use". In other words, once a particular plot is given a certain use, that is very likely to be its use 10, 50 or even 100 years later. If this sounds like an exaggeration, take Dublin Bus. Dublin Bus has 7 depots, only one of which is outside the central city. The other six depots are all multi-acre sites in very valuable locations. Three of them – Donnybrook, Phibsborough and at Mountjoy Square – are not even close to any termini of its core routes, the majority of which are now outside the M50. The only thing all these central depots have in common is that they were all once Dublin United Tramway Company depots, back in the 19th Century.

4.10 The core problem here is that the social cost of using such land for low intensity purposes is not internalised within the organisation that owns the land, in this case CIE. The simplest way to internalise this externality is to introduce a land value tax, also known as a site value tax. This is where a small fraction, typically 5%, of the upfront value of a site is charged as a property tax each year. Undoubtedly, including the residential and agricultural sectors would be politically very challenging. Nonetheless there is nothing to stop the government from bringing a land value tax to apply to all commercial, residential, and development land – and all publicly owned land.

4.11 This would not be an additional tax – rather it would replace existing charges, including commercial rates, stamp duty and development levies. Current proposals to bring in annual charges on derelict and vacant sites, in the Dublin City Council area, may have some effect at the margin but are unlikely to have a substantial effect on the availability and cost of development land. This is particularly the case as the single largest owner of vacant and derelict sites, Dublin City Council, is exempted from the charge. It is also highly likely that these charges will incentive minimal use, rather than optimal use, in order to avoid the tax.

4.12 In order to make housing in bigger cities affordable, the priority must be to use land well, i.e. to continually question and revise the restrictions we make on land use. For example, manufacturing comprises an increasingly smaller part of all developed economies. The vast bulk of economic activity is now in services. However, many cities – Dublin included – still have vast tracts of otherwise valuable land retained as low value or indeed vacant industrial space.

4.13 The implications of the lack of a land tax can be seen, for example, in the Dublin Industrial Estate, near Glasnevin and within the Dublin City Council limits. This is a 170-acre site that could provide thousands of new homes, close to O'Connell Street, the new DIT campus, the M50 and to lots of green space. In addition, the new Cross-city Luas extension will terminate at the Dublin Industrial Estate. There can be very few who will argue that the best value use of the site would be to keep it industrial.

4.14 However, consider the incentives of Dublin City Council. There is no gain for it to rezone the land as residential or indeed mixed-use, because such a rezoning has no immediate consequence for those who occupy the site currently. Indeed, if DCC rezoned, there could be pressure for it to go down the route of a compulsory purchase order, in order to convert the site out of it existing use. Switching to a land value tax would remove the burden of having to issue numerous CPOs and address issues of title from the City Council and place it instead on the private sector, in particular those who currently own the sites and those interested in redeveloping the land as residential or mixed-use.

4.15 With hundreds of thousands of vacant industrial square metres dotted around the M50 and its hinterland, the market value of this industrial land at the Dublin Industrial Estates, if not the structures, is close to zero. If this land were rezoned for a mix of residential, commercial and public uses, its value would be somewhere between €1 billion and €3 billion. Taking an average figure of €2bn, a 5% land value tax would yield €100m a year. This is value that society – including Dublin City Council – has created but is being allowed to lie fallow.

4.16 As with other areas, this policy objective provides clear policy implications. A land value tax, a tool used effectively in many other jurisdictions to get land used well, should replace commercial and industrial rates, stamp duty and, if also applying to residential homes, local property tax. In tandem with local authority zoning and development plans, land value tax would facilitate a city's evolution year on year. It is worth emphasising that land value tax will also need to apply to publicly owned organisations.

4.17 By lowering the cost of land, and making more land available for residential purposes in central locations, if needed, the average price of a home need not be any higher in Dublin than elsewhere in the country – as was the case before the 1980s. However, to do this, we need to think not of land as a speculative asset but as a service with huge value. Land is valuable because of society's efforts, not the efforts of the owner, and therefore the social return on public monies invested should be returned to society.