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Commercial Property

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Recovery of market should come as no surprise

Bill Nowlan

Demand has caught up with – and outstripped – supply in the Dublin commercial market, but we must not let the opportunity slip away

Grand Canal Docks by night: Dublin is no longer being seen by international

Some seem surprised that the commercial property market is in full recovery mode in Dublin, with values rising rapidly. They also seem surprised with the unprecedented volume of transactions.
However, they should look back to an article that my colleague, Frank O'Neill, wrote almost two years ago (see wkn.ie/media.html), which predicted that this would happen. We called it "the big switch".

We forecast that up to €30 billion of assets had to move from one set of owners to a new set.
We envisaged that the former owners (being controlled by the banks and Nama) would want their money back and the new owners would be backed with equity. The old owners would be distressed sellers: the new owners long-term investors.
Indeed, Reits (real estate investment trusts) were created in Ireland to enable some of that equity to come from domestic and overseas investors via the stock exchange.
In addition, investment is coming from international property investors such as Blackstone, Lonestar, German pension funds and also some from Irish property funds such as Iput and Irish Life. A little is from high net worth individuals – both Irish and international.

Yields and rents

The price rise is driven by the movement in yields and rents. Dublin is no longer being seen by international investors as a basket case for real estate but a modern city emerging as a great European capital.
This is partially driven by the presence of the Googles, Facebooks and other FDI business, but also by Dublin's position as a gateway to Europe from the US and Asia. The chatter about Britain leaving the EU is doing no harm, nor is the fact that we are part of the euro zone.
The fall in interest rates to near zero and the hunt for yield by investors is also helping matters greatly.
It was perceived that, at the property level, commercial and residential rents fell to levels way below replacement cost, which effectively stopped new development and made it inevitable that rents would rise to viable levels – which is what is now happening.
Historically, when rents fall and development halts, the delay in producing new stock usually results in rental levels significantly exceeding the base viability level, which is probably about €40 per sq ft in Dublin central business district.
Rents, in my view, could reach €60 per sq ft before any meaningful new supply emerges to satiate demand. It takes at least two years to build a new office building even after receipt of planning, but the planning process can take as long again – if not longer.
The big question is how far will property yields fall – and this is not just an Irish question but an international one. Yields in Dublin have fallen by at least 200 basis points and prime now stands at about 5 per cent.
Yields in London for comparable office properties are 50 basis points lower but with rents in euro terms approaching €80 per sq ft and over €100 per sq ft in the West

End. But yields on long state bonds are half these rates and property has an inflationary hedge when yields start going up but bonds do not.

Some would say we are in the middle of a bubble, but the characteristics of a bubble are that they are driven by insubstantial and unsustainable factors.

What we had up to 2008 was a borrowing-based bubble, but this current wave of Irish investment is virtually all equity-based.

While equity investors may lose money, they do not visit that loss on anyone but themselves, unlike what happened in the great financial crash.

What we are seeing is a sustainable recovery based on careful analysis by professional investors who understand how to mind their own money. However, the questions for Ireland Inc are serious.

We are now regarded as serious players in the world property and economic scene and not yokels playing with borrowings from their own out-of-control banks.

But we also have to behave like other sophisticated cities and countries.

We have serious blockages in our planning and infrastructure delivery systems which, if not rapidly fixed, will prevent new supply emerging across all sectors.

Whilst the shortages of new housing and offices can be blamed on the decimation of the building industry and shortage of finance, overseas investors are not the slightest bit interested in the blame game. They want to see action, and fast.

Need for speed

One just has to look at the way other countries can move from building concept to reality in ultra-short time.

Many of the new cities in China 10 years ago were pastures. In Ireland, we need a Singapore-type approach to providing new residential and commercial buildings. To do so requires a change in attitude at the top towards enabling development.

Our planning process is designed to stop things happening – not to make them happen.

The Government's 2020 policy paper promises action and Nama has committed to supply land and initiate development.

The money and demand is there but the question mark at an international level is over the effectiveness of our development and planning industry to deliver.

If new supply does not quickly emerge one way or the other, then international investors will really start worrying about our commitment to implement change. But for the present, just watch the big switch happening in Technicolor.

Bill Nowlan is chairman of WK Nowlan Property and a director of Hibernia Reit Plc. The views expressed in this article are personal opinion and are not those of either organisation