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25/3/05



The commercial property market is going through one last binge before the detox has to start, warns Bill Nowlan

Would a normal person invest in a commodity that is going into oversupply, is overpriced and has little prospect of income increasing? The Irish answer is "yes".

The commercial property investment market is, in my view, going through one last binge before reality emerges and the detox has to start. This feeding frenzy is being driven by the perceived infallibility that Irish property values will always go up.

Commercial property values are currently rising due to yield compression arising from pressure of money - both borrowing and equity - with no focus on the long term realities of little or no rental growth.

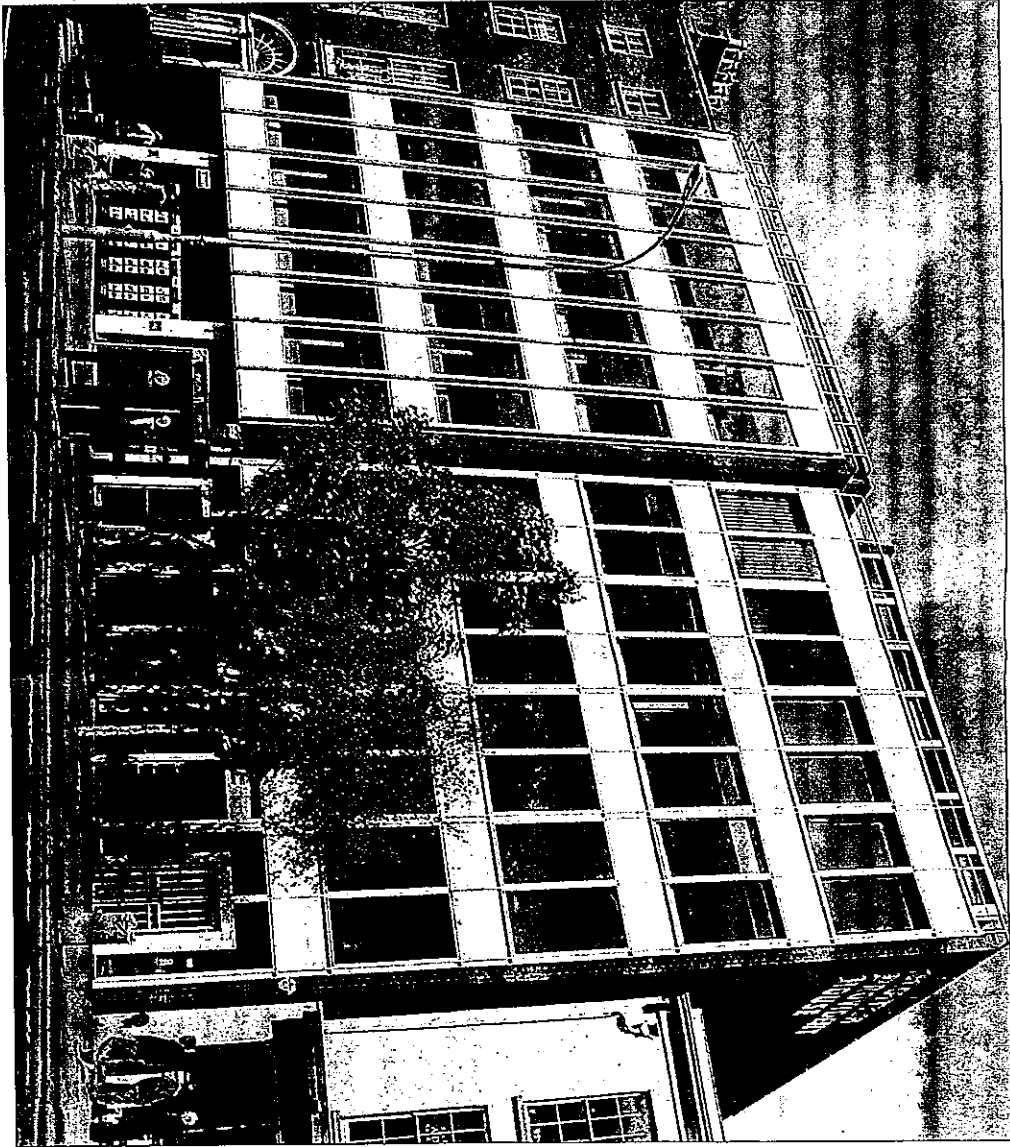
The underlying fundamentals of the property market have been forgotten in this current feeding frenzy. That fundamental is, of course, customer demand for floor space and the price that those customers (tenants) will pay. When did you last hear an investor refer to a tenant as a customer?

The music will stop, either suddenly due to some unforeseen event, or the more likely scenario is that reality will gradually dawn on investors that current rental income will not remunerate the capital invested and that rents are not going to rise in the foreseeable future.

Rents will not rise because our vastly expanded and mainly professional property development industry has been, or is in the course of, providing more floor space than could possibly be required by existing or new tenants for business occupation.

Reality is that there is no shortage of business buildings in the Irish economy. No shortage is in sight even if our population grows as predicted. Reality is that there are more commercial buildings out there available for letting or in an advanced stage of planning than tenants need now or are likely to need for a very long time. Tenants are becoming very impatient people again!

The development industry is both the engine of, and the cause of, the problem. We have an oversupply of offices, an oversupply of industrial space, with the possibility of an oversupply of retail being a little further away other than for retail warehousing which is fast reaching saturation point. If you don't believe me look at the



Scottish Provident House at 25 St. Stephen's Green, Dublin 2, is currently for sale along with 11 other Irish property investments owned by Scottish Provident. The 120,764 m² (13,000sq ft) modern block is currently producing a rent roll of €600,000 from several tenants. The Irish investments, valued at over €120 million, may end up being sold as part of a €1.4 billion (€2,035 billion) property portfolio in the UK. Photograph: Joe St. Ledger

SCS/IPD Rental Value Growth

YEAR END	2002	2003	2004
OFFICES	-0.5%	-1.5%	-1.4%
INDUSTRIAL	-0.1%	-0.7%	0%

With office yields rapidly moving towards 4 per cent, the available cash flow from rents give little scope to pay a dividend, service debt and pay for repairs/renovation. God forbid a period of void!

Perhaps the time has come to look at the alternatives to property and heed the words of economists like Nobby Kallacher of Davy's who points out that property price earnings ratios are way above those on blue chip shares.

The property circle is getting harder and harder to square. Indeed, if interest rates make any upward movement then it will be impossible to square and there will be some forced selling. This will inevitably have a knock-on effect on values and then the correction process may get underway. I am not forecasting a collapse of the property development industry or of the investment business. What I am forecasting is a lot of very disap-

pointed investors who may be servicing debt out of other resources than rental income and for a very long time.

A further rapid rise in property values or a rise in rents is not going to happen to save the day. Property, except in some special niche situation, is a commodity, just like coffee beans, oil or lumber. We have had our one-off adjustment in Ireland and it won't be repeated in my life time.

The property development industry will remain alive and well and very happy to supply new product at prevailing prices and this is what will prevent a second boom in property prices and disappoint a lot of expectant millionaires.

Next week in the continuation of this article, I will look at the long term property investment outlook in Ireland. Bill Nowlan is a consultant property advisor and town planner