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COMMERCIAL PROPERTY

Mixed signals leave the market in a twist

The level of oversupply in many markets is the most worrying feature of all, writes Bill Nowlan.

So the Irish property market is in a twist. Some parts of the market are in a tailspin and others are booming.
In the retail market, in the last few weeks there were at least five big new shopping centres successfully opened whilst on the other hand land values are falling like a stone and the owner occupier residential market is stalled. But residential and office rents are rising. On the investment front, as a result of the banking crisis, investment yields in the US, UK and Europe have moved out by at least 50 to 75 basis points, giving a 10% fall in values- but surprisingly the Irish IPD index actually moved upwards slightly in the last quarter. This dichotomy in the market place is what I call a twist!

Against this background, quo vadis for 2008?
Is the party over and if so for how long? What part of the market will recover or continue on unharmed and for how long?
The answers to these questions are complex and uncertain and will depend on a number of factors which I can only attempt to touch upon in this short article.

The first and most immediate issue is the action and reactions of the banks and the central banks to the property sector. The second issue is the health and growth rate of the economy. The third is the level of oversupply or undersupply in the various parts of the market - and there is undoubted oversupply in some markets due to the proliferation of developers and new development schemes. The fourth being business confidence, consumer confidence and property buyer confidence.

The 'petrol' in the tank of all property markets is bank lending, be it simply for the new house purchases, for the funding of land acquisition or for infrastructure or new development. Bank lending for all these activities is currently being curtailed for two reasons, firstly credit has got more expensive, not just because of rising ECB rates, but because the banks are charging each other more for credit, and secondly because credit, which was plentiful up to recently is now suddenly very scarce. Accordingly the days of widespread availability of easy and cheap money which was a feature of our recent markets is currently absent. The evidence of this is that the rate at which Bank Credit Committees are processing new loans has dropped to a fraction of what it was a year ago. To get a bank loan today, for a property scheme, you need to have a very viable and stress tested project and have a strong track record with a friendly bank plus some strong collateral security. This is not unhealthy and will separate the men from the boys. However, my fear is that in the current banking and property climate that some existing projects will slip below the profit waterline and that some banks could force their clients to sell in fire sale circumstances. Such action has the potential to severely further damage confidence and would further impact on property values. So it is imperative that the bankers do not panic and risk further damaging the fragile market. There are other ways of dealing with such problems.

On the economy, enough confusion has been caused by the various economists with their optimistic and not so optimistic forecasts for the economy. But the heartening thing is that none of them is forecasting a growth rate lower than 2.5% in 2008 and beyond which is the growth rate for the rest of Europe. Also our demographic and urban growth rates are much stronger than elsewhere in Europe. Economic confidence is there but property confidence is fragile

The level of oversupply in most markets is the most worrying feature of all. This is the product of over zealous developers and over zealous bankers in the past. Although speculative housing development has almost stopped, some economists are saying that we have a full years supply of houses available for occupation totalling 40,000 units or more This is anecdotal because no developer wants to say what stock he has available and unsold -be it houses, offices, warehouses etc. However I can say that I am personally aware of several schemes where there are unsold houses in their high hundreds and I touch only a small part of that market in my day to day practise. Also whilst these alleged 40,000 houses are now built, there are also plenty of sites ready to go with full planning permission which could be completed very quickly i.e. in 6 to 9 months. Many of these sites are at historic land prices so the fall in land prices will not affect the future supply chain. I can not see developers putting up house prices for a long time and most experienced developers would now admit, privately and not publicly, that they were too greedy in the past and put up house prices too high and thereby damaged the golden goose.

The same oversupply of unoccupied stock is a feature of most of the commercial markets with vacancy in suburban Dublin offices projected at 24% for the end of 2007 and 16% in the Dublin city area (completed and under construction). This is despite a record demand and take up of new and second hand offices and warehouses but the supply keeps increasing because of the volume of schemes.

There is an elephant in the kitchen which no one is discussing. The reality is that we have more developers and more development schemes than the economy needs or is likely to need at current rates or likely rates of economic activity. The deficits of supply, which were a feature of the early days of the Celtic Tiger, are no longer. There has to be attrition or shrinkage in the development industry.

Retail is the odd man out with apparent unlimited demand for new shops - but is it just a late cycle phenomena with a delayed market adjustment?

Finally to confidence. Property values are sustained when buyers and sellers trade at a price or value where both think he/she is doing a good deal. The market rises on a deal by deal basis when two purchasers or more have confidence that they are getting a bargain and sellers want to use the money for something else. Ergo, both have confidence in their deal. It the entire combination of those one off deals that make the market.

Buyers over the past 10 years have lived with expectations of prices risings and were prepare to carry the cost of their decisions often covering the (temporary) shortfall in interest payments in expectation of an offsetting capital appreciation. However with low expectations of capital appreciation, real fear of prices falling and with a higher price for money, then deals just don't get done. Confidence is absent.

What could bring back confidence is lower interest rates and the restoration of a normal banking system. Interest rates are likely to fall as a backlash to the banking crisis and the rising dollar. Also a contributor to confidence will be the rising rents in rents for offices and residential which I refer to above and which could get people looking again at property purely for its strong cash generating characteristics - and not solely at capital appreciation. Lower transaction costs in the form of significantly reduced stamp duty would probably add to confidence but only somewhat.

As I said at the beginning, the Irish property market is in a twist and predicting its short term gyration is impossible. But one thing struck me forcefully recently which is that the house that I built in 1970 is now worth roughly 80 times its original value and this equates to just over 12 % per annum - but then I did live though an extraordinary average inflation rate of 6.7% p.a. So remember, property is a good long term investment despite the short term wobbles and twists.

Bill Nowlan is a Consultant Strategic Property Advisor bill@wkn.ie