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Equilibrium in market, so it's back to the norm

The investment market is in equilibrium and this means the fun and excitement generated by the Celtic Tiger period is over.

Bill Nowlan reports

Last year I opened my forecast for the investment sector for the following 12 months with the phrase "the market is dead - long live the market".

Hindsight would indicate that I was right in my forecast for investment performance with perhaps the exception of the retail sector which showed some sparkle of real life.

Based on the SCS/IPD survey for the past 12 months of 2003, the office sector showed minus 4 per cent capital return, the industrial minus 4.6 per cent and the retail plus 12.4 per cent.

In the same period the income return was an average of plus 5.7 per cent.

The blended or overall capital and income combined rate from all sectors was plus 6.3 per cent. This is a far cry from the approximate 25 per cent per annum for each of the five years in the period up to 2001.

On the asset turnover front, the real action in 2003 was in UK property where Irish investment is reported to have reached a staggering €2 billion in purchases.

Here in Ireland the turnover was higher than expected at about €800 million in purchases with the disposal of much of the Green Properties portfolio, the AIB deal and the Royal Liver sales in Henry Street and elsewhere.

Whilst the high volume of sales may have made the estate agents very happy, the investment returns will not have made their clients, the investors, very pleased.

My forecast for the year ahead in 2004 is that the flow of the market will be slow and turgid.

I would be very surprised if there is anything like the volume of deals at home in Ireland or abroad in the UK as there was in this past, exceptional year.

Office rents will be static, industrial rents will be likewise but perhaps there will be some slight growth in retail rentals.

Property investment yields, already driven down to the lowest level for half a century by huge private sector buying, supported by borrowed money, will hold static provided banking yields don't move up too much.

The institutions, who were out of the property investment market in 2003 other than to sell off surplus properties or to massage their portfolios, will remain out of the market in 2004.

This is because the asset allocators within those institutions, who with an overweight in property, have recently seen a good recovery in the equity markets and believe that the growth in equities will continue with more mileage there than in property - a view with which I am inclined to agree with in the short term.

I am not pessimistic but realistic. This is normality in the property investment market.

This is the market environment which I was accustomed to for most of my 27 years with Irish Life - other than for the short and glorious periods of mainly inflation-driven growth which happened every five or seven years or so.

It may disappoint many young men in estate agents or young investors who have lived on the thrills of the roller coaster of the past few years and who have experienced a market with double digit growth and ever rising rents. That is all over.

Some young people may have forgotten, or ignored the fact, that property is a long-term investment and the consistent return is made by patience, active tenant-focused estate management and attentive portfolio management supported by quality research.

Property investment is, was and will always be about generating consistent rental income or cash flow. Manage the pennies and the pounds will look after themselves.

This is what the institutions have always recognised and done well, and it is what pays the pensions, the bank interest and eventually gives the capital gain.

Over the past eight years or so, a lot of quick money has been made by individuals who were washed along by the extraordinary demand for property caused by the regular 10 per cent per annum growth rates of the Celtic Tiger.

They bought for X and sold for three times X. If they had high borrowings they made vast amounts of money.

Many of these individuals made money by happening to be in the right place at the right time and were swept along by the rushing river or was it a torrent. Often it was not good judgment but sheer luck.

It will not happen again in my lifetime.

Why will it not happen again? Although economic growth will return hopefully in 2004, the capacity of the development industry has grown to meet the property and floor space demands of the modern Irish economy.

The development industry is now three to four times the size it was in 1994 and can supply vast amounts of space very quickly to meet virtually any level of demand.

What happened between 1994 and 2002 was an aberration. Back in 1994 rentals then were at a level which was 50 per cent below the cost of replacing the bricks and mortar.

(By way of illustration, when I bought Lansdowne House in 1995 the price was £9 million and the insurance cover the day we closed was £13 million).

Today, current rentals have risen to such a level that developers can provide an unending supply of office and industrial floor space to the market, generally on relatively short notice from stockpiled sites with planning permission and still make good profits.

The cost-push factor is gone as is the demand-pull factor. The result is a market in equilibrium and this means the fun is over - it's back to slog and hard work for all serious property players in 2004.

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