IRISHTIMES.com
Wednesday, October 6, 2010

When will building resume?

Probably not any time soon, as no developer in his right mind will start a new scheme until the current oversupply of buildings is used up, writes BILL NOWLAN

My last article focused on the likely characteristics of the property market when normality returned and the journey from here to there. The feedback was good and I was asked to follow up with my views on the development industry and when we are likely to overcome our current difficulties.

Firstly, there will be no significant development until the current stock of surplus buildings is absorbed. No developer in his right mind will start a new scheme while he has an unsold stock of existing houses, offices or apartments. Secondly, the economic viability of most schemes is shot. The fall in sale prices has destroyed viability and the consequence is little or no value in development land and zero or negative profitability.

Thirdly, there is a big supply of zoned and serviced land within the system – much with planning permission. This supply is sufficient to meet needs for a long time – possibly for up to a decade – especially outside Dublin.

Fourthly, the levy regime that requires developers to pay for all infrastructures at rates ranging from €10,000 to €40,000 per residential unit (and equivalent for commercial) will absorb any significant recovery in land value. The Government could give a moratorium on levies to kick start the industry but this could be fraught with risk as it has taken almost a decade to structure the levy system and we all know about the political pressures of “temporary” taxation reliefs.

Putting these facts together I see that development will be very much like it was for most of my career in the 1970-2000 era. Builders will build houses and be happy with the building profits they earn from laying blocks and hammering nails, ie a 15% mark- up on their costs. Builders will drive white vans and not Porches or helicopters.

Land values will stay at a range of zero to 25% of the value of the finished product . The international norm is 25%.

There will be few high-density schemes as the market does not want apartments except in special locations such as city centres and traditional flat locations such as Ranelagh and Rathmines in Dublin. In addition, the construction cost of apartments is higher than that of housing and the economics no longer work due to the very big fall in apartment values – which is a much greater fall than in houses. Planners, please take note.

Builders will revert to their old methodology of building show houses and then pre-selling them in phases of 10 or 20 units. Only when they are sure that these sales will close will they proceed with opening the show houses again. The next phase of houses will follow as the first is completed and sold. (See panel for a breakdown of the economics of such a scheme for a three-bed house in the North Dublin fringe.)

Densities for such a scheme would be at about 15 houses to the acre or, put another way, in "planning speak", densities of 17,000sq ft per acre. Such a scheme would give land values approaching €400,000 to €500,000 per acre – ready to go.

In more salubrious areas the figures would look a little different as density could fall but building costs would rise. Land values might get to €1m per acre and houses €100,000/

€150,000 more expensive but the builder would still be happy with the same profit levels of 15%.

Given the big supply of land I could see these types of figures pertaining for at least five years and possibly for a decade after "normality" returns. It will all depend on the economy, demographic changes and the supply of serviced and zoned land. In addition to the mad bankers, one of the things that drove the land market crazy in the 2003-7 period was the scarcity of zoned and serviced land plus delays in the planning process.

The profit earned in this new development environment will depend on attention to detail in managing construction cost, providing units designed to current market taste and watching location carefully. I do not see a return to the queues of people to place deposits for a very long time.

On the commercial front the pattern will be very much the same. Pre-letting or pre-selling office, retail and industrial projects will be the aim of professional developers. Banking will only be available where there is a pre-sale or a pre-letting and/or the developer has sufficient collateral and track record to cover a long vacancy. Few developers will have this capacity. Few projects will start speculatively unless bankrolled by someone with deep pockets.

This is the way it used to be before madness engulfed our industry. We may be heading back to the days when the institutions and public companies were the main suppliers of development finance. We also may see the publicly quoted development company appearing again.

Asking prices for rents and sales at proposed schemes will be quoted at current price levels with no adjustment for potential price growth that might or might not happen. Limited schemes will be viable on this basis.

Back in the mid-1980s this was the situation and as a result a lot of development was then not viable or fundable. Our cities languished. Then the Government (correctly) introduced the Urban Renewal Tax Allowance to make the IFSC viable and get it up and running. The scheme was extended to upgrade the apartment stock, which was successful, and later into the urban renewal scheme. The mistake was not to turn off the pump-priming tax relief when the engine was up and humming. But, again, part of the current mess came about because Governments did not understand the economics of property development and gave in to vested interests and extended the schemes irresponsibly.

A clear understanding of property economics in Merrion Street and the Customs House is badly needed – learning the fundaments of the industry by blowing up the system is not the way to run an economy.

Maybe next time it will be different but I doubt if I will be a player then.

Bill Nowlan is a chartered surveyor and chairman of W K Nowlan & Associates, a property asset management advisory company in Dublin