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When will market go back to normal?

Elm Park, on Merrion Road, Dublin 4 – the loans for which have been taken over by Nama

BILL NOWLAN

Nama has probably already put a floor to the market prices for commercial property

THE ARRIVAL of autumn and the approaching first anniversary of Nama has forced me to change my focus from thinking about the present state of the Irish property market to try and picture what the property market will look like when "normality" returns. What will be the route from here to there?

Normality will be a marketplace where houses, offices and shops let and sell in volume and at prices which no one gets excited about and everyone takes for granted. It will be like the mid-1990s, where deals were being done, but took a little time and effort, and rents and prices were stable, only rising gently with inflation (low). Credit was available, but limited.

It will take time to get there but when this new normality arrives, estate agents will be doing their thing, valuers will be confident of their pricing and bankers will again rely on property as good security for their loans.

Development projects will have started again but only on schemes that are clearly viable and based on current prices and letting levels – no more blue-sky schemes supported by blue-sky prices and bankers.

This normal property market will be a dull place – a dull place that true property professionals feel comfortable to operate in, collecting rents, arranging viewings, organising contracts. No Get-Rich-Quick-Harrys relying on yield compression and ever-rising prices to justify their existence and scoffing at the old hands. Property will not be the subject of chat in the pub or the taxi.

Three things are stopping us getting to this new marketplace. Firstly, we have a semi-dead economy with little new demand for our big stock of vacant buildings. Secondly, there is little or no credit available to enable transactions to happen. No bridging loans, no mortgage loans for housing. Thirdly, confidence is missing. Everyone is afraid of paying too much, of grabbing a falling knife.

All of these contributed to the downward spiral which was acute during 2009 but eased off in the early part of this year. The graph will flatten out and reach a bottom – that bottom will be in different places in different markets and locations.

But the bottom will arrive and it will arrive quietly – it may have arrived in some places.

We will know the bottom has arrived firstly when vendors refuse to sell (or let) at prices that are patently silly and secondly when buyers with funding have the confidence to sign contracts.

What is a silly price? It is hard to define what a silly price is but measures of prices will include replacement cost and recent lettings or sales (however limited), the availability of some credit and/or equity buyers, and also the gut feeling of grey-haired property professionals. But vendors need really to be able to say no to silly offers and not have bankers or other creditors forcing them to accept that price.

There must be some sort of realisation across the board by bankers and receivers/creditors that it is better to hold on to the asset and wait than sell at that “silly” price.

The most important participant in the Irish market is Nama. It has acquired or is acquiring all its assets based on property valuation levels set as of last November. In recognition of the fact that valuation levels at that date were significantly depressed (being about half what they were at the top of the boom),

Nama are paying a small mark-up, averaging about 10 per cent, known as long term economic value.

It is highly unlikely that Nama will sell assets at below its buy-in price and this, in my view, gives us a major yardstick as to what is a possible floor to the market and an indication of what is or is not a silly price. This is not public knowledge but it is not hard to make an educated guess.

Nama is now working through the business plans for its clients and these will provide for sales of the underlying property asset over a period of years. It is highly unlikely that Nama will approve any disposals in these business plans at prices below its buy-in price plus long-term economic value margin.

So Nama in practical terms has probably already put a floor to the market prices for commercial assets. We may be at the floor for Nama-type properties. The same cannot be said for the residential market where prices continue to sag as it is a totally fragmented market with no key player. I will come back to the residential market later.

Two things could upset the floor set by Nama in its marketplace, which is mainly the commercial market: first, disposals by non-Nama banks and their receivers could force down values below those of last November; second, if Nama does not have the patience or the capacity to delay disposals by its clients until the market can absorb those sales at their buy-in prices.

This will be a hard one to call for the Nama board who will want to start getting money back asap. On the other hand, its annual cost of funds is low and the ECB is patient.

With this unofficial floor to the market set by Nama, is now a good time to buy?

With a yield spectrum of 7 per cent-plus on quality Dublin city buildings and reflecting rents that are below replacement cost, I think there is now good value out there for long-term commercial investors.

Putting my money where my mouth is I have personally transferred a chunk of my (depleted) pension fund into quality Irish property both directly by participating in the purchasing of an individual office building and indirectly by acquiring units in unit- linked property funds.

I am advising my risk-tolerant clients to follow suit and some of them are acting on that advice. There is a risk that we may not be quite at the bottom but history shows it is impossible to get timing perfect and one has to take a view. If there is a fall ahead it will not be a big fall and I am quite happy to take that chance with quality Dublin property as time will undoubtedly cure any premature acquisitions.

Turning to the residential market the big issue is that no one is setting any kind of floor – there is no Nama effect. The determination of what is a “silly” price is left to the individual. If he or she wants to sell simply for personal convenience then they may choose to postpone that sale.

But in some cases they may not have any choice but to sell so as to meet other liabilities. Again, if it is a family home there may be some protection but if it is a second home or a holiday home it is likely to be a forced sale with a ripple effect on the rest of the local market.

I would personally be a slow buyer in the residential market unless I was very focused on a particular market segment and could identify value there. The Government should do something to assist confidence in the residential sector such as putting a temporary moratorium on stamp duty to reduce the huge transactional costs associated and encourage individuals to trade up or down. The revenue lost would be small in relation to the positive impact of getting the market moving and the flow through to the overall economy.

Bill Nowlan is a chartered surveyor and town planner and is managing partner of property asset management company W K Nowlan Associates in Dublin. bill@wkn.ie