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Central Bank Dublin ; a significant force in the market is the need for Irish banks to deleverage over the next seven years to comply with new banking rules.

BILL NOWLAN

Navigating the strong currents in the Irish property industry will be the big challenge for 2013. The extent of these forces could make it a great year or a terrible one.

We are finishing 2012 with some sense of direction, with about €600 million in investment sales, a reviving housing market, particularly in inner Dublin, and a level of mortgage finance emerging for house buyers. Maybe this trend will continue, but the forces at work could drive us off this benign course.

Those forces include bank deleveraging, uncertainty about the euro's future, a moribund world economy, the impact of the Budget on the Irish economy, the absence of credit for purchasers, the level of foreign direct investment into Ireland and the limited availability of equity to buy property. But whatever the outcome, it can't be worse than the experience of 2009-2011, when almost nothing positive happened.

Bank deleveraging

Probably the most significant current is the need for the Irish banks to deleverage over the next seven years to comply with new banking rules. The extent of deleveraging so far by the Irish banks is about €35 billion but the rundown of the loan books has a long way to go. This will involve sales of loan books to overseas investors.

As a result, many professional borrowers will have a new banker in the not too distant future – and not out of choice. That lender will have a totally different attitude to his debtor than his former Irish banker, having bought the loan at a significant discount to its nominal value.

The expectation is that the new banker will adopt a far more aggressive approach to their borrower but the good news is that that they will be prepared to slice and dice to get a result. That result will be either a turn on the price paid for the loan, or a handsome income, while awaiting the eventual disposal of the asset. I have tried to get an estimate on the likely level and timing of loan book sales but there is a very wide range of estimates in the marketplace. Nama seems to be in the best position as it does not have to comply with the various Basle rules applying to the banking sector. It also has very cheap funding and is well ahead of its bond repayment commitments. The big question about bank deleveraging is the risk that much more property comes onto a credit-starved Irish market than it can absorb and thus forces down values even further.

Values

Until I learned recently about the possible scale of the deleveraging coming down the tracks I would have subscribed to the idea that we were at the bottom of the property value curve, particularly in Dublin.

However, now I am not so sure, specially in the secondary markets where most of the loan books are secured. It will come down to four factors: volume of sales; price paid for the loan; investment timescale of the loan purchaser; and the ability of the borrower/property to generate income to service the loan or capital to pay it back from its own resources or by forced sale of the asset – even at a significant discount. Trying to guess the outcome of this and its impact on asset values is like predicting the winner of the 3.30 at Punchestown.

However, as regards prime property, particularly in Dublin, I am much more confident. The amount of such property is probably lower than the demand for it. I wrote in my 2011 year-end article that the values of quality property in Dublin would rise and I was right – they will probably rise again in 2013 but they could be the exception to the experience nationally.

Long term prospects

A more optimistic longer term prospect for Irish property comes from looking overseas. Ireland is a blip in the international property world but what is happening overseas does influence what happens here.

In the world of international investment the big story is the hunt for high yields in a low yield, low inflation environment. The average income yield from stocks and shares is just 4 per cent. Safe bonds yield even less. Property is catching the attention of institutional investors with yields from property double equity and bond yields. For example, the Investment Property Database’s (IPD) average UK portfolio yield in 2011 was almost 8 per cent – it was over 9 per cent here.

Investors worldwide are seeking high income yields from their assets and property is attracting much attention because of its high yield currently. Institutional property holdings have fallen as low as 5 per cent – but before the fad of equities and the hedge fund took fire a decade or two ago, it was close to 25 per cent.

In my view this is all about to reverse. The next 10 years will be the decade of property as investors seek to rebuild their property portfolios both to get high yields and hedge inflation. It is one of the reasons that there is such a weight of money currently seeking quality property in Dublin.

Big challenge

Finally, the big and hidden challenge for the Irish property industry is to work with the Government to find ways to get new affordable homes for the 93,000 Irish people on our housing lists.

The Government simply does not have the skills or indeed the €15 billion to provide these homes. In the Netherlands and other countries social housing has been profitably provided by the private sector for many years.

Reits (real estate investment trusts) may be one method of turning a problem into an opportunity, QIFs (Qualifying Investor Funds) another.

But leaving it to the Government, particularly one as poorly equipped as this one in property matters, will end in tears – not good strategy.

Bill Nowlan is managing partner of property asset managers WK Nowlan Associates