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Banks must get lending again

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The Government has reduced stamp duty and guaranteed the banks, buyers are ready to pay realistic prices, so banks must get the market moving again by taking on new lending, writes Bill Nowlan

PROPERTY VALUATIONS are in the spotlight. We have moved from a position of general overconfidence in property and its inherent value to one of distrust of anything or anyone to do with real estate.

There is now a widespread belief that the valuations of the properties which are held as security by the Irish banks are not realistic and do not reflect conditions in the property market. There is now a classic situation evolving of the pendulum having swung too far with a general under-confidence in property as an asset class.

Before focusing on valuations, I would like to remind readers that under normal circumstances, it is unusual for a bank lender to rely on pledged assets to realise repayment of a loan. The whole principle of banking is that the borrowers should and generally have the capacity to repay out of normal cashflow and selling the asset is only a last resort.

Irish banks generally do not appear to be exposed to the sub-prime sector and its "toxic loans" which sparked off the current crisis. What they have are significant loan books with individuals and property companies which are linked to the performance mainly of the Irish and UK economies and property markets and, to a relatively minor extent, to the European and US markets.

Given that property is an integral part of the overall financial system and is central to its current problems, it is important for many reasons that the banks and other stakeholders know where they stand in relation to current values. However, in these bad times, property valuation itself is problematic, principally because the underlying basis of all property valuation is comparison with open market transactions and activity in the market is now almost at a standstill.

Unlike stocks and bonds, there is no central marketplace for property and no quoted current prices. There are well-founded property indices for particular property types which are useful in identifying value trends. However, an index will not show what has happened to the value of a specific property in a specific location taking into account all of the diverse factors which can affect the value of an individual property.

The basic process of property valuation is a comparison of the property to be valued with recent open market transactions in comparable properties and adjusting for the differences in the properties' relative characteristics.

The process is seen at its simplest in the valuation of houses and apartments where the comparative variables are limited. The valuation of investment property and development land is more complex but is essentially estimating the present value of a future income stream. There are many factors at play here including rents, yields, costs, inflation and growth projection, planning, etc.

The valuer's skill lies in analysing the relevant elements of comparative transactions and, having regard to that information, selecting the appropriate inputs to build the valuation.

An invariable feature of a strong market is a high level of activity and valuers can avail of a wealth of up-to-date information on transactions and deals, thereby providing a solid basis for valuation advice and opinion.

The valuation of property is regulated by codes of practice and guidelines established by the surveying and accountancy professions. A key code of practice is that for an open market valuation there is an assumption of a willing buyer and willing seller. In good times, there is an abundance of willing sellers and willing buyers. In bad times, that assumption becomes onerous.

At this moment, there are practically no transactions taking place in the Irish commercial real estate market and very few in the residential arena that valuers can use for comparison purposes. This is for three reasons. First, the prevailing fear of buying at a current price that is too high. Second, no one can get any money to do a deal due to the banking paralysis. Third, vendors have not accepted the facts of life that the world has changed and prices have fallen significantly.

All of these issues feed on each other and make life challenging for valuers. However, experienced and independent valuers who are in touch with the market and with prospective purchasers and tenants, have a good sense of where the market is and of the levels at which the market would start operating again.

Bankers, too, are acutely aware of the difficult valuation situation. They are getting "tone-of-the-market" valuations from their independent professional advisers and are basing their internal assessments of loans on such valuations. However, this is being done quietly and confidentially because such valuations may possibly mean a breach of banking terms for more recent loans.

In my view, values are in the order of 25 to 30 per cent lower than the historic high prices at which some properties were acquired over the past year or two, while development land values have generally more than halved in the past two years.

However, it is well to remember that much of the property held as security by the banks was acquired pre-2006 before values peaked and is no way at any risk of default.

The big valuation risk today is that, if confidence and cashflow is further eroded by the banks not making credit available for realistic deals, then valuations could slip further and that is why it is so important and urgent to break the downward spiral, to get cash flowing again and to rekindle confidence in a future which will undoubtedly arrive one way or the other.

The Government has done its bit by reducing stamp duty to a more realistic level for commercial property and by guaranteeing the banks. The buyers are there - at realistic prices. It is now over to the banks to get the property market moving again by taking on new lending.

As I have said in several earlier articles, while I advised my clients to withdraw from the Irish market from 2006 onwards, I would be advising them to buy here and now at realistic price levels and provided bank finance is available on reasonable terms. Let's all get back to normality!

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