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**CEM** OCCASIONAL PAPER SERIES

# **THE IRISH INVESTOR'S ATTITUDE TOWARDS COMMERCIAL PROPERTY INVESTMENTS IN 2011 AND BEYOND**



# THE IRISH INVESTOR'S ATTITUDE TOWARDS COMMERCIAL PROPERTY INVESTMENTS IN 2011 AND BEYOND

An information paper by David Hourihan, Course Leader for the BCSC Diploma in Shopping Centre Management at CEM

CEM OCCASIONAL PAPER SERIES

November 2012

## EXECUTIVE SUMMARY

Since the beginning of the global credit crisis the Irish economy and, in turn, the Irish property markets have experienced an unprecedented period of turmoil. Overall, the business environment both at home and abroad for Irish investors has remained extremely tough since our first survey in 2008.

The biggest challenge now for the Irish investor, both in the domestic and international markets is the lack of readily available finance. The Irish commercial property market would also benefit from greater transparency. This could be achieved through producing more independent market reports on commercial real estate in Ireland, and the wider availability of transactional evidence.

The Irish government's handling of the upwards-only rent review debacle in 2011 and the uncertainty it created was less than helpful in what was already a fragile investment market. It is expected that the level of commercial investment transactions in the Irish market will rise in 2012, possibly back up to the preceding-10-year annual average of approximately €1 billion due mainly to international interest in the Irish market.

Over the next three years (2012–2015), modern well-let city centre offices will be sought after, whereas modern suburban offices, older city centre offices, Georgian offices and retail properties in the Irish investment market will be most vulnerable to further falls in value. It is anticipated that many Irish private investors and syndicates may have to sell their international property investments over the next three years (2012–2015).

Those Irish investors in a position to acquire international property investments will be extremely cautious and will only be looking for modern, fully let properties in prime locations. There is now a clear preference among Irish investors for prime Euroland investments. Since the 2008 survey, Irish investors have lost their appetite for properties in Eastern Europe, North America and beyond.

The Irish love affair with property has been severely tested over the last four years but it has not gone away.

## METHODOLOGY

In June 2008 and February 2011 CEM undertook two Internet-based market surveys on the Irish commercial property investment market.

The objective of the 2008 survey was to consider Irish property investors' attitudes towards commercial property as a type of investment. The research also sought to establish what locations and property types Irish investors would or would not be investing in within their domestic and the international markets over the following three years.

Questionnaires in the 2008 survey were issued directly to 50 Irish investors, surveyors and valuers. We received 37 responses to the survey.

In 2011 a second survey was undertaken to look at how the attitude of Irish property investors had changed in light of the severe global economic downturn.

As part of the 2011 survey an online questionnaire was issued to 138 Irish agents/advisors, asset/property managers, fund managers, private investors and valuers in order to sample a truly representative body of people involved in the Irish investment market. We received 46 responses to the survey.

The names of those who participated in these surveys are confidential – however, respondents were given the option to disclose their names. The relatively high number of respondents willing to supply their details was helpful in judging the quality of the responses as respondents will have carefully considered their answers before putting their names to their completed questionnaires.

Of the 46 respondents to the 2011 survey, 28 requested a summary of the questionnaire results.

We encountered various constraints in carrying out this research, which are worth noting. They included the following:

- The Irish property investment market is a relatively small tight-knit community of investors, valuers, banks, financial institutions and specialist surveyors, and the environment in which Irish investors operate is highly competitive. Therefore, it was always going to be the case that the number of Irish investors and advisers available and willing to participate in an online market survey would be limited.
- Currently, market transparency (in terms of transactional evidence and research) in the Irish home property market is relatively opaque in comparison to other larger European property markets. According to Duncan Lyster, writing in 2011, the Irish commercial investment market had been paralysed for almost three years. This is still the case today (2011) and the result has been that very little market transactional evidence has been available. To add to this problem, the production of commercial property investment reports on the Irish market for public consumption is currently provided by only a handful of large surveying firms and their representative professional bodies. While these reports are professionally produced and helpful, the involvement of these organisations in the same commercial property marketplace arguably amounts to a conflict of interests. One exception to this is the widely recognised Irish property investment market report that is

independently produced by the international real estate performance analysts Investment Property Databank (IPD). Lyster (2011) went on to say that the Irish market needed to have access to more details about transactions that were taking place to provide price benchmarks and that it was incumbent on chartered surveyors to encourage more accurate reporting of letting and sales activity. This information would allow occupiers and owners to operate with greater confidence. The home market would in turn greatly benefit if more independent research and accurate transactional evidence were to be made available, in order to give a more complete picture of the market to both domestic and foreign investors.

- A number of the participants in the survey required assurances about the confidentiality of the survey. While they were interested in the results of the survey, they did not want their names attached to quotes used in the results. Such concerns would inevitably have been reflected in the number of people who were willing to take part in the market research.
- This paper recognises that international investors have shown significant interest in seeking to acquire discounted commercial property investments in the domestic market. However, this paper is primarily focused on the Irish investor's attitude to commercial property investment in the domestic and international markets.



## SUMMARY OF THE 2008 SURVEY

The first survey in 2008 was undertaken before the National Asset Management Agency (NAMA) was established in 2009. NAMA was set up by the Irish government in response to the Irish banking crisis. NAMA has a mandate until 2020 to repair

the balance sheets of Irish Banks and improve liquidity by removing the worst property loans – mostly land and development assets, according to Property Week (2010). NAMA manages a portfolio of properties worth approximately €81 billion.

## RESULTS OF THE 2008 SURVEY

### The Irish domestic market – 2008 survey

In the five years before 2008 the biggest factors affecting the Irish investment market were the lack of investment product and high acquisition costs (stamp duty was at 9% for all commercial property acquisitions over €150,000 in Ireland).

However, by 2008, market sentiment had become extremely negative, with the majority of respondents reporting that they were expecting a significant downward adjustment in commercial property capital values over the coming two to three years. The majority of respondents underestimated the level of downward adjustment in commercial capital values in the domestic market. Most anticipated a 10–15% fall in values over the coming three years. In hindsight, very few investors in the international property investment community at this time fully appreciated the scale of the global downturn and the effects it would have on the property markets.

Investors who were in a position to acquire investments were only interested in heavily discounted prime offices for opportunistic and strategic reasons. The focus of Irish investors in 2008 had narrowed to prime modern offices as the sub-sectors (modern suburban offices, older city centre offices and Georgian offices) and the retail and industrial sectors were identified as being particularly vulnerable to rising vacancy levels and anticipated falls in consumer spending.

At the time of the survey the most pressing issue in the marketplace was the mismatch between buyers' and sellers' expectations.

Looking forward, the factors that Irish investors believed would most affect the Irish investment market over the following two to three years (from 2008/09 to 2010/11) were: the cost and availability of finance; followed by occupier demand; and rental growth.

## International markets – 2008 survey

- As with the domestic market, finance costs and the limited availability of finance were the main constraints in the international marketplace.
- The main objectives for Irish investors seeking to invest abroad over the following three years (2008–11) would be to seek higher returns followed by ‘diversification of property holdings’.
- Western Europe was the most popular location with Irish investors because it was viewed as an established and relatively safe market.
- Within Western Europe the United Kingdom was the most popular location because of the size of its property market, similar lease structures, market transparency, and its proximity to Ireland.
- Prime cities in Germany and France were also popular because of the strength and stability of their economies within the Eurozone.
- Outside of Western Europe the US was of particular interest because of favourable exchange rates, the size of the market, market transparency and opportunities to pick up distressed property investments.
- A third region, which respondents believed would be of interest to Irish investors over the following three years, was Eastern Europe, closely followed by Scandinavia.
- It was expected that Irish private investors and syndicates would hold and consolidate their international property investments over the following three years (2008–11).
- Irish institutions were expected to reduce their property investment holdings over the following three years (2008–11) because of pressures to maintain acceptable liquidity levels.
- Almost all respondents agreed that those Irish investors seeking international property investments over the next three years (2008–11) would only be looking for modern, fully let commercial property investments in capital city locations.



## THE IRISH MARKET IN 2011 AND BEYOND

In researching market sentiment among Irish property investors towards property as an investment type we reviewed recent secondary, published data produced by the leading Irish property consultancies and Irish national daily newspapers on the Irish commercial property investment market.

The main findings of this research were that in December 2011 the Irish government announced a range of property measures which were aimed at clearing perceived barriers to investment in the Irish commercial property investment market, set out below:

- The proposal to retrospectively prohibit upward-only rent reviews in existing leases was abandoned. Writing in the Financial Times, Murray Brown J (2011), commented that upward-only rent reviews were a feature of the Celtic Tiger economy, which saw property prices rise faster than in any other EU state. The proposal to ban upward-only rent reviews in existing leases was initially mooted in the pre-election campaign by the new Irish government in early 2011 and according to Lisney (2012) was the largest obstacle to investment activity during 2011 as it created uncertainty in an already troubled market.
- Stamp duty was reduced from 6% to 2%. This measure, according to Jones Lang LaSalle (JLL) (2011), brings Irish stamp duty rates into line with other European norms, and in a world of low returns and risk, it reduces the hurdle investors have to reach to break even in the first couple of years after acquiring an investment.
- Capital gains tax exemption relief was made available for properties to be purchased up to the end of 2013, and which are to be held for a minimum of seven years.

Ireland's debt market is still in turmoil. According to Molloy (2010) the Irish commercial property market is vulnerable because of the size of refinancing debt. Many Irish property loans are carrying negative equity after an estimated 60% slump in the values of shops, offices and warehouses over the past three years (2007-2010). Not surprisingly, according to Lisney (2012), debt is still very difficult to secure even for prime properties and the conditions attached to loan offers are very onerous for the investor. Jackson (2011) states that the capital ratio stress tests undertaken by the banks, and the streamlining by the new government of the banking system to form two pillar banks, have not resulted in a significant increase in the availability of funding to date. Overall, according to SCSI/RICS (2012), the availability of finance remains the biggest stumbling block for the property market and this worsened in 2011 as the banking crisis continued. Foreign banks may lead the way out of the current impasse on the debt side, particularly for prime property investments.

Total returns for 2011, according to EGi (2012), were -2.4%, matching the figure reported in 2010. The retail sector saw the steepest decline in values for the year (a drop of 12.1%), followed by the industrial sector, which was down by 11.8%. Phil Tily of IPD (quoted in Wallace 2012) said: 'The raft of property reforms announced in December may take time to affect Irish values. The decision

not to implement rules regarding upward-only rent review legislation and the removal of capital gains tax on purchases before the end of 2013 should restore a degree of positive investor sentiment towards the market’.

Jackson (2011) believes that the outlook for 2012 will be very difficult to call and that it is largely dependent on a few key factors. For banks looking either to exit the Irish property market or reduce their exposure to property, the sale of loans is the most likely route for them to take in order to dispose of a significant volume of property in a relatively short period of time.

Demand among Irish investors is strong, according to Jackson (2011), for good-quality office investment opportunities. This sector is seen to offer good rental growth prospects, as the

current market rental levels are below replacement costs, so existing supply will dwindle. It is anticipated that the price gap between prime and secondary properties will widen in this sector.

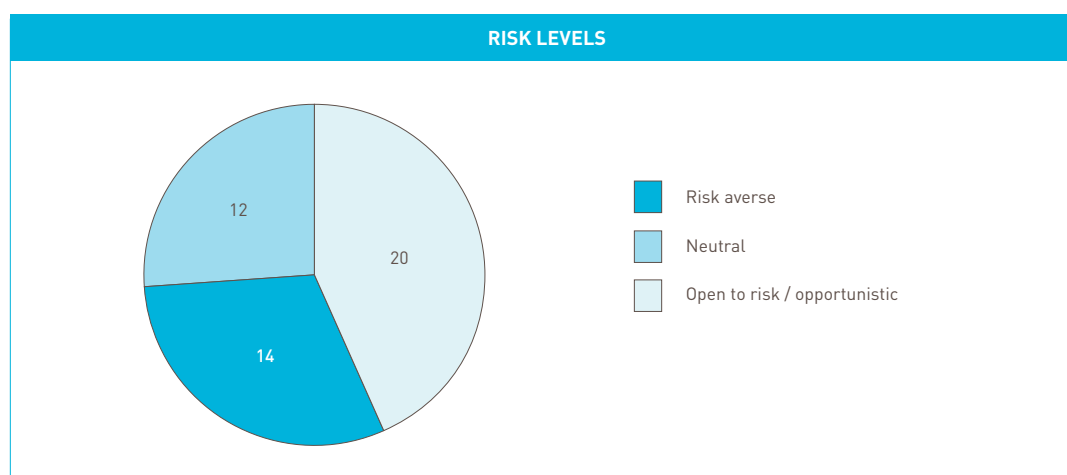
According to Lisney (2012), the volume of transactions for 2011 was approximately €200 million, compared to €245 million in 2010 and €3 billion at the height of the market in 2006. The 10-year average annual turnover level is approximately €1 billion and it is anticipated that in 2012 transaction levels may rise to the previous-10-year average level. There are concerns in the marketplace that banks, NAMA and forced sellers may release a large supply of investments into the Irish market. According to Jackson (2011) these concerns mean that potential buyers are factoring in a future drop in pricing into their analysis of an investment, and so are being extremely cautious.



## SUMMARY OF THE 2011 SURVEY

### The Irish domestic market – 2011 survey

The results of the February 2011 survey on the Irish domestic market can be summarised as follows:



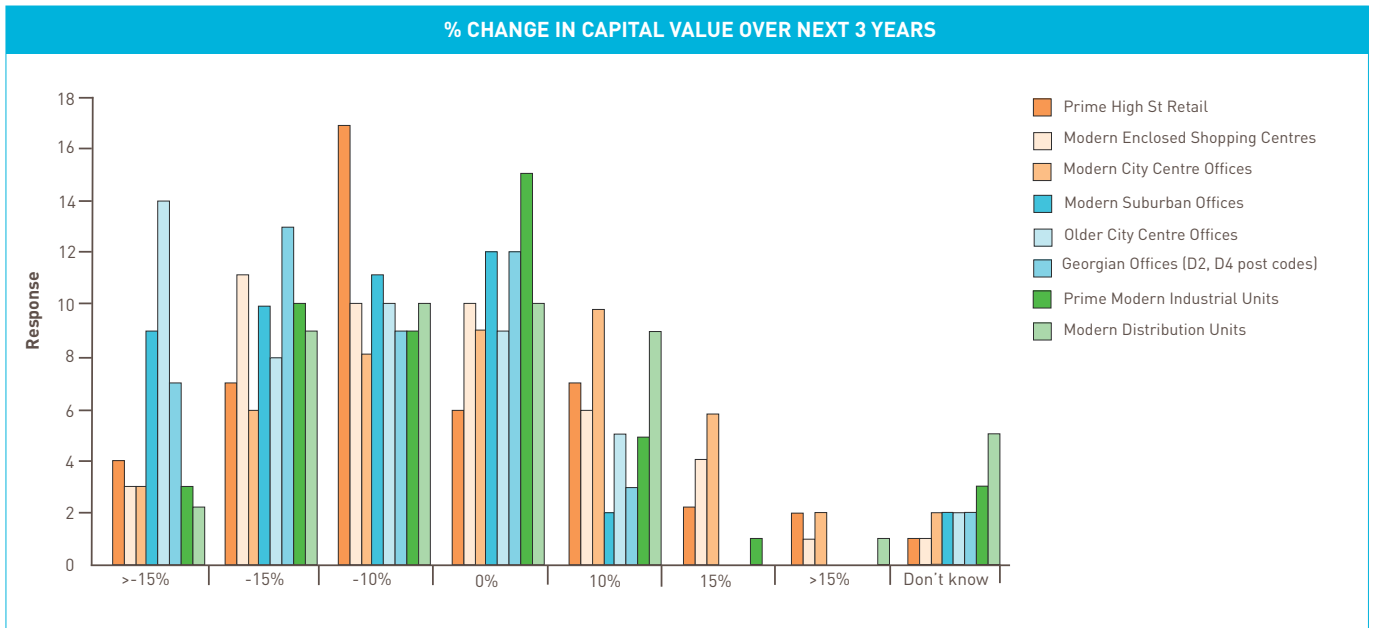
Of the 46 respondents, 26 considered themselves either risk-averse or neutral. Twenty of the 46 respondents classified themselves as open to risk/opportunistic. These respondents saw that there were existing opportunities in the marketplace and believed more would follow as the year progressed.

There was a lot of uncertainty in the marketplace as to whether there would be further significant downward adjustments in commercial property capital values in Ireland over the following three years (2011–14). Twenty-six of the 46 respondents believed that there would be further significant adjustments, while 20 respondents believed that the worst of the price adjustments had already occurred and that the market had bottomed out. Concerns raised by respondents included the lack of confidence in the marketplace, falling rents, lack of market transactional evidence, the government's proposal to remove upward-only rent reviews from leases and uncertainty over how the

banks, receivers and NAMA would offload properties onto the market.

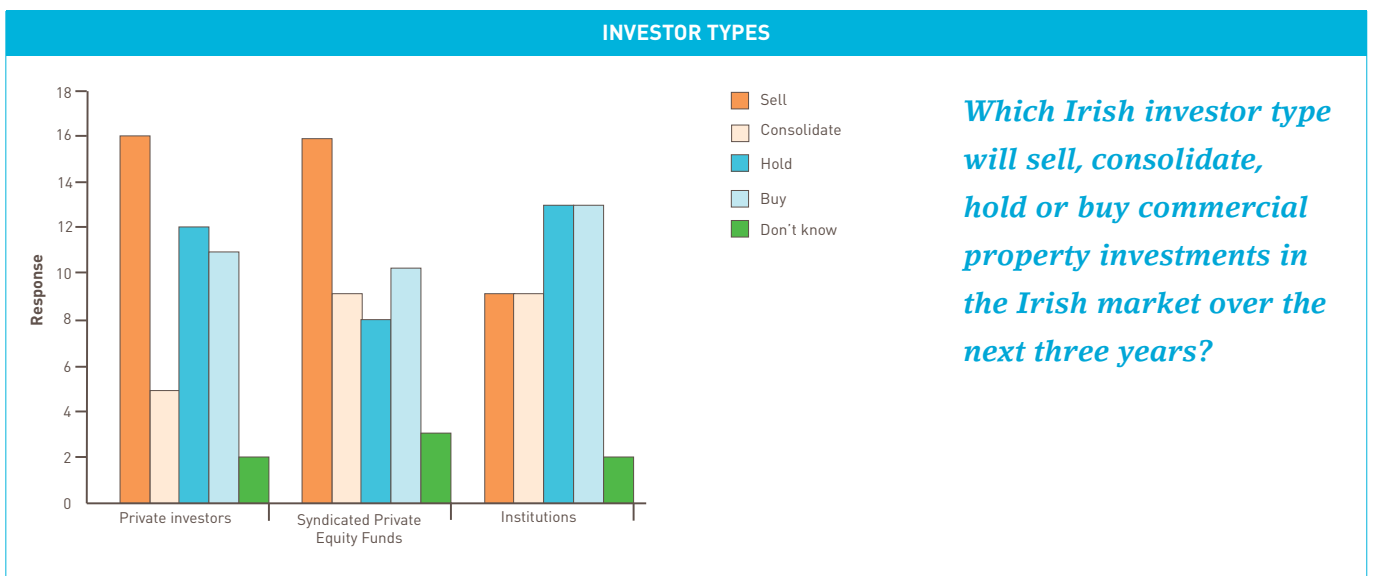
The results of our 2011 survey indicate that over the next three years modern suburban offices, older city centre offices, Georgian offices (Dublin's D2, D4 postcodes) and prime high-street retail sectors are most at risk in terms of further falls in value. It was not expected there would be a change to the value of the industrial sector, whereas modern city centre offices are expected to rise in value.

As with the 2008 survey, the office sector was believed to be of most interest to Irish investors, followed by the retail and industrial sectors. In addition, investor focus would be on prime locations. Respondents commented that because of the unprecedented turmoil in the Irish markets and the lack of finance, Irish investors would continue to adopt a 'wait and see' attitude over the following three years.



Respondents anticipated that over the next three years the banks and NAMA might require many Irish private investors and syndicates to sell their Irish property investments. Otherwise, it was felt they would look to hold onto/consolidate their Irish property investments and that investors in a position of financial strength would look to pick up opportunities over this period.

There was an expectation among respondents that institutions would hold on to and buy Irish property over the coming three years as they would be under less pressure with early redemptions requests from their policyholders and less reliant on the debt market.



*Which Irish investor type will sell, consolidate, hold or buy commercial property investments in the Irish market over the next three years?*

According to the 2011 survey, the main factor that will affect the Irish property investment market over the next three years will be the cost/availability of finance. One respondent (a valuer) stated that: 'Lack of funds is at present depressing the market and inhibiting recovery/growth'. Occupier demand and rental growth were the next set of concerns, followed closely by the lack of investment-grade property. Respondents were largely neutral on acquisition costs, largely because of the government's reduction of stamp duty rates on commercial property in its 2009 and 2011 budgets.

Additional comments made by respondents are set out below:

'Liquidity is needed for the market to function – NAMA's role is fundamental. Domestic debt-backed investors are out of the market. The Fine Gael and Labour policy on rent reviews, if implemented, will totally undermine banking, NAMA and external investor confidence.'

'The lack of investment-grade property availability means that international investors interested in investing in Ireland will not find the type of product they require and will move on elsewhere. If there continues to be a lack of available finance then the market will not recover until there is.'

'Foreign investors, especially those in Euro funds and German open-ended funds, are seeking surety of income and capital protection at what are perceived to be historically low prices. The problem is that the volume of such investments available to purchase is quite small and is held mainly by institutions. The lack of finance is already hampering every market and especially the non-institutional buyers who rely on funding.'

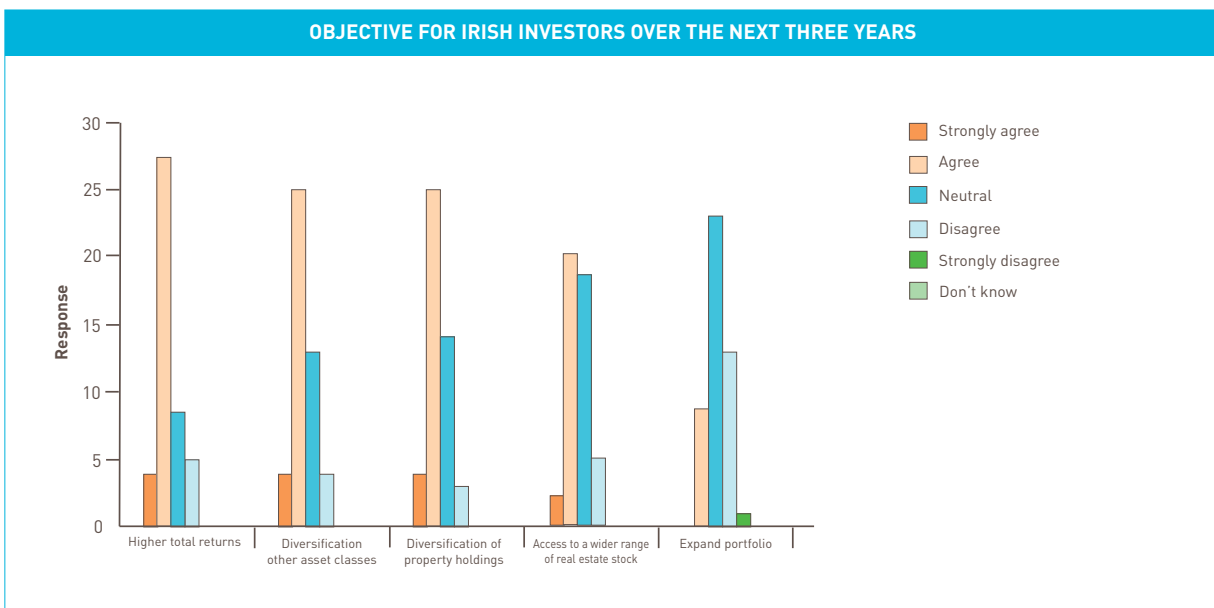
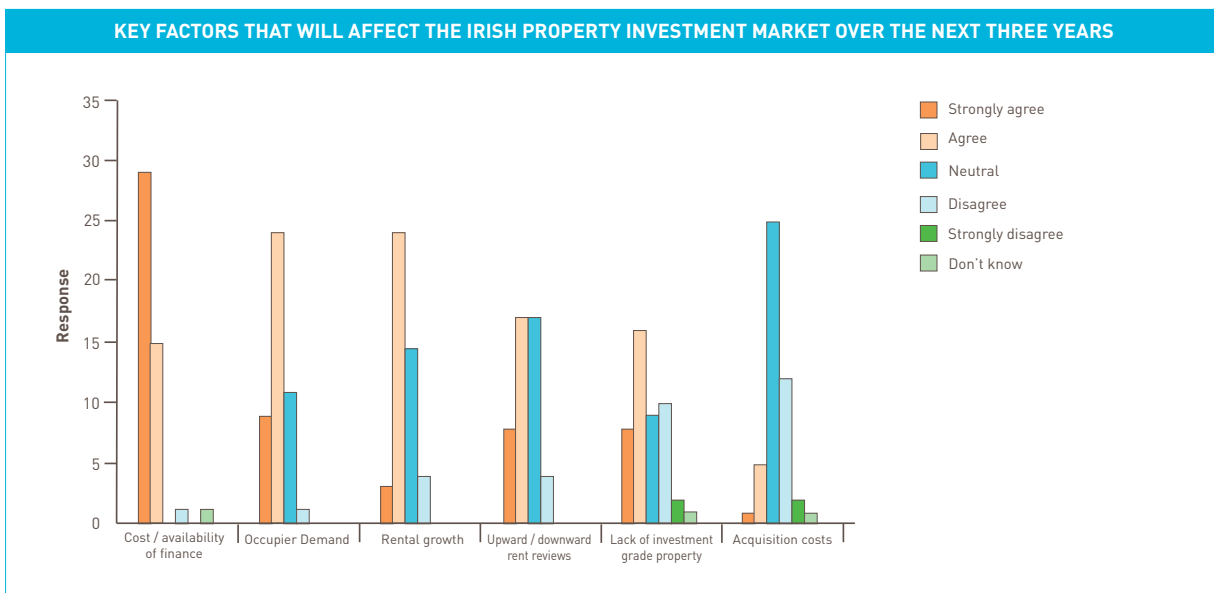
'NAMA will control the supply of investment property. government policy and the banks will play a huge part in the market.'

'Availability of finance for investment/development will be very difficult to secure unless the investor has plenty of equity.'



It is quite clear from the 2011 survey what the main objectives for Irish investors over the next three years were. Irish property investors will continue to protect and improve the investment structure of their property holdings through consolidation and diversification. According to one respondent: 'Investors who have suffered declining capital values and rental returns will seek

to consolidate back into stronger investment types in prime locations'. Irish investors will also seek to address risk within their portfolios by rebalancing their portfolios. They will seek to diversify into other asset classes and also look to access a wider range of property in terms of location, size and type.



## SUMMARY OF THE 2011 SURVEY

### International markets – 2011 survey

The results of the 2011 survey on Irish property investors in the international market can be summarised as follows:

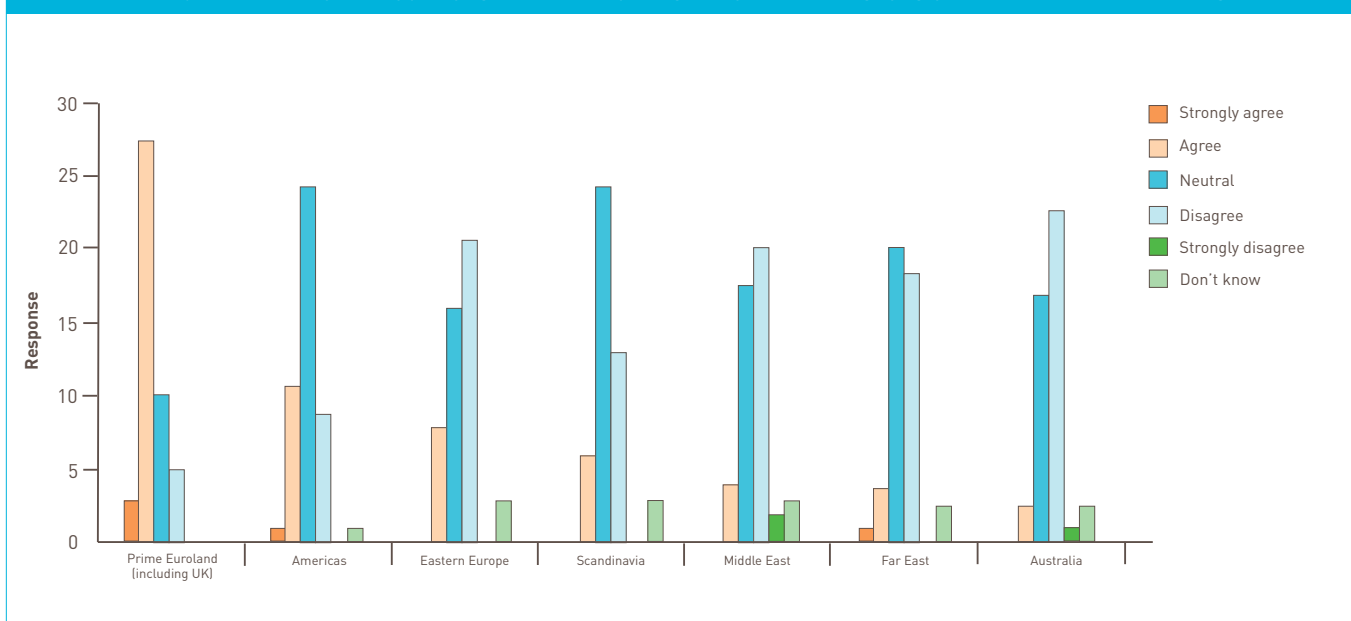
As in the 2008 survey, there was a particular level of interest from respondents in the prime Euroland region. However, a gap has opened between prime Euroland and the rest of the global regions, indicating that Irish property investors have become more cautious about buying property in international markets. Comments made by respondents included:

‘In the main Irish investors tended to borrow from Irish banks when buying abroad. This is no longer feasible. Only very strong investors will be able to borrow from the international banks. How many very strong investors remain?’

‘Where liquidity permits, Irish investors will seek to diversify their international portfolios in the next few years. The UK remains the most attractive market primarily due to familiarity with that market. Investors will be reluctant to enter farther flung markets unless they are already actively involved there.’

‘Given the losses incurred to date, safe havens will be more attractive. The Far East and Eastern Europe have traditionally been regarded as having issues around proper legal title/planning issues. Investors will primarily return to what they know best and are most comfortable with.’

WHICH INTERNATIONAL LOCATIONS WILL ATTRACT IRISH PROPERTY INVESTORS OVER THE NEXT THREE YEARS



London and south east England will be the most popular UK regions for Irish property investors over the next three years, according to the 2011 survey, while regions such as Northern Ireland and Wales will not be of interest to Irish investors. Comments made by respondents included:

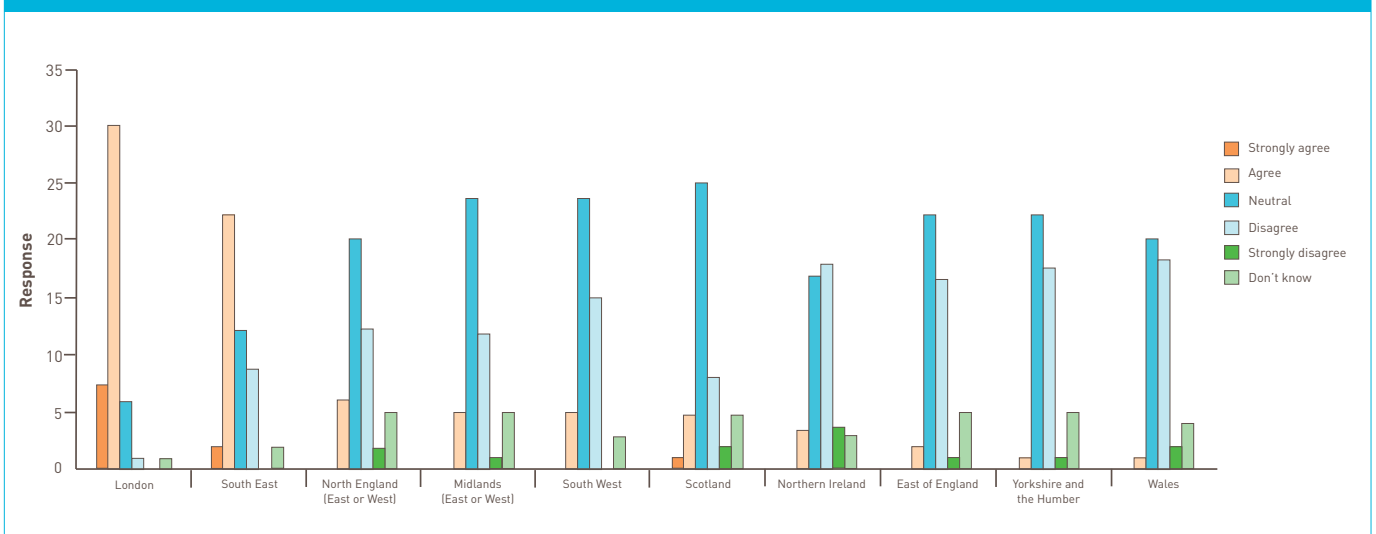
‘London remains the most attractive market to Irish investors due to familiarity and the ability to get institutional-grade leases. South-east England may get some spin-off from this. The larger centres in northern England could also see some interest. Northern Ireland is still seen as a place

that is coming from a low base and with increasing interest from multinationals in Northern Ireland, property investment should follow.’

‘The London market has proved resilient despite the UK recession. The large pool of buyers/sellers in this market makes it a stronger investment choice.’

‘The focus will be on prime London and good south-east England high-street retail.’

WHICH UK REGIONS WILL ATTRACT IRISH PROPERTY INVESTORS OVER THE NEXT THREE YEARS



In the 2011 survey, respondents anticipated that over the next three years many Irish private investors and syndicates would sell their international property investments and consolidate their portfolios. According to one respondent: ‘The future for any bank-financed investor is tied to NAMA and what they might decide.

The jury is still out’. Respondents expected that the Irish institutions would be unlikely to sell their holdings but would focus instead on strengthening the risk profile of their property portfolios.

Based on the 2011 survey, those Irish property investors seeking to acquire international property investments will be very cautious and will only be looking for institutional-type property investments which are in prime locations and fully let on long leases to tenants with AAA-strength covenants.

Comments made by respondents included:

'There will be less demand for redevelopment opportunities, as the Irish market has left a bad taste in mouth of non-experienced investors.'

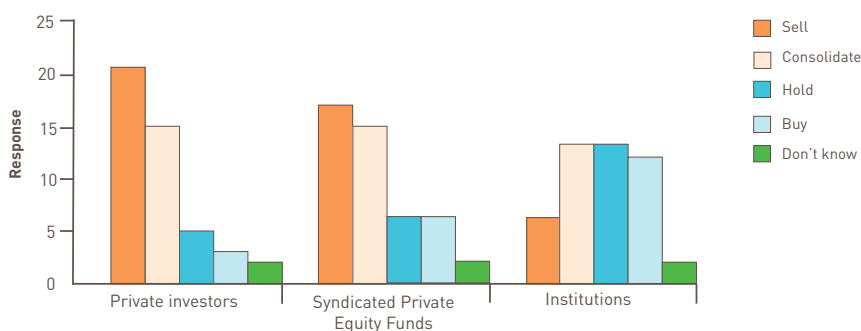
'Available properties offering short-term capital gains are unlikely to be of interest to Irish investors as many serious property investors are long-term players.'

'Given the financial crisis that we have experienced any investor going forward will stick to prime city locations, with modern buildings that are let to secure occupiers and require little management.'

'Quality covenants on long leases will be sought after to balance portfolios. Too many portfolios have land banks which have plummeted in value.'

'Security will be an issue going forward. "Playing it safe" will be on all investors' minds after the recent national and international turmoil.'

INVESTOR TYPES



*Which Irish investor type will sell, consolidate, hold or buy commercial property investments in the international markets over the next three years?*



## CONCLUSIONS

Overall, the business environment, both at home and abroad for Irish investors, remains extremely tough since our first survey in 2008 and, by comparing our findings from our 2008 and 2011 surveys, it is clear that the severity of the downturn caught most Irish investors by surprise. As Warren Buffet once said: 'You only find out who is swimming naked when the tide goes out'. Unsurprisingly, Irish investors have adopted a more cautious approach in terms of their selection criteria, i.e. property/sector types, risk profiles and their locations.

### Irish market

The Irish government has addressed various barriers in the local market, such as stamp duty, in their latest budget. However, its handling of the upwards-only rent review debacle and the uncertainty it created was less than helpful in what was already a difficult market.

Our 2011 survey identified that the biggest challenge for the Irish investor, both in the domestic and international markets, was the lack of available finance. Debt is still very difficult to secure, even for prime properties, and the conditions attached to loan offers are very onerous for the investor. It is anticipated that foreign banks may lead the way out of the current impasse on the debt side, particularly for prime property investments.

Our secondary market research would suggest that the Irish commercial property market would benefit from greater transparency through more independent market research and the wider availability of transactional evidence, two characteristics evident in all mature investment markets.

The results of our survey indicate that over the next three years modern suburban offices, older city centre offices, Georgian offices (Dublin's D2, D4 postcodes) and prime high-street retail sectors are most at risk in terms of further falls in value. It is not expected there will be any change in value in the industrial sector, while modern city centre offices are expected to rise in value. Irish investors are clearly focused on the Irish office investment sector. This sector is seen to offer good rental growth prospects, as the current market rental levels are below replacement costs, so existing supply will dwindle. However, buyers are increasingly looking for quality according to Jackson (2011) and the gap between prime and secondary property Irish investments is widening.

It is forecasted that the level of commercial investment transactions will rise in 2012 to the previous-10-year average of approximately €1 billion. However, respondents to our 2011 survey stated that there are on-going concerns that banks, NAMA and forced sellers will release a flood of commercial investment properties onto the Irish market in the near future and, as a result, investors are analysing opportunities with extreme caution. Many of our 2011 survey respondents echoed this concern, stating that they would continue to adopt a cautious 'wait and see' approach to the Irish commercial investment market over the next three years.

### International markets

As an open economy, the Irish market is heavily reliant on international trade. Since the beginning of the global credit crisis the Irish economy and, in

turn, the Irish property markets have experienced an unprecedented period of turmoil. It is clear from our surveys in 2008 and 2011 that this turmoil has had an adverse effect on Irish investors' activities in the international markets.

While our 2008 survey suggested that many Irish private investors and syndicates would look to hold and consolidate their international holdings over the following three years, our 2011 survey indicates that they may be required to sell their international property investments over the next three years.

Those Irish investors in a position to acquire international property investments will be extremely cautious and will only be looking for modern, fully let properties in prime locations.

As in the 2008 survey, there was a particular level of interest from 2011 survey respondents in the prime Euroland region. However, a clear gap has opened between prime Euroland and the rest of the global regions, indicating that Irish property investors have become far more cautious in the international markets since our first survey in 2008.

Within the Euroland region the UK commercial property investment market will be of particular interest to Irish investors over the next three years. London and south-east England are traditional stomping grounds for Irish Investors; however, opportunities are limited due to the strong levels of competition from other international investors in these markets. Other parts of the UK, such as Northern Ireland and Wales, will not be of interest to Irish investors over this period.



## ABOUT THE AUTHOR

David Hourihan MSc in Property Investment FRICS. David is the Course Leader for the BCSC Diploma in Shopping Centre Management at CEM.

Over the last 20 years David has worked in the commercial property asset management, valuations and agency sectors of the property industry in both the UK and Ireland.

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