

Commercial property market to recover by early 2010

Bank of Scotland (Ireland) independent survey of Chartered Surveyors finds sentiment weak with recovery more than a year away

An independent survey of commercial property experts, conducted in July, found that while overall current sentiment has fallen substantially since the end of last year, the market was expected to recover towards the end of 2009 or the start of 2010. *[NB: This survey was conducted before the financial turmoil of recent weeks.]*

This is the seventh Survey of Business Sentiment in the Commercial Property Market carried out in July of this year, commissioned by Bank of Scotland (Ireland) and carried out by the Society of Chartered Surveyors (SCS) and the Dublin Institute of Technology, which surveys Chartered Surveyors in the commercial property sector in Ireland.

Market Recovery

The survey found that close to half of the respondents (46%) believe that the market will recover in 2009, but probably towards the latter end of the year. Just over 40% expect that the recovery will not take place until 2010, more likely in the first half of the year. About 12% believe that the downturn will be a little more prolonged and it will be 2011 before a recovery takes place. No respondents saw the current situation lasting beyond 2011.

The survey also finds that the factors that are expected to trigger the recovery in the market are general confidence in the economy and access to funding. Other significant issues identified were the need for lower interest rates, improvement in the global economic climate, reduction in inflation, an increase in employment levels/reduction in unemployment and lower oil prices.

Sentiment Index

The overall index of sentiment has fallen from 56.5 in November 2007 to 26.6 in July 2008. Indeed sentiment has fallen by a significant amount in all three sectors (office, retail and industrial). This compares with the starting position for the index of 100 in May 2005 and a figure of 99.9 in November 2006. In the space of 20 months sentiment, as measured by the index, has fallen by over 73 index points.

Commenting on the findings, Declan O'Hanlon, Head of Property Banking at Bank of Scotland (Ireland), said: "It is unsurprising that sentiment in the market place has fallen for a second period as the economic and financial turmoil continues. This survey was carried out before the momentous events of recent weeks so I would expect it to take longer for the market to recover, probably at some stage in 2010. Also, we would hope the changes in commercial property stamp duty announced in the Budget last week will encourage activity and optimism."

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Also commenting, Sean McCormack, President of the Society of Chartered Surveyors, said: "The wave of negative sentiment apparent from the survey results and its impact on falling commercial property values is now a market reality. Notwithstanding the financial sector crisis of recent weeks occurring after the survey results were taken, the Irish economy and the property sector will have the opportunity to recover and build on strong growth already achieved. Welcoming the Budget decision to reduce stamp duty on non-residential property from 9% to 6%, Sean McCormack anticipates that the measure will assist in the reactivation of the commercial property market."

Capital Values

Forecasts for change in capital values in all three sectors are down on the November 2007 survey, with between 87% and 91% of respondents expecting values to fall. In addition, a significant proportion of responses suggest that the decline in values will be in excess of 10%.

Rents

Expectations for rental change are generally somewhat less subdued than for capital values, but the dominant forecast across all three sectors is that rents will fall. Rent-free periods, break clauses and shorter leases emerge as the key lease inducements across the market with some small variation in emphasis in the three sectors.

Rental income is regarded as the main rationale for investment, with three-quarters of respondents regarding it as more important than capital gain in the eyes of investors. This is a reversal of the view held last November.

Yields

There is a general consensus that yields will increase across the three sectors. The yield forecasts generally reflect the greater negative sentiment in relation to capital values relative to rental values.

Activity

Sentiment in relation to activity levels has fallen across the market since November 2007. With the single exception of enquiries in the office sector, no respondent in any of the sectors forecast an increase in either transactions or enquiries over the next 12 months. Generally between 67% and 90% of respondents forecast a fall in transactions across the three sectors and between 50% and 73% forecast a fall in enquiries.

The expectation in relation to development either starting-up or at the planning stage is much more pessimistic than in November 2007 right across the market. The percentage of respondents forecasting a decrease in development starting-up ranges from 90% (industrial sector) to 100% (office sector). For development at the planning stage, the range is 77% to 90%.

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Editors Notes

The survey, which is designed to provide an objective view of business sentiment in the commercial property market in Ireland, was undertaken in July 2008.

The Commercial Property Sentiment Index

The survey produces an index of sentiment in the commercial property market as a whole and broken into three sectors – office, retail and industrial. The base date for the index is May 2005 and this forms the base against which subsequent values can be judged. The starting value of the index is 100 for the market as a whole and for each of the sectors.

Other Findings

- Forecasts of occupier demand are now substantially weaker than last November right across the market, with between 58% (retail sector) and 91% (office sector) expecting demand to fall.
- Investment demand attracts similar sentiment with between 75% (retail sector) and 93% (office sector) forecasting a decrease over the next year.
- Similarly the mood in relation to speculative development is very downbeat and much weaker than in the previous survey. In all three sectors, respondents were unanimous in the view that the level of speculative development starting in the next 12 months will fall, while the percentage expecting speculative development at the planning stage to decline ranged from 80% to 100%.
- There was wide variation in the estimate of the scale of overseas commercial property investment from Ireland in 2007, but the dominant estimate was between €3 and €5 billion. In relation to 2008, almost 85% of respondents forecast this at less than €3 billion significantly down on the dominant forecast in the November 2007 survey of in excess of €5 billion.
- On average, the estimates for the destination of overseas commercial property investment from Ireland in 2007, suggest that the UK received about 48%, a little down on the estimate of 52% from the November 2007 survey. The share accounted for by the rest of the older EU states is estimated at 17%, down from the previous estimate of 26%. The newer EU states share is estimated at 14%, up from the earlier estimate of 8%.

The importance of the UK is expected to fall to 43% in 2008 with the older EU states slightly gaining share (to 19%). The newer EU states, other European locations and the rest of the world are all expected to increase their shares a little.

- The retail sector was again regarded as the sector of choice for investors within the Irish commercial property market over the past 12 months, ranked in first place by two-thirds of respondents, down from 87% in the previous survey. The office sector is the second most preferred sector.

The retail and office sectors are expected to switch places in order of preference in the next 12 months. The industrial sector is expected to be the least preferred investment over the next year.