propertyforecast

Volume 11 Issue 4 | April 2008

AUTHORITATIVE INTELLIGENCE ON FUTURE PROPERTY TRENDS

Survival strategies

So where are we in this down cycle? Have we reached mid way, is it only really beginning to get up steam or will we all by the end of this year be wondering what the fuss was about?

There will be very few supporters of the last suggestion at the moment even though **Mervyn King**'s unveiling of the £50bn (Special Liquidity Scheme) package to loosen up mortgage markets and get the housing market and inter-bank market back on the front foot has cheered up some. However, other commentators say its not going to be enough. The theory is, of course, that banks will now be able to pass on the benefits of interest rate cuts to their customers thereby cheering the housing market up and halting the creeping cloud of gloom threatening to embrace other sectors of the economy. But initial soundings on this have not been promising.

The **Bank of England** will swap Treasury bills for mortgage debts and other collateral from the banks. It will only accept better quality mortgage debt, highly rated European mortgages and credit cards, so as to hopefully protect the interests of the poor old tax payer already smarting at the **Northern Rock** debacle where there is potential exposure to £100bn of liabilities. Its only a short term measure over at most three years we are told, and the banks have to guarantee the money will be returned.

Apart from charging banks a commercial rate of interest to use the facility the Bank will also value the assets it receives at a discount (£70-£90 worth of Treasury bills for every £100 of asset backed securities). And if £50bn isn't enough then more is on offer just as long as the current logjam can be sorted out and banks start feeling confident enough to do business again with each other.

So what's wrong with that? Well the main problem is that the dodgier loans will still be in the system, while some of the better bets may start entering the more dodgy zone if house prices collapse this year as some commentators believe they will (see **Fred Harrison**'s comments on page 2).

The banks will, despite the new money coming in, remain very much on the defensive and ultra cautious in a market where asset prices are expected to decline. The **Royal Bank of Scotland** (RBS) will not be alone in needing to raise more money from investors with other banks following its capital raising route. RBS is contemplating the sale of its £5bn insurance division following its £12bn rights issue and has announced write downs of £5.9bn. **Barclays** and **HBOS** may follow suit and all in all none of the banks is exactly going to be in the mood to 'splash the cash' in the mortgage sector however much the government might want them to. Meanwhile, **Darling** wants them to make a full and early disclosure of their losses in order to 'clear the air' and allow normal service to resume as soon as possible.

There should be further interest rate cuts coming so the pressure really will be on the banks to meet the government half way and ease the predicament of those millions needing to re-mortgage in the next 18 months as well as aspiring first time buyers. So there will be some improvements but the banks will want to give away as little as possible.

Overall, we fear that the negative sentiment that seems to abound in all sectors of both the residential and commercial market at the moment has an unstoppable momentum. The question in both sectors of the market is not – have prices further to fall? But rather, how much further will they fall? And how long will this process take to bottom out?

The commercial market has had rather longer to take in the bad news but fresh concern is arising about the rental market with companies increasingly suffering from high taxation and poor consumer/business confidence contemplating smaller space requirements and job cuts. Not good news when over 2m sq ft of office space is reportedly coming on to the City market in the next three months. Meanwhile, **JP Morgan** forecast recently that City vacancy levels would peak at 12.2% next year leading to –16% rental growth over the

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Property FORECAST

A monthly analysis charting future trends for property finance, investment and development

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One prediction that was right

In January 2007 we ran an article by author and independent economic analyst **Fred Harrison** entitled: “2008/2009 could see dramatic turning point in housing market”. It goes without saying that this prediction has proved to be correct but, as he states below, this forecast was actually made almost a decade ago. So how did he come to this correct conclusion and what does he predict will happen now?

My timing was impeccable. Ten years before it happened, I predicted that Britain’s housing market would peak in the winter of 2007/08. The forecast was based on my reconstruction of a 14-year property cycle, the data for which was the historical evidence from the US, Japan, Australia and the UK. The US housing market peaked in 2006, because America came out of the 1990s recession a year ahead of Britain.

Link my correct forecast to my equally correct prediction of Britain’s 1992 economic crisis (published in 1983), and we must assume that there are fewer uncertainties surround the property market than many commentators would have you believe.

My next book, *The Renegade Economist*, identifies the barriers to understanding how the property market actually works. Tracing the evidence to its doctrinal roots, I make sense of the misinformation that was circulated over the past 12 months. Both government and private agencies distributed data and judgements that were inconsistent with what was happening on the ground, or was likely to happen in the following two years.

A dangerous state of denial pervaded the run-up to the peak in property prices. One result: many low-income people purchased homes that they could not afford. Now negative equity will wipe out their deposits and burden them with debts while they return to the rented sector.

An example of the distortions is offered by the forecast for residential building land on the **Valuation Office** website. This shows the price of land rising steadily at about 10% a year, without a break, through to July 2012 (Fig. 1). And yet, building companies began slashing their purchases of land in mid 2007. According to **Savills**, land prices fell 16.6% over the past 12 months. In the South-East, residential land prices slumped by more than 10% in the first quarter of this year alone.

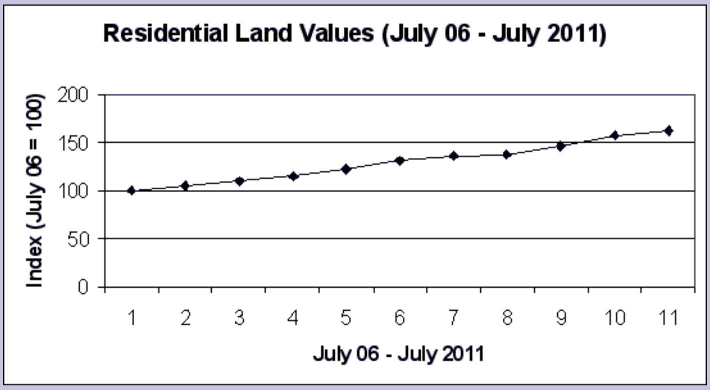


Figure 1

Source: Valuation Office

If public agencies publish misinformation, we cannot expect public policies to be correctly aligned. Property markets do not conform to conventional economic theories. A comparative study of boom/busts over the past two centuries provides the evidence.

According to economic wisdom, the housing market should have remained buoyant beyond 2007 because a latent demand had not been exhausted. Instead, the “fundamentals” that engrossed property pundits proved to be grossly misleading, distracting people from all the signs that should have warned them that a cyclical turning point loomed.

The fundamentals were constantly cited to reassure prospective buyers that there would be no significant decline in prices. In other words, the risks of negative equity were ignored. Then the IMF published its World Economic Outlook last month (April). This revealed that a large part of the rise in house prices could not be attributed to economic fundamentals. Britain had one of the most inflated property “bubbles” in the world.

Because of the poor quality of analysis, politicians continue to claim that Britain’s housing crisis originated in the sub-prime scandal in the US. But when I published my 1997 forecast, the sub-prime mis-selling scam had not even been invented! So even without the sale of mortgages to low-income people on the margins of America’s cities, the UK housing cycle would have terminated. This outcome is programmed into the DNA of the capitalist economy. My account for this claim appears in *The Renegade Economist*.

An inquest into analytical failures is necessary because, without understanding the generic cause of property cycles, we cannot identify the remedial policies. Figure 2 identifies some relevant trends. The two lower lines preoccupy policy-makers: people’s wages, and some arbitrarily defined index of inflation. The line representing building costs shadows the general index on inflation.

House prices attract the occasional attention of the **Bank of England**, but asset prices are regarded as a problem when it comes to fine-tuning the economy. In reality, these prices cannot be regulated by monetary policy; as I note below, the counter-cyclical policy has to be sought in fiscal policy.

The top line on the graph, with its wild swings, is ignored altogether for macro-economic purposes. This tracks the price of land. It is the most sensitive measure of how an economy is performing, but is the index that mainstream economists regard

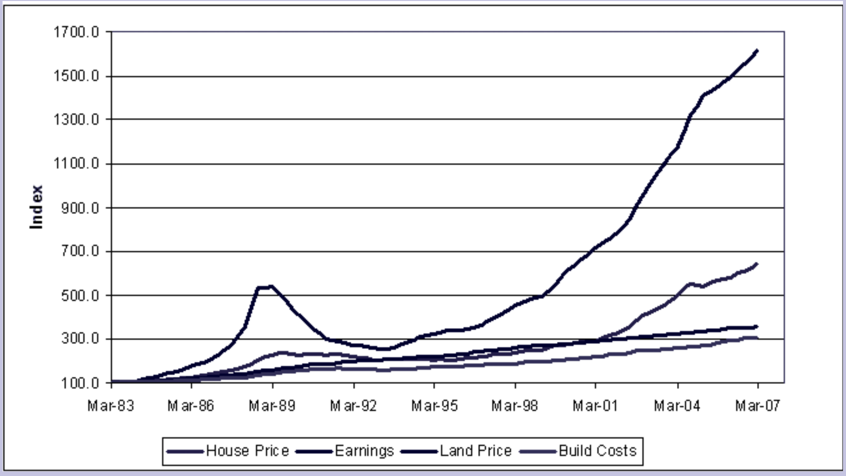


Figure 2 Sources: House Prices: Halifax UK house price index, non-seasonally adjusted Team Limited

as irrelevant. Given the myopia in the markets, when it comes to land values, it is not surprising that property forecasters are of little help to investors. Even if they are old enough to remember what happened in 1974 and 1992, investors lack the theoretical apparatus to plan their strategies according to a rational timetable.

Fig. 3 is one of my key forecasting indicators. It tracks the rate of return on land in the building sector. Building companies made a profit of up to 150% on their land banks during the peak of the cycle that has now come to an end. These capital gains determine much of what happens in the property market.

When capital gains of this magnitude can be made with no effort it is not surprising that the building sector fails to earn a high rating from consumers. Sticking up houses is just the tiresome means to the primary end: releasing the land value from end-users. When money can be made so easily from land, why bother to improve productivity? Why worry about the high level of consumer dissatisfaction with building companies, when the land market insulates Profit & Loss Accounts from customer criticisms about defective construction?

I stick to my forecast that we are heading for a depression – a protracted downturn, not a recession. Measures could be taken to minimise the damage. The property sector could – in its best long-term interests – play a leading role in such an initiative. To cure the boom/bust cycle, the unearned rewards from dealing in land would have to be eliminated. Charging people for the benefits they receive at each location is the key counter-cyclical policy.

The lower the profit from land, the weaker the incentive to hoard (and speculate in) sites. Builders would enjoy a more stable commercial environment – in their role as builders – if they paid for more of the infrastructure that they need to service their developments. This would reduce the amount they could pay to landowners. A properly structured system of payments would prevent land owners from holding the country to ransom; they would have to accept lower prices for development sites.

Building companies, by showing willingness to cooperate in restructuring the tax regime, would help to diminish the damage to private enterprise that ensues from current arrangements. An example is provided by the response to the government's plan to levy a tax on vacant commercial property. The industry's reaction: buildings will be demolished to avoid paying the tax.

The government's policy is misconceived. Why penalise investors who construct buildings by taxing them? To maximise incentives, the correct policy is to place charges on the value of land alone. As locations benefit from the provision of public services, owners should defray their share of the costs. Whether the owners of land choose to put their sites to use, or not, would be up to them, so long as they funded the costs of the public services that give value to their land. This fiscal reform would remove the incentive to demolish serviceable buildings, and encourage owners to bring their land forward for use.

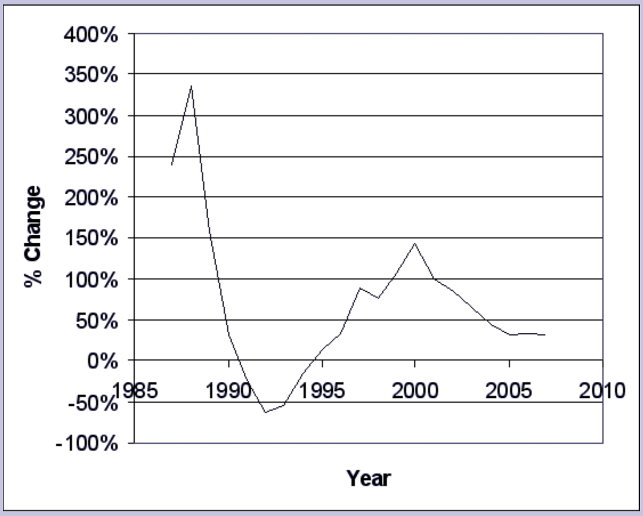
Phasing in the tax shift (it would be combined with commensurate reductions in income taxes) would need to be carefully undertaken. **The best time to execute the policy is at the bottom of the cycle. That will be in 2010.**

Policy-makers and property investors could work together, to plan their strategies for the full length of the next cycle – a cycle whose amplitudes would be much diminished, delivering long-term profits without the dreadful costs at the end of the cycle.

Fred Harrison is a director of Economic Indicator Services.

The Renegade Economist is published by Motherlode Books (£10) at www.renegadeeconomist.com

Figure 3 Land Values: Rate of Return from Residential Development



Source: EIS (www.businesscycles.biz)

Uncovering the secrets behind Property Alpha performance

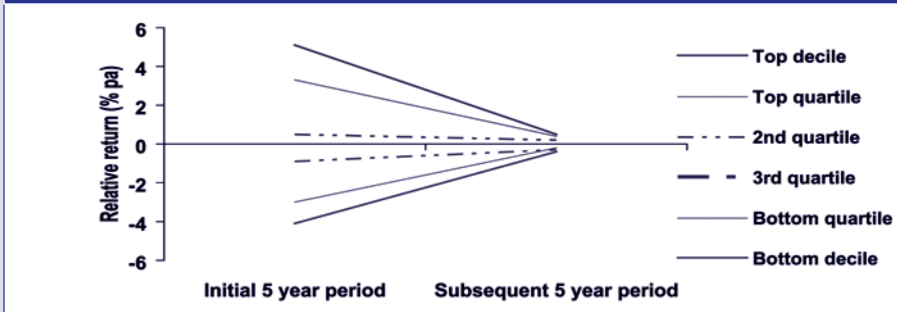
The search for alpha – superior risk-adjusted returns attributable to fund manager skill – has had a profound impact on the wider investment management industry over the last 10 or so years, says **Paul Mitchell**, Director of **Paul Mitchell Real Estate Consultancy**.

In particular, it has led to a shift away from fund managers and asset classes where research has proven alpha to be elusive – notably active equity fund management – in favour of cheap, "commoditised" forms of investment (such as index-trackers and derivatives), and towards those asset classes where alpha is perceived to be available.

Property has been largely unaffected by these developments so far. Without the detailed research undertaken in other asset classes, the impression has lingered that property, as an heterogeneous and "inefficient" market, is an alpha asset class. The advent of an active derivatives market, however, means that this notion will be subject to greater scrutiny and that property might be affected in the same way as equity fund management.

These considerations were the motivation for the research undertaken by **Dr Shaun Bond** and myself as part of the **Investment Property Forum**'s 2006-2009 Research Programme . The objectives were to assess if there were fund managers who could systematically deliver alpha and to consider the implication for property fund management and investment. The research generated some surprising conclusions and some valuable insights into the factors behind out-performance and the strategies that "winning" fund managers have adopted.

Figure 1: Average relative performance, according to initial performance quantile, five year horizons



The approach we took to assessing if alpha systematically exists in UK property was to follow the methodologies used in other asset classes. The starting point is the possibility that a single period's good performance may be "luck" or just a one-off. Rather than assuming this performance is alpha, the acid test is if such good (or poor) performance can be sustained over more than one period. Such analysis is known as persistence.

A further complication is that out-performance may be generated through taking greater risk, rather than resulting from "skill". Alpha is widely accepted to be the return after accounting for risk. However, while techniques to control for risk are well established in other asset classes, this is not the case in property. We based our approach to controlling for the effect of risk on performance on the techniques used in other asset classes but, recognising that it might not be universally accepted, gave precedence to the analysis of simple, relative performance.

With IPD's help, we analysed the persistence of performance of funds in IPD's database over different time horizons since the early 1980s: consecutive 10 year horizons (1 set in total – 1987-96 vs 1997-2006), consecutive five year horizons (four sets in total) and consecutive three3 year horizons (seven sets). Table 1 summarises the results of the analysis of persistence over the 10 and five year horizons, focusing on the top performers.

For both relative performance and alpha, the proportion of funds initially in the top 50% and the top quartile sustaining such performances over the following period typically was not substantially different to that expected by random chance. However, with the exception of risk-adjusted alpha over the 10 year horizon, the proportion of funds remaining in the top decile was disproportionately high. The conclusion is that

Table 1: Fund transition matrices, 10 and five year horizons

	Proportion of funds in same group in both initial and following 10 year period		
Group	Relative performance	Risk-adjusted alpha	Expected proportion, if random
Top 50%	48%	60%	50%
Top quartile	35%	35%	25%
Top decile	29%	17%	10%
	Proportion of funds in same group in both initial and following 5 year periods		
Group	Relative performance	Risk-adjusted alpha	Expected proportion, if random
Top 50%	53%	53%	50%
Top quartile	36%	31%	25%
Top decile	19%	11%	10%

Table 2: Fund characteristics associated with and predictive of performance and alpha

	Explains performance/alpha	Predicts performance/alpha
Fund type	Occasional tendency for life funds to show poor performance/alpha, no strong evidence for other types.	Not predictive
Fund size	Occasionally positively associated with performance and alpha, negatively most recently.	Not predictive.
Equivalent yield	Varies over time, more often than not associated with good performance and alpha although negative most recently.	Predictive of subsequent good performance and alpha.
Development exposure	Varies over the cycle but typically associated with substantial under-performance.	Not predictive.
Net investment	Varies over time.	Typically not predictive.
Sector specialisation	Typically does not affect performance and alpha.	Not predictive.
IPD structure score	Mildly positive up to the mid-1990s but subsequently negligible.	Not predictive.
IPD property score	Consistently the most powerful influence behind good performance and alpha.	Not predictive.

systematic out-performance is limited to a small elite.

Another way of portraying these patterns is to show the corresponding performances of the funds. As an illustration, Figure 1 groups funds into quantiles (quartiles, deciles) according to their initial five year relative performance and then shows the subsequent five year performance of the same set of funds. Not surprisingly, given the results shown in the table above, the performances of good and bad funds subsequently converge.

All this indicates that, in property, past performance is not a good guide to the future. Although the chart shows that good performers subsequently retain a modest performance advantage, a strategy of constantly re-investing in the most recent period's top performers is unlikely to pay-off given transactions costs.

What are the reasons behind this tendency for good (and poor) performance in property not to persist? We explored this in two ways. First, we analysed the fund specific factors behind relative performance and risk-adjusted alpha. Second, we looked at the factors which predict subsequent performance. The findings are summarised in the table above.

Our analysis indicated individual asset performance (represented by the IPD property score) was the most substantial and consistent factor behind good performance. However, asset allocation to property sectors (reflected in the IPD structure score) was much less important and in fact became negligible from the 2nd half of the 1990s. The analysis also revealed that a high development exposure was typically associated with under-performance.

This less important role for asset allocation in contributing to medium term performance is consistent with the short term attributions undertaken by IPD which UK fund managers will be very familiar with. Its disappearance over the last 10 years as a factor contributing to medium term performance, however, is more remarkable. This might be associated with the narrowing of returns across property sectors in recent years and the constraints which increased transactions costs now put on tactical strategies but it could also reflect a lack of success in getting the strategy right year in year out.

Most notably, none of the characteristics in Table 2 explaining performance predict future performance. This is not surprising as the key conclusion from the analysis is that past performance does not predict the future, hence the influences behind past performance (particularly good stock) are unlikely to be indicative of future performance. In particular, it suggests that there is a limit to how much performance can be extracted from good stock. The only fund characteristic consistently predictive of future performance was a high yielding portfolio. This is difficult to reconcile as a high-yield strategy varied from being a positive to a negative contributor to performance over the cycle.

It was also possible to glean from the data and interviews with investors some insights into the strategies which deliver persistently good performance. In general, these seemed to involve "doing things differently" to the mainstream, investing only where and when prospective returns looked attractive (in particular avoiding development and City offices) and a willingness to invest in parts of the market which others were wary off (e.g. alternative property sectors). There was also a tendency to follow a high yield strategy.

What does all of this mean for the future of property investment and fund management? The observation that most property fund managers systematically deliver low levels, if any, of alpha might indicate that property will go the way of equities and in particular see a shift towards cheap index-products such as derivatives.

The feedback from interviews with investors, however, was that this was unlikely. On the one hand, the fund management fees (specifically for balanced funds) were not perceived to be excessive; there would also be a heavy cost in transferring an exposure from property to derivatives. On the other hand, and more fundamentally, investors were not confident – given the track record of their pricing to date – that a derivative exposure would provide an IPD-type return.

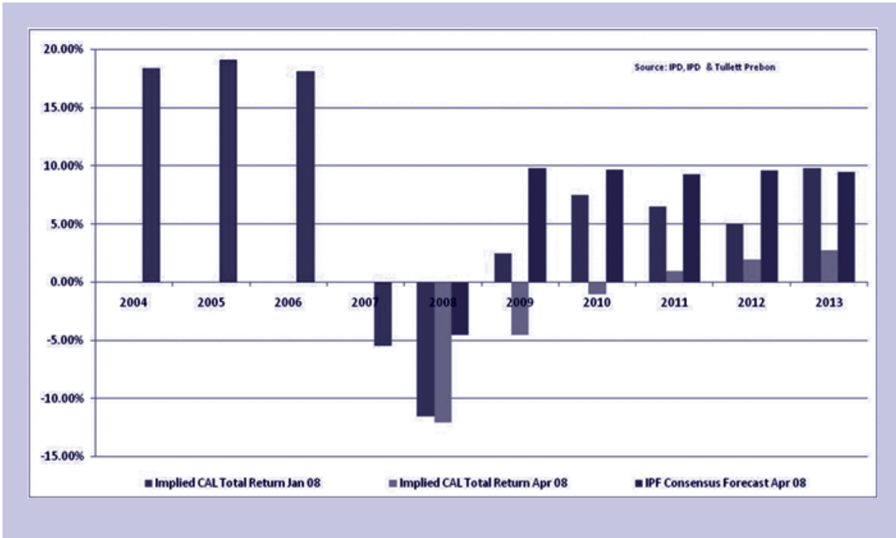
Instead, investors were planning to improve their risk-adjusted returns by increasing exposures to international property and alternative property sectors and in particular investing in illiquid and opaque markets where their peers were reluctant to go.

The programme is funded by a cross-section of 24 businesses, representing key market participants. The report, Alpha and Persistence in UK Property Fund Management, is available from www.ipf.org.uk. The views expressed are not necessarily those of the IPF.

Paul Mitchell
Director
Paul Mitchell Real Estate Consultancy

Future pricing of property total returns changes since the credit crunch

Property derivatives have been widely recognised as one of the leading indicators of the future performance of the property market. Here **Gary McNamara** of **DTZ Tullett Prebon** looks at what **UK IPD All Property** derivative pricing was implying for 2007, 2008 & 2009 at the start of the credit crunch in July 2007 and how that implied total return has changed as time has gone by.



According to a recent **Cambridge University** study, markets always 'overshoot'. Possibly due to traders testosterone levels, but whatever it is, this irrational conduct or unwarranted pessimism/optimism that drives prices beyond or below 'fair value' compels investors to use all tools at their disposal to search for that sweet spot of timing. Now, as evidenced by property derivatives, investors can take advantage of the difference between traditional property forecasts and the implied returns of the derivatives' market which have been highlighted by the credit crunch.

It is clear that the maturing property derivatives' market is leading the way in terms of downward pricing. But what investment opportunities does this divergence imply, and what strategies should investors be considering in a falling market?

Property investors have used derivatives in the current credit crunch environment in the following manner:

- To hedge portfolio risk
- To guarantee IPD out-performance
- To trade opportunistically (eg: to buy at low levels compared to forecasts)

Back in March 2007, total return forecasts for 2007 were around the 10% level, yet the December 2007 contract was priced pretty conservatively, implying around an 8% total return. It was at around this time that a few leading lights from the property world questioned how long the bull run could go on and with that, derivatives prices started to turn.

By June, the Dec 07 contract was trading at Libor + 25bp or about 6.25% in today's language. From here the drop was pretty severe. The contract to take the biggest hit though was the December 08. This traded in March at Libor + 20bp

Property derivative prices move daily and factor in the latest news and sentiment from the macro and micro events that affect all financial markets, not just property. Here is a short overview of the year to date.

With the onset of the credit crunch in Q3 2007, property derivative prices fell sharply again and many forecasters lowered their expectations for returns for the next three years, although nowhere near the levels that swap prices were implying.

Q3 2007 trading volumes, however, increased from those recorded in Q2 and, despite a year of turmoil, trading volumes in 2007 nearly doubled the whole of 2006 (which reached £3.9bn). Trading volumes to the end of Q3 were £6.6bn (in UK and Europe).

In October 2007, December 2007 contracts implied total returns for 2007 to be -0.86%. Meanwhile, 2007 returns peaked in July at 4.61%, using the IPD monthly estimate annual index. Since July monthly total returns have been negative with October being the first major fall returning -1.47%. At this time the Calendar 2008 (i.e. December 2007 - December 2008) contract implied a total return -5.6%. The IPF consensus forecast for the same period was +0.9%.

Towards the end of 2007 there was demand for swaps starting in December 2008 by which time many perceive the valuation correction in the property market will have occurred. But it is worth noting that the Calendar 2009 contract, (i.e. total returns from December 2008 - December 2009) was implying a total return of +2.6% compared with IPF's +5.7%.

Throughout November and December the national press reported that many funds employed up to 12-month redemption periods on their funds. Couple this with the much publicised short term liquidity issues in the money markets and it is easy to understand why property derivative prices continued to slide. Such bearish press impacts property derivative prices immediately, and falls have been registered all the way along the curve, particularly on the front two contracts.

In November the December 2008 contract, starting on 31st October 2007 and ending on 31st December 2008 was implying a total return of -8.9% for this period. One month later after further bank write-down's the same contract was implying total returns of -11.4%. When income return is removed this implies just over a 17% fall in capital value for the period.

However, 'out of adversity comes opportunity' and toward the end of the year opportunist buyers began to emerge. The longer contracts i.e. those maturing in December 2010 and 2011 were traded as pricing started to look attractive.

With the valuation correction seemingly well underway in November 2007, and further mark-downs expected to the middle of 2008 forecasters are expecting solid total returns further out in 2009 and 2010. The IPD November monthly annual estimate did not disappoint showing a total return of -3.63% for the month, incorporating capital growth of -4.02% and income return of 0.39%. This is the largest ever monthly fall since the previous low of -1.76% in May 1989.

After the release of the eagerly anticipated IPD November estimate, several big property funds announced significant reductions in valuations of their portfolios, (**New Star** and **Norwich Union** to name but two) with further falls likely.

One of the overwhelming barriers of entry into the derivatives' market for many has undoubtedly been a lack of understanding. To outsiders, pricing can appear complicated and intimidating. As of January 15th 2008, the major market participants have got together and changed the way derivative contracts are quoted and as such made them far more 'user friendly' and accessible. No more Libor +/- spread which equates to an X% implied return. Now, it is simply: I pay X% per year to receive IPD performance, or vice versa.

January 15th also saw the release of IPD's December 2007 monthly estimate at -3.72%, the biggest ever monthly fall... again! December 2007 capital value alone fell 4.13% and for the whole Quarter 4 2007, capital value fell 9.96%!

At the end of December and in the first week of January, property swap prices rallied from their lows and there certainly appeared to be some opportunistic buying again, particularly in those contracts maturing in 2010 and 2011. However, with the release of various forecasts predicting a weak December 2007 IPD number, swap prices sold off again. The implied total returns graph shows what property derivative mid-market prices implied for future calendar years in January 2007 and April 2008.

These further falls in pricing not only reflect the big drops in the IPD index, but the general doom and gloom being reported in the press on a daily basis.

UK All Property derivative contracts to December 2008 were pricing in a fall in capital value of over 25% from the highs of June 2007. For many investors, buying total return swaps at these low levels guarantees the outperformance of the IPD index.

Looking at property forecasts, the outlook for 2009 onwards is looking considerably better than that for 2008. Valuations are still falling, but to a lesser degree with the January 2008 IPD monthly estimate coming in at -1.56%.

The IPD annual index for 2007 was released on February 29th. A quick addition of the monthly estimates led us to believe total returns would be around the -5% level, but the actual number was in fact -3.42%. This was significantly higher than expected and it certainly made a few eyes water in the derivatives world. Expectations were that the annual figure would be slightly better than the estimates, but not by over 150 basis points.

Prior to the release of the number, derivative prices had started to rally all the way along the curve. The December 2008 contract moved from a -12.25% mid up to -10.75% in just a few days. However, following the data release, the bids moved back to -12.50%, in anticipation of further falls being factored into the index. The December 08 then settled at -12.5% until news that **Bear Stearns** was in trouble emerged, resulting in yet another drop to -13.25%. Therefore the trading opportunity still exists and continues to be at a very tempting level for those looking to buy IPD property exposure in the UK.

Longer contracts to Dec09 and Dec10 have behaved in a similar fashion. They were bought right up to the release of the annual number, but since then have sold off indicating a longer recovery period.

There has also been much talk over the past month that the total returns implied by derivative prices are too bearish. To date they have looked forward and led the market and have yet to be proved wrong. With such differing views there is a market and money to be made and, unlike direct property, derivatives can be bought or sold hastily to profit from opposing views.

Gary McNamara
DTZ Tullett Prebon

Continues from p1 ▶

next two years.

The news on jobs is mixed. So far the credit crunch reverberations have not had too much of an effect overall but City job losses are inevitable.

Government data released this month showed claims for unemployment benefit dropped by 1,200 to 794,300 in March to leave the jobless rate unchanged at 2.5% after revised February numbers produced an increase of 600, the first rise for 17 months. The jobless measurement used by the **International Labour Organisation** put the unemployment total at 1.61m or 5.2% of the working population. The number of people in work in the three months to February reached a new peak of 29.5m, an increase of 152,000 over the period. All pretty positive.

However, the **Centre for Economics and Business Research** is predicting 19,200 jobs being axed in the City from now till early 2010 while others are predicting even higher figures. In the property consultancy world agents are already cutting back staff and a more widespread impact is slowly but surely making itself felt in other property-dependent/related industries.

It would be very surprising indeed if official figures don't show a trend to increasing job losses in future months although it should be remembered as a counterpoint that the severely weakened pound is at least helping the export sector to improve its performance and hopefully support jobs in the process.

Whether this situation will deepen into a more major crisis of confidence reflecting itself in more serious job losses, larger numbers of repossessions etc remains to be seen. The hope is that the latest government moves coupled with lower interest rates and other moves by financial authorities to ease the blockages in the credit markets will slowly turn the tide. But even the greatest optimist cannot surely see much improvement over the next 12 months when the patient will continue to suffer and the headlines remain rather bleak.

Survival plan

So like Mr Darling it's a matter of having a survival plan and even better, taking advantage of the current conditions, to prepare for better times. That means being ready to invest in the emerging markets in whatever ways seems appropriate and looking for sectors

Continues on p16 ▶

The credit squeeze impact on the Irish market

Ireland has not been immune to the credit crunch and the subsequent tightening in bank funding in recent months. Indeed, the cost and availability of bank funding is dampening transactional volumes in many sectors of the Irish property market at present, most notably the investment sector says **Marie Hunt** Director of Research, **CB Richard Ellis**, Dublin .

It is also impacting on Irish investment activity overseas. Irish investors spent €12 bn on commercial property investments during 2007, of which only €2.2 bn was invested domestically. However, considering the difficulties sourcing finance in the current climate, it is difficult to see how this quantum of total Irish investment could be replicated in 2008.

The US sub-prime crisis of last summer has now evolved into a wider global credit squeeze, which is having various impacts on commercial property markets across Europe, something which the Irish market has not been immune to. The most obvious impact has been a tightening in the availability of property finance costs for investment. Like financial institutions all across Europe, some Irish banks, which have significant loans on their books that they would have liked to have securitised and sold down, have been unable to do so. As a result, they are unwilling to take on significant additional loans. While certain banks are to some extent, still willing to lend, the total volume of available debt has diminished considerably and Irish banks are now much more cautious about

- who they will lend to
- the types of property they will lend against and
- the terms on which they will lend

Many borrowers across Europe are reporting that the overall impact of the credit squeeze on their finance costs has been very limited, and that for 'normal' deals (excluding the very largest or riskiest deals - e.g. very large single asset purchases or speculative development) they have solid relationships with their lending banks who are continuing to make finance available. In the Irish market, where finance is available, it is generally at lower loan-to-value ratios and a higher margin against market interest rates than Irish investors have been accustomed to, which is undoubtedly impacting significantly on the volume of transactional activity. This is most notable in the domestic investment market in Ireland, with virtually no investment transactions concluded in the first quarter of 2007.

The more restricted availability of debt finance is significantly reducing the purchasing ability of Irish investors who traditionally have been highly leveraged. One key observation is that the bulk of Irish investment property is owned by wealthy investors and developers, many of whom built up considerable equity during the extraordinary development boom that transpired in Ireland in the last ten years of economic activity. In addition, the Irish investment market is the only market in Europe where there is no cross-border investment activity with 100% of commercial property assets domestically owned.

No pressure

Perhaps surprising to overseas observers, none of these Irish investors are coming under pressure to sell property assets in the current climate, being much more focused on long-term capital appreciation than any short-term decline in capital values. With no sellers evident and buyers having problems securing funding at rates and on terms that are acceptable to them, an impasse has occurred with no transactional activity in the Irish investment market being the result.

While prime yields in the Irish market have been adjusted by approximately 25 basis points since the beginning of 2008, this is purely based on sentiment in the absence of transactional evidence. **In the absence of yield contraction and with rental growth now more subdued, the most likely scenario is for low single digit growth from the Irish commercial property market in 2008.** The prospect of lower returns, coupled with the ongoing difficulties in sourcing finance for investment will undoubtedly dampen Irish investor appetite for domestic investment opportunities in 2008 and it is difficult to envisage last year's total investment spend of some €2.2 bn being matched.

Second impact

A second impact of the credit crunch across Europe is where financial services' organisations (notably the big banks) have been directly affected by sub-prime losses. They, and others, are cautious about the outlook for their sector and there are some reports of major banks (many of whom have recruitment freezes and/or have made redundancies) putting occupational requirements for new buildings across Europe on hold.

Whether this has a significant and prolonged impact on the market depends on (a) the extent to which such players are major occupiers in a particular market and (b) how long the current financial uncertainties persist. To date, in the Irish market, there does not appear to have been any retrenchment of office occupier requirements with office demand remaining very strong regardless of a slowing economic climate but this is undoubtedly a threat if the current crisis continues indefinitely. Total take-up of some 200,000 sq m, which is on par with the ten year average for Dublin city, is expected to be signed in 2008. In any event, the Dublin office market is reasonably well insulated from a downturn in demand from financial services occupiers with office take-up in the Irish capital well diversified between different occupier types, namely business service companies, IT companies, legal firms etc.

Third impact

The third and probably most important impact of the credit crunch relates to its impact on the underlying "real" economy. Consumer credit is being reduced across Europe, which will ultimately impact on consumer spending and in turn economic growth potential. Given the lower economic growth prospects for the Irish market, with GPD growth of approximately 3.0% projected for 2008 compared to rates of growth that were at least twice this level in recent years, many companies are being cautious in terms of their expansion/ investment plans, which will further reduce business growth amongst their associated suppliers. If this, coupled with a weaker housing market in Ireland (house prices have fallen by up to 15% in the last 12 months) feeds through into a wider economic downturn, then this will undermine rental growth prospects in all property sectors.

However, regardless of wider concerns, property market fundamentals in the Irish occupier sectors remain solid and are aided by the fact that the credit squeeze has already reduced the potential for future speculative development starts. There is no doubt that weaker economic growth will reduce rental growth prospects in the Irish market but provided it does not turn into a significant, prolonged recession a pause in growth is more likely than falling rents, particularly when you consider that many speculative schemes have been put on hold or have been unable to secure funding.

This, in turn, will help support capital values and should stimulate a return to higher levels of investment activity once the current financial uncertainties moderate. However, there are clear downside risks to this scenario – most notably, that the economic slowdown could turn into a more severe recession. At present – despite some of the headlines from some economic commentators – it is too early to say definitively what will happen, although it is worth noting that Irish economic growth, albeit less favourable than during the heady days of the 'Celtic Tiger' period, remains very favourable compared to other European economies.

Despite all of these concerns, the Irish 'love affair' with property continues unabated. While there appears to be no shortage of Irish capital looking to invest in real estate, investors are being very cautious and in many cases are adopting a tactical "wait and see" attitude. There was a significant fall in investment volumes in the UK at the end of 2007, but activity in London in 2008 already appears to be picking up following some fairly sharp upward movements in yields.

> *"The trend in the current economic climate is a 'flight to quality' and a focus on prime office and retail opportunities"*

Irish investors will undoubtedly lead the charge in this respect and are already gearing up to invest quite heavily in the UK market in 2008, now that they perceive the re-emergence of 'relative value' following the very sharp yield correction that was witnessed in recent months. Irish investors spent €4.7 bn in the UK in 2007. Many Irish investors believe that the yield correction in the UK market is now slowing down and that with further cuts in UK interest rates expected, investment in prime assets in the UK at this juncture looks very appealing.

Prime yields

Elsewhere in Europe, the impact of the credit crunch on prime yields has, to date, been fairly modest. In many cases, lower levels of interest rates coupled with better medium-term rental growth prospects than in the UK may well mean that there is less yield "correction" in many European markets than has been seen in London. Nevertheless, some further upward movement in yields is to be expected in many European markets as short-term rental growth prospects weaken slightly in the face of lower economic growth.

Irish investors will therefore focus their attentions on more established markets across Europe. While the fashion in recent years was for Irish investors to seek out investment opportunities in a range of diverse markets, always seeking out 'new' destinations and sectors in which to invest their capital, the trend in the current economic climate is a 'flight to quality' and a focus on prime office and retail opportunities a small number of established markets in Western Europe, where they have previously invested and where they have a good knowledge of the local property market characteristics as well as local taxation and legal systems.

Interestingly, many Irish investors are now looking seriously at property investment opportunities in emerging economies with much interest in the property, demographic and economic potential of countries such as Brazil, Russia, India and China. While it will undoubtedly be some time before Irish investors buy properties directly in these markets, there is growing interest and we may well see some Irish investors choosing to do what they rarely do, and investing indirectly in these emerging economies.

The impact of the credit crunch will undoubtedly be felt for many years to come. The property market has suffered as a result but no more so than any other sector of the economy. Regardless of the global backdrop, Irish investors will not retreat from the property sector but there is no doubt that in this more uncertain climate, these investors will continue to proceed with caution for the foreseeable future.

It would appear that the Irish investment story is now a story of 'wealth preservation' as opposed to 'wealth generation' as was the focus in the last decade. Therefore, while Irish investors won't retreat from property as an investment asset class, they may be willing to accept less attractive returns and adopt less aggressive investment strategies than they have adopted heretofore.

Marie Hunt
Director of Research
CB Richard Ellis, Dublin

Malaysia's attractions increasingly evident

With a population of 24m (59% of whom are under 30 years old), urbanisation occurring at a staggering rate of 10% per annum and with supply estimated at 44% of current demand, the Malaysian property market is an exciting place to be right now.

Add to this a ten-year high for affordability (only 18% of monthly income is required to service a mortgage), low interest rates, longer repayment periods on mortgages and increasing wages, and indicators for profitable investment abound. As major high-tech suppliers to China's growing wealthy market, Malaysia is economically robust, with unemployment below 4%, GDP 6.1% in 2007 and consumer confidence sustained at 10%.

The country's Malaysia My Second Home scheme (MM2H) (see www.malaysia-my-second-home.com), offering individuals with a certain level of income, long-term residency in the country as well as several tax incentives, goes a long way to encourage investment and relocation. In addition, further government initiatives specifically designed to encourage foreign professionals and skilled workers to come to Malaysia are being created. These include plans for faster work permit approval, introduction of a new visa category and multiple entry for Chinese and Indian nationals.

Since the abolition of CGT in April last year, the country has become markedly more appealing to investment purchasers. Prime Minister **Abdullah Ahmad Badawi** hoped the decision would "inject more excitement and dynamism into both the property and financial sectors" and complement the other pro-investment incentives implemented by the government. Whilst CGT may formerly have hindered property purchase decisions, its absence has result in increased market liquidity and a healthier investment environment. Although the Malaysian property market is still relatively undervalued compared to other countries, its robust, reassuring and stable economy and the removal of this tax should contribute to a long term rejuvenation of the property sector. Since the Asian Economic Crisis, property prices have been rising steadily and capital appreciation has been at around 6% in recent years.

The property market is further supported by Malaysia's thriving tourism industry. Increased visitor numbers, predicted to reach 20m last year, have significantly bolstered levels of demand meaning property to cater for tourists is likely to be in continuous demand and offer sustained returns. Within the property sector, two trends are discernible: firstly, there is a concentration on affordable luxury properties with the numbers of gated housing projects and non-landed luxury units increasing. Secondly, there is growing demand for serviced apartments, particularly in central locations such as the capital Kuala Lumpur.

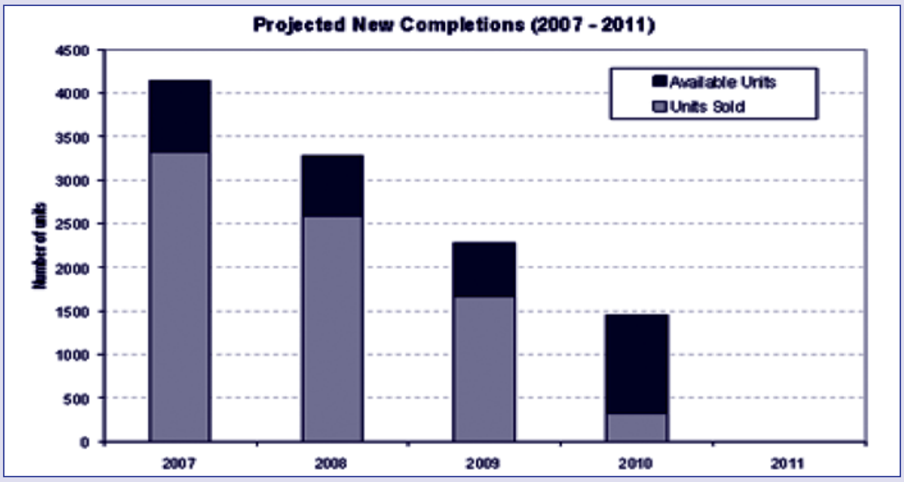
With its topographical diversity, Malaysia offers investment opportunities to satisfy a range of investor needs. The popular tourist destinations of Langkawi, Penang and Sabah benefit from short term, year round holiday lets and offer exceptional lifestyle properties, whilst the capital, Kuala Lumpur, has the capacity to deliver Malaysia's highest capital appreciation and most promising yields; more suitable for long-term investors.

Demand for prime residential units in 2007 remained steady, reflecting Malaysia's strengthening economy whilst the majority of prime residential projects entering the market in 2006 and 1Q07 achieved high pre-sale rates. According to the *The Edge*, a Malaysian news website, Kuala Lumpur City Center (KLCC) leads the Malaysian property market in terms of price where properties average RM1,335 per sqf with some high end developments reaching over RM2,500 per sqft. Out of 17 developments reaching completion in the KLCC area over the next two years, approximately 90% of the units have already been sold (approx. 3394 units), approximately 38% of these to foreigners. These stats then, indicate the strength and potential of Malaysia's property market as it stands.

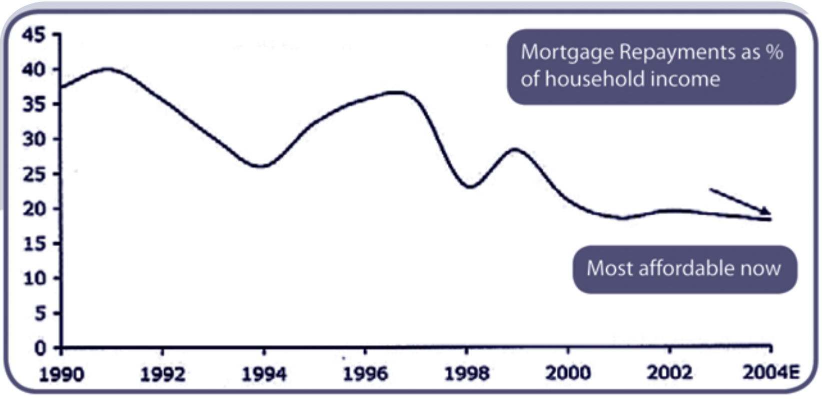
Experts are confident that the property market will remain positive throughout the US recession as demand for luxury property is still high, and the market not oversupplied. Slight saturation may occur at the lower end of the market, but this shouldn't affect high end units. Prices are expected to continue to increase in KL this year as prime luxury properties are still significantly cheaper than properties of corresponding calibre in Singapore, Bangkok, Hong Kong and other major cities.

Economy

GDP growth in Malaysia last year reached 6.1% and real GDP growth is expected to average 5.7% p/a in 2008 and 2009.



Source: www.capitallandfinance.com



Source: CLSA Asia-Pacific Markets

Meanwhile, the **Economist Intelligence Unit** expects growth to average 5.6% per year between 2010-2012, bolstered by firm domestic demand. As a founding member of the **ASEAN** (Association of South East Asian Nations) and a full participant in the ASEAN Free Trade Area, Malaysia then, has the credentials of a strong and forward thinking economy.

Known as the "manufacturing hub of the east", Malaysia's manufacturing sector now accounts for 31.6% of GDP whilst exports of manufactured goods make up 78.4% of the country's total exports. Malaysia has matured from being the world's largest producer of rubber and tin, to one of the world's leading exporters of semiconductor devices, computer hard disks, audio & video products and room air-conditioners. Earning the epithet "Multimedia Super Corridor", Malaysia's export growth was further bolstered by the tech recovery of 2006, expanding at a pace of around 10.0%.

Malaysia's strong market-oriented economy, educated multilingual workforce and well-developed infrastructure, mean the country is one of the largest recipients of FDI among developing countries. Foreign Direct Investment has grown consistently since the Asian Financial Crisis in 1997, with figures reaching as high as $8.6bn in 2007. The **Institute for Management Development** (IMD) ranked Malaysia in the top 25 most competitive countries in the world (for countries with a population of greater than 20 million), ahead of Japan whilst it is currently ranked as the 19th most globalised country in the world by **A.T. Kearney**.

Undervalued currency institutions and individuals are ploughing their money back into Malaysian assets not only for direct growth but also foreign exchange gains from the Malaysian Ringgit. **Goldman Sachs** and **Morgan Stanley** are therefore predicting big movements for the Ringgit following its undervaluation as a result of being pegged to the US$. With China ready to ease its grip on the currency, Malaysia will have little reason to hold back the Ringgit; one more reason to obtain Ringgit assets as soon as possible.

With its booming economy, high levels of FDI, controlled inflation and low levels of international debt, the Malaysian banking sector is now as confident as it has ever been. This confidence, combined with low interest rates and increasing salaries, means banks are now far more likely to lend on real estate assets; offering higher loan-to value mortgages and longer repayment periods. As a result, Malaysian locals are faced with the highest affordability this decade which has resulted in rising prices.

Furthermore, with banks having to actively compete for a slice of the residential mortgage market, the need to continually offer competitive products means there are regular bigger and better financing solutions being offered to prospective house buyers, whether they are locals or foreigners. It is estimated that now only 18% of the average household monthly income is required to service the mortgage for an average priced house whereas during the financial crisis of 1997, as much as 35% was needed. Further, with incomes continuing to rise, there is still plenty more room for growth.

City	USD price per sqm
Hong Kong	$ 12,599
Japan	$ 11,870
Singapore	$ 11,800
India	$ 10,333
South Korea	$ 4,000
Thailand	$ 2,819
Philippines	$ 1,969
Malaysia	$ 1,400
Sri Lanka	$ 1,075
Indonesia	$ 993
Cambodia	$ 250

Source: Global Property Guide

Interest rates are an important factor in the lending market and are expected to remain low or to rise just slightly over the coming months. With the robust economy and domestic demand continuing to rise though, this should not affect overall market confidence.

Where to buy – established and emerging hotspots

Kuala Lumpur is an Asian Tiger that roars. In the last 150 years, it has grown from a small town to a major capital city, now offering some of the most exciting property investment potential in the world. Kuala Lumpur has a robust financial sector and thriving high-tech industry which feeds the insatiable Chinese economy and attracts large numbers of young professionals to the area.

Over the last few years, KL property has experienced strong capital growth, however investors are still able to acquire properties for good value compared to other Asian and capital cities. 80% of all units scheduled for completion in 2007 and 2008 were sold prior to completion or have already been sold – a statistic intimating the high demand currently characterizing this market. Impending supply due in 2009 has also achieved a sales rate of 75%.

Extremely high levels of urbanisation fuelled by the city's burgeoning financial sector, as well as the expansion of KL's fashionable "silicon valleys" of Cyberjaya and Putrajaya, have contributed to phenomenal growth levels, putting pressure on existing supply. Capital appreciation in KL Centre is now sitting at 15%; double that of the rest of the country.

The best long term opportunities lie in the buy-to-let market of KL, particularly with high end or serviced apartments which cater for the high numbers of expats and young professionals flocking to the city. Property is mainly in tower blocks, with many developers offering luxury, serviced apartments, with guaranteed rentals of between 6-8%.

Kuala Lumpur City Centre (KLCC) as it is commonly known, is the traditional centre for multi-national business and tourism, and is where the majority of 5 and 6-star hotels are found. A convenient downtown spot, KLCC offers everything for businessmen and tourists alike. With bountiful restaurants, shopping malls, and beautiful green parks, KLCC is the jewel of Kuala Lumpur and a good place to invest. Located within five

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Buy to let – more stable than is realised

There have been a lot of panic headlines about the potential collapse of the buy to let market in the light of the credit crunch, tightening mortgage criteria etc. But, argues **Ian Potter**, Head of Operations for the **Association of Letting Agents** (ARLA) there is much misunderstanding about the nature and stability of the buy to let market and its core investors.

The appeal of buy to let was always predicated on the contra-cyclical nature of house sales and the rental market as well as the long term long term nature of property investment. It was this combination of capital appreciation and rental demand that first attracted investors into the Private Rented Sector when **ARLA** introduced the whole concept of buy to let in 1996, and little has changed since then.

Except that is for a polarisation between those content with one or two investment properties, or perhaps a small portfolio, and those who have gone on to the professional end of the market with portfolios of up to 100 properties and more.

There is, too, another segment of this market described often, and erroneously, as buy to let. That is the small minority who have bought speculatively off plan, sometimes with the active encouragement of developers and without buyers knowing or checking rental demand or the true rental valuation. But this is not buy to let. ARLA warned against this form of activity, frequently described as Buy to Flip, more than five years ago.

This speculation has often hit the headlines, but it has nothing to do with mainstream, long term investment in residential rental property, let for long term tenancies.

Buy to let was launched as a long term investment proposition 12 years ago. Without fail,, each quarter's ARLA survey shows that the vast majority of all buy to let investors, aim to keep their property investments for between 15 and 20 years. And this has remained unchanged since last August, and the start of the credit crunch and the demise of **Northern Rock**.

The first quarter 2008 ARLA survey of investment landlords shows that 45% expect to acquire more investment property during the coming twelve months. What is more, 88.5% state they have no intention of selling should house prices fall. These figures have shown little change in the three surveys carried out since last August, let alone for the years before.

Investors have borrowed an average of 71% of the purchase price to acquire individual properties. However, across their portfolios, large or small, they average a Loan to Value ratio of 56%.

With this amount of equity in investment portfolios, buy to let landlords looking to extend are not likely to fall foul of the credit crunch. In any event, ARLA research suggests that the majority of investment landlords are not financially stretched. Instead they have substantial cushions of their own wealth.

These buy to let borrowers tend to be in a far younger age range than is the case for the general distribution of personal wealth in the UK. The median ages for borrowers are in the early forties which implies that getting on for half of them are actually less than forty and all looking to take a long term view.

At the inception of buy to let, the country

Continued from p11 ▸

hours of 60% of the world's population and home to the world's longest fully automated light rail transit system, KLCC has many strong investment credentials.

Golden Triangle

Jalan Sultan Ismail, at the heart of Kuala Lumpur city centre, is a much sought after address. Within close proximity to the world renowned and iconic Petronas Twin Towers, and a mere stone's throw from the Central Business District, whilst surrounded by shopping malls, tourist attractions, entertainment venues and hotels this is a prime location for rental properties.

Suburban locations are also popular and many new developments are targeting high-income families with new communities offering on-site facilities such as golf courses, pools, shops and services. The Klang Valley and Mont Kiara in particular are attracting high levels of investors and developers. Appreciation here is still in the region of 15% with rental yields averaging a healthy 8-10%.

Mont' Kiara

Mont' Kiara is an extremely popular township strategically located at the heart of Klang Valley, 15 minutes to the North West of KLCC and 10 minutes from the Central Business District. It is an established commercial and social hub with good public transport accessibility, modern transport links and public transport. As with any major city, traffic tends to present a problem, however plans to construct a new road between Jalan Kiara and Jalan Kiara 3 should greatly ease traffic in the surrounding area. Further, the Jalan Duta-Kiara flyover which opened just a few months ago, is providing a new alternative route into KL's city centre and is diluting traffic on some of the other main approaches.

Complemented by a resort office-retail complex, the strategically located Mont' Kiara enclave in Bukit Kiara attracts a high expatriate population, representing more than 30 nationalities, particularly Japanese and Korean who comprise almost half the total residential population. Served by three local international schools (American, French & British), and with a Japanese school just 15 minutes away, Mont' Kiara attracts both the international business and lifestyle communities. Mont' Kiara is the first township in Malaysia with full broadband services for residential and business users, and for recreation, the area boasts a prestigious golf club, equestrian had just come through the worst – some say the only – housing crash of the 20th century. The ability of house prices to go down as well as up was still very fresh in most people's memory.

This re-inforced the appeal of buy to let as it works with the contra-cyclical nature of the housing market. Traditionally as house prices soften or fall, rental demand goes up. That has not changed, but there are two other factors that did not apply then.

The first is the combination of a low inflation economy coupled to the lack of trust in the pension industry that began in the late nineties. Low inflation made deposit accounts, a traditional home for savings, unattractive and alternatives were sought both for that and for conventional pensions.

The other vital factor, often overlooked, is the sea change in the perception of renting. This has been brought about by the improved standards introduced by a more competitive rental market. It is this that has made renting socially acceptable for the first time for generations.

Before the crash of the early nineties, there had been a Rush to Buy, driven by the Right to Buy local authority housing and the compulsion to create a home owning democracy. It was considered that there was something wrong, if at the moment a young person started work, they were not actively engaged in trying to get on the housing ladder. And they were often not financially mature enough to take on the responsibility of a mortgage while interest rates, by today's standards, were astonishingly high.

On top of that, the Private Rented Sector was still suffering from the well-intentioned but disastrous Rent Acts of the 1960s and 70s and had fallen to its lowest point of all time, just 7% of all housing.

All that baggage has gone. Few are stampeded into buying before they are ready. Instead, young people, well off by the standards of the 80s, now elect to rent good quality accommodation until they have made their own work and lifestyle choices and decisions.

Demographics are driving tenant demand: Renting by choice, renting for mobility and flexibility, renting because it saves the cost of buying. Underlying all this are the extra factors of immigration and those waiting to see what is happening to house prices before entering or re-entering home ownership, the contra-cyclical effect coming into its own.

The sums for the buy to let investor remain the same as ever. A realistic rental valuation should show that there is enough to cover mortgage payments, void periods, service charges, agents' fees and insurance. It is not a difficult sum to work out, and many have done it very successfully, many times and over many years

At the tenth anniversary of buy to let in 2006, ARLA research suggested that the average annual growth in buy to let tenancies for the following ten years would be between 20-30,000. With an uncertain housing market and following the traditional cycle this growth rate is likely to increase.

Meanwhile, it is probable that there are the landlord investors there to provide for this increased demand. Although most aim to stay in the market for the long term, there is a continuous two-way flow of landlords and properties. Many landlords leave the sector entirely each year, or downsize, counteracting the impact of those either coming into the market for the first time or increasing their property portfolios.

The effect of the 18% capital gains tax is yet to be seen. However, it is probable that, at the least, it should even out the flow of investors entering or leaving the market but, more probably, make residential investment more attractive.

Buy to let mortgage default rates are low and there is no obvious reason why they should rise. With the advent of buy to let, the psychological barrier to buying and selling property without vacant possession has gone. Should an investor need or want to depart the sector, the investment can be sold with a tenant in place, making the purchase still more attractive to the incoming landlord.

There is, too, a silver lining in current market conditions. The private rented sector should now see the back of speculative cowboys and some of the dubious practices that sprang up during the fat years of fast rising house prices. It was these that so often gave buy to let an unwarranted bad press.

With those people and practices departed, it augurs well for the private rented sector. ARLA came up with the whole idea of buy to let to bring in private individuals to help finance good quality property for long term tenants after the housing problems of the early nineties. This was achieved. And it will be achieved yet again, especially if house prices really do hit the buffers.

Ian Potter
Head of Operations
ARLA

club, cafes and restaurants, commercial centres and a sports stadium.

In the early 1990's luxury condominiums in Mont' Kiara were selling for around M220psf whereas properties now command prices of at least RM700psf. This represents a 218% price increase over the last two decades; a very handsome return.

As with any market characterized by such growth, both in the number of projects and capital value, there are some concerns as to whether Mont' Kiara can sustain its growth and whether the most opportune times to invest are behind it. Key developers in the industry though, believe Mont' Kiara's future is very optimistic. Existing supply of vacant land, even with the influx of new developments, is very limited which puts a bound on future natural supply. Further, with global prices of building materials such as steel and ready mix concrete, continuing to rise, house prices are being pushed up even further. Many KL real estate agents favour Mont' Kiara, confident that it will continue to thrive over the long-medium term.

Sabah

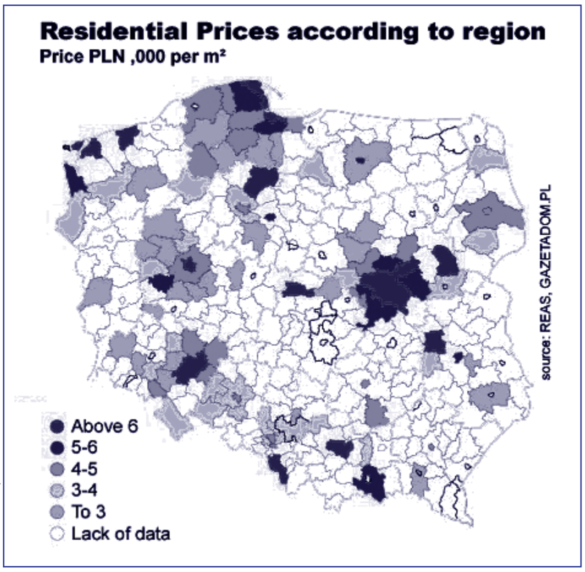
At the other end of the spectrum, nestled in the South China Sea is the Malay owned island of Borneo; one of the world's best kept secrets. Karambunai, its prime region, is a tranquil haven hidden in stunning Sabah. From the azure South China Sea to lush verdant rainforests, Sabah is a place of breathtaking natural beauty with crystal blue coves and pristine white beaches. Sabah Tourism Board maintains that with the very high occupancy figure of 72%, the area still has a severe holiday bed shortage of 3000. What is more, Sabah has one of the highest tourism growth rates in Malaysia and visitor numbers were expected to reach 2.3m last year in accordance with the expansion of the international airport. Target tourist arrivals for Sabah in 2010 sit at 4m, meaning demand for holiday property should also rocket. This is a prime place to invest for those looking for strong returns and a beautiful holiday home.

Mortgages

Malaysia has one of the best mortgage markets for non-resident foreign buyers in the world with up to 80% LTV mortgages available subject to status. The Malaysian Bank lending rate is 6.75% but most other lenders will offer a discount of between 1-2%. Set up costs are generally low and the process ordinarily takes between 4-6 weeks.

Emma Holifield
Property Frontiers

Will Polish residential growth continue?



Prospects for the Polish residential market remain good despite the current world economic turbulence says **Philip Evison** of **King Sturge**'s Warsaw office.

According to latest Government data, Poland's GDP increased to 6.5% in 2007 with 2008 expected to record a 5.5% rise. Analysts attribute this growth to growing consumption and the relatively low share of Polish exports in overall GDP. Nevertheless, long gone are the days of easy profits in speculative real estate investments as investors and developers face a maturing market with potential buyers postponing purchases either in the hope of price reductions or of receiving extra incentives from sellers such as free parking spaces.

Similarly, lending institutions are becoming more cautious due to the illiquidity of western capital markets with only two banks currently willing to lend over €40 m for residential construction financing without syndication. Banks are now placing their trust and money on well financed groups with strong track records and with developments in strong locations..

After joining the EU in 2004, developers saw plenty of opportunities in the Polish market. Despite having the biggest economy in the ex-communist Central European states to have joined the EU, the country possessed one of the region's lowest housing stocks. In 2004, Poland had 314 dwellings per 1,000 inhabitants with an average of 3.1 persons per dwelling. This amounted to an overall national housing deficit of roughly 1.5 m units with developers, on average, building only circa 130,000 units per annum. With existing inexpensive stock, cheap credit and a well developed mortgage market, investors and developers began flocking to the Polish residential market starting an unprecedented housing and construction boom.

With prices rising an average 25% year –on –year since 2004, developers who entered the market found themselves in a boom market where entire schemes where sold-out prior to construction commencing. However, with rising interest rates, more competition and growing labour and construction costs, house prices began to rise to levels that excluded many potential buyers who were being priced out of the market. In addition, government intervention in the local investment market through an "anti-speculation" tax at the beginning of 2007 (a 19% tax on a property's increased value if sold within five years of its original purchase) and tax relief cancellation for residential re-investment in the housing sector, resulted in an end to the residential investment market boom by the fourth quarter of 2007.

As a result, developers have now begun to restructure their business assumptions to correspond with current market conditions with King Sturge noticing more traditional thinking on residential end-sales returning to the market

Mortgage market the key to success?

One of the keys to Poland's growing residential development market has been the rapid expansion of bank loans to individuals fuelling increased household consumption and economic growth. Until the sub-prime debacle in the summer of 2007, Polish banks offered mortgages of up to 100% on properties on 30 year terms in any one of the following denominations USD, CHF, PLN and EURO (although 80% loan-to-value ratios were more common). However, restrictions on granting credits in Swiss francs from mid-2007 have effectively decreased the number of loans granted, while high prices have resulted in lower numbers of prospective customers.

With almost every residential unit bought in Poland depending on mortgage finance, a 17.7% drop in the last quarter of 2007 in mortgage applications suggests to us a 5-10% decrease in the number of mortgages going through in 2008 even though total mortgages finalised in 2007 of 312,000 marked an all time record.

As of today, total outstanding residential household bank debt in Poland stands at circa PLN 56bn (€15.9bn); a figure more than double 2005's figure of PLN 24 billion (€6.8bn). Within this figure, residential housing loans comprise 86% of the total debt with the remainder representing consumer loans.

In a country such as Poland where the level of per capita wealth is much lower than the European Union average, strong growth in bank lending is a sign of changing consumer behavior and convergence to western European spending habits. With only 18% of property in Poland currently mortgaged, increasing mortgage uptake is generally predicted to reach European averages of 54% in the future.

2008 – a market slowdown?

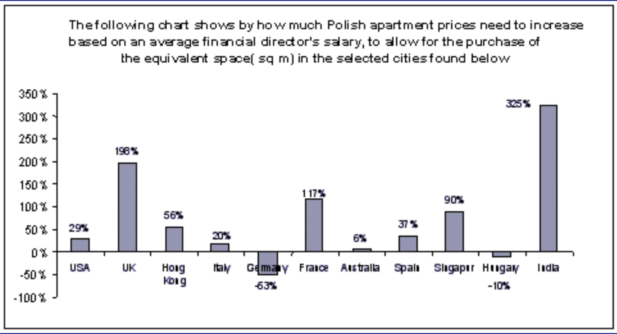
2008 has already seen attitudes amongst prospective buyers change with purchasers withholding their investment decisions as speculation surrounding the global economic crisis mounts and reports of price reductions begin to circulate in the press.

Developers have responded in a variety of ways to the sales slow down. Some are waiting quietly whilst maintaining existing prices; others have opted for camouflaging price reductions by paying VAT on behalf of purchasers (resulting in price reductions of 7%) or offering incentives such as free white goods or free parking spaces. Some developers have even decided to withhold the start of new construction projects although 2007 saw a 46.7% increase in the number of building permits issued.

During 2006 and 2007, there was an oversupply of developments offering units at the luxurious end of the market. This was partly a result of increased activity by foreign investors transferring western consumer habits and standards to the Polish market but due to developers wishing to offer high-end city centre locations in their portfolios. As a result, Warsaw's luxury market has reached saturation point at 20 % of the overall market with the majority of prospective purchasers now seeking residential units at the more budget end of the market equating to price levels ranging from between PLN 6,500 -8,750 /m² (€1,846 -2,485 /m²). This growing share of the premium segment in the market has also had the effect of raising average house prices.

Being the most active residential market in the country, Warsaw is also the most mature market. With a deficit of approximately 150,000 units, the city nevertheless represents circa 12% of the total national output delivered to the market with 18,000 units completed in 2007.

Despite an official population figure of 1.72m for the capital, unofficial estimates are higher at circa 2.3 m, making Warsaw's percentage of the national population around 4.5%. With only 62% of the Polish population living in urban areas compared to a weighted average of 74% for other countries in Europe, we expect household demographics to change. For example Warsaw has a much lower proportion of the national population if compared to cities such as London (12%), Paris (13%), Madrid (14%), Brussels (10%) or Vienna's (19%). With further urbanisation and net internal economic migration projected, experts agree that the current 3.4m single member households can be expected to reach 5.1m by 2030 with a large percentage choosing to reside in the capital.



As affordability and increasing demand become ever more important issues over 2008 and beyond we expect development activity to continue apace but with developers turning their attention more to new market opportunities in suburban or satellite town locations and offering cheaper housing in an increasingly competitive market.

Philip Evison
King Sturge, Warsaw

DIARY

7-8 May
THINK08
London
▶ www.think08.co.uk

14-16 May 2008
IPD European Property Investment Conference 2008
Berlin, Germany
▶ www.ipd.com/Events/Conferencesandbriefings/IPDEuropeanPropertyInvestmentConference/tabid/146/Default.aspx

20-22 May
Sustainabilitylive
Birmingham
▶ www.sustainabilitylive.com

4 June
RICS South West Property Conference 2008
Bridgwater
www.rics.org/Services/Events/swpropconference_e_040608.html

21 - 22 June 2008
EPEX 2008
London
▶ www.ukpropertyservices.co.uk/investment-property-events.html

10 June
BPF Annual Property Conference
London
▶ www.bpf.org.uk/events/event/23298/bpf-annual-property-conference

24 September
Sustainable Buildings for Occupiers
London
▶ www.newzeye.com/conferences_education/conferences.cfm

26– 30 October
Interbuild 2008
Birmingham
▶ www.interbuild.com/?gclid=CIznt3z65ICFQItEAodzGe1wQ

29 Oct 2008
Real Estate Finance & Development
London
▶ www.financial-conferences.com/events/E50951.htm?ginPtrCode=00000&identifier=47d0432ab14f8c6b9ef28efd0fe51250

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which seem more bullet proof than others or offer future potential.

Some recent examples: **Marks and Spencer** accelerating its expansion in India through its partnership with **Reliance Retail** (40% of retailers expect emerging markets to provide their main source of growth over the next five years according to **CB Richard Ellis** research); **Savills** opening its first Latin American office in Mexico City while its fund management arm launches a Euros1bn (£805m) opportunity fund to invest in retail and residential investments in Turkey; **Residential Land** spending £80m in the West End and west London buying three blocks of flats to take advantage of residential market falls; **Paul Wight**'s **Cadena** launching a European student housing fund; **AAIM**'s first foray outside the commercial property sector, raising its first tranche of equity for its £2bn infrastructure fund; **John Duffield**, Founder of **New Star Property** homing in on infrastructure investment opportunities in India by forming a joint venture with **Tata Asset Management** of India in the form of a Luxembourg-based fund which will be open to British investors from June; and look at the budget hotel sector where **Travelodge** has been announcing massive expansion plans and new openings throughout the UK. The list could go on and on.

So while it is tempting to dwell on the disasters such as **Erinaceous** and trot out the inevitably ghastly figures pertaining to various sectors of the commercial and residential markets at the moment there is plenty of room for hope. Business is still being done and lenders are still lending, albeit with great caution. There is still plenty of purchasing power out there even if many people/institutions are sitting on their hands and awaiting events. The next twelve months will see further price declines all round but everyone knew the party could not go on forever. Its time to re-balance and get back to property basics while at the same time expanding horizons and taking in the opportunities opening up in the global marketplace.

Batten down the hatches but don't despair, in our view the worst will be out of the way over the next eight months. While 2009 will be relatively tough also the shoots of recovery will begin to show and 2010 should see a return to happier times.

Philip Marvin

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Published 12 times a year by Newzeye Ltd,
The Chapel, Wellington Road,
London, NW10 5LJ, UK

Printer Chris Fowler International
Unit 202 Tower Bridge Business Centre
100 Clements Rd, Bermondsey SE16 4DG

ISSN 1463–1830

a **newz**eye publication