Distressed Irish Property

A short report by

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Ireland´s property bubble was one of the biggest in the world, and its crash has been equally dramatic.

More than most countries, property ownership in Ireland has always been equated with wealth and security. During Ireland´s famous economic boom or "Celtic Tiger" years between 1995-2005, the belief that property was a one-way bet became deeply and dangerously ingrained in the national psyche. Perhaps this was understandable: the longer any phenomenon continues the more normal it looks. Such is the psychology that generates price bubbles. And Ireland led the world in the size and duration of its bubble.

This will be my third report on the Irish property market in the last 7 years. The first (in 2005), was for a British media firm seeking to enter into the Irish property magazine and exhibition market on the back of a successful Irish TV program. The second (in 2007) was for an emerging market specialist keen to set up an office in central Dublin to promote properties in Eastern Europe and South America to globetrotting Irish investors.

If someone had told me in early 2007 that I´d be writing a third report in 2012 regarding the 60-70% discounts available in Ireland after a brutal 4 year recession, I´d have questioned their sanity.

In the past 4 years however, property prices in Ireland have fallen faster and farther than anywhere else in Europe. The Irish property landscape has changed beyond all recognition. The market used to be dominated by independent mortgage lenders, builders and sales agents. It is now dominated by a state created "bad bank", liquidators and distressed property auctioneers.

The Irish economy has been put through the meat grinder in the past 5 years and in our view, the combination of stable rents and falling purchase prices is presenting some incredible opportunities for cash buyers seeking tenanted properties.

In addition to providing some background to the Irish boom, bust and recession, this short report outlines Ireland´s potential in the coming years and the types of opportunities currently available.

Warm Regards

Colin Murphy

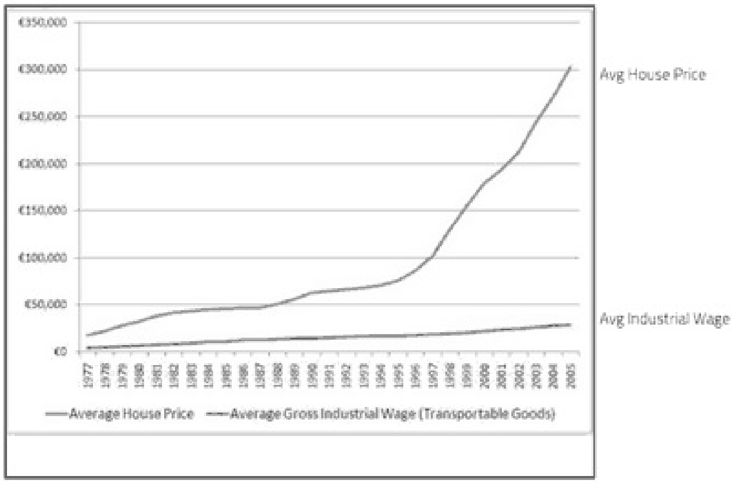
March 2012

BRIEF BACKGROUND TO THE IRISH MARKET

Since joining the EU in 1973, the Republic of Ireland transformed from a largely agricultural society into a prosperous, modern, technologically-advanced economy. Unemployment fell from 18% in the late 1980s to 4.6% by 2007 and average industrial wages grew at one of the highest rates in Europe.

Inflation regularly brushed 5% per annum, pushing Irish prices up to match those of Nordic Europe. Public debt was dramatically cut (it stood at about 34% of GDP by the end of 2001) to become one of Europe's lowest, enabling government spending to double without any significant increase in taxation levels.

Income in Ireland didn´t increase gradually like it did for most of Western Europe during the 1990s. Hundreds of thousands of Irish people moved from surviving on a low wage to wondering what to do with large amounts of excess cash in a very short period of time. Between 1992 and 1997 disposable income for the average Irish person increased by 44%. Between 1997 and 2002 it increased a further 70%.



The psychological impact of this new found wealth combined with an avalanche of cheap and ubiquitous finance and a deeply ingrained attraction to property ownership was incredibly potent.

The years from 1995 to 2007 saw record levels of housing construction in Ireland. Land and house prices mushroomed and it seemed as if there was a never-ending bandwagon on which everyone was going to get rich by simply building or buying a property and waiting for it to increase in value. Average new house prices increased by 344% between 1994 and 2007, with prices in Dublin increasing by 408%.

Demand was sustained by banks and building societies offering finance packages that enabled people to purchase at price levels where a normally functioning finance market would have shut them out. Stories abound of trainee hairdressers buying 4 bed townhouses and taxi drivers accumulating large property portfolios across the country. 100-105% interest only mortgages became the norm and the link between a person's income and the amounts being lent lost all touch with reality. The ratio of house prices to income soared to an eye watering 11:1, way beyond the 4:1 levels which are considered prudent.

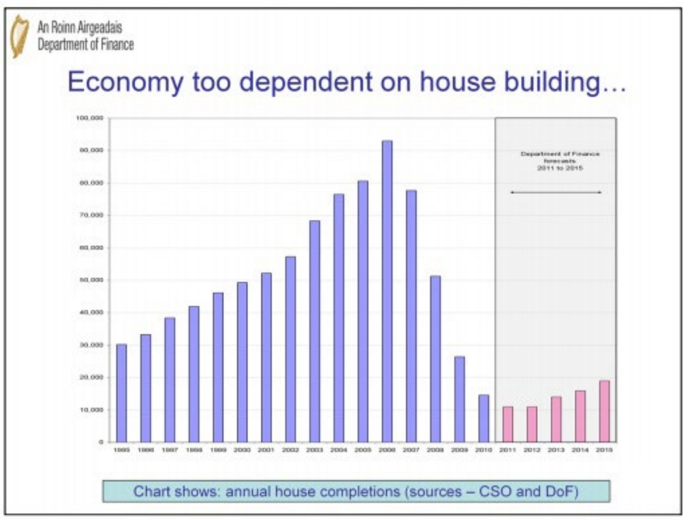
In addition to banks inflating the market with generous finance terms, the other big driving force behind the building frenzy was the array of tax incentives which the government made available to property developers. In 1981 and 1986, laws were introduced providing "Section 23" incentives which provided massive tax relief for the capital expenditure incurred in the construction, refurbishment or conversion of property. People were building hotels, offices and residential blocks all over the country to avail of tax deductions. Whether or not the location chosen was appropriate for a rental or resale demand was often a secondary consideration.

BRIEF BACKGROUND TO THE IRISH MARKET (CONT.)

As early as 2004, highly regarded international figures and publications such as *The Economist* were warning of a crash in Irish property prices. Rent yields were falling nationwide on residential property and output rapidly outpaced natural demand. For example, 2004 saw the construction of 80,000 new homes compared to the United Kingdom's 160,000 (a nation with 15 times Ireland's population). In 2006 a further 90,000 were built.

Even when many Irish people realized that local property prices were too high and that the rental returns simply weren´t there, they didn´t snap out of their buying frenzy. Instead they sought high returns elsewhere and spent billions of euro in the UK, Spain and Eastern Europe.

As Ireland had not experienced a property crash in living memory (unlike the UK in the early 1990s and Spain in 2000), Irish buyers were regarded as fearless in their overseas acquisitions. The Irish, with a population of well under 5 million, became the third largest investment group in Europe, and with interest rates in their home markets very low, record amounts of capital left the country in search of new assets abroad.



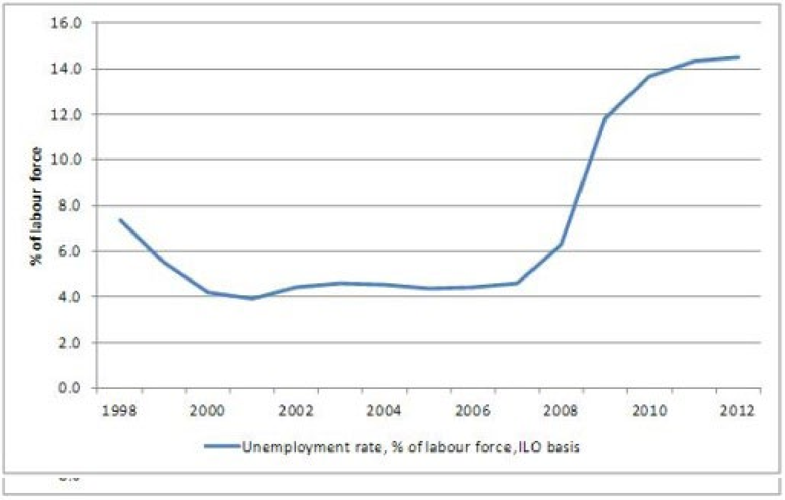
Many similar stories could be told about countries in Europe and states within the USA. However, the Irish still seemed in a class of their own when it came to property mania. All in all, the country found itself in an incredibly vulnerable position in early 2008. People were highly indebted, the construction industry employed 12% of the labor force and the Irish government was heavily reliant on tax receipts from property transactions.

The subsequent subprime mortgage crisis in the US, the collapse of Lehman Brothers and the collapse of external funding for Irish banks all combined to bring the country to the very brink of bankruptcy.

RECESSION & PROPERTY MARKET COLLAPSE

In 2008, as a global credit crunch was developing, the Irish economy slowed, the property market stalled and the extent to which Irish banks had overstretched themselves became scarily clear.

With the large loss of construction sector jobs, banks lending less money to businesses and falling consumer demand, the rate of unemployment increased from 4.6% in 2007 to 14.3% in early 2012.

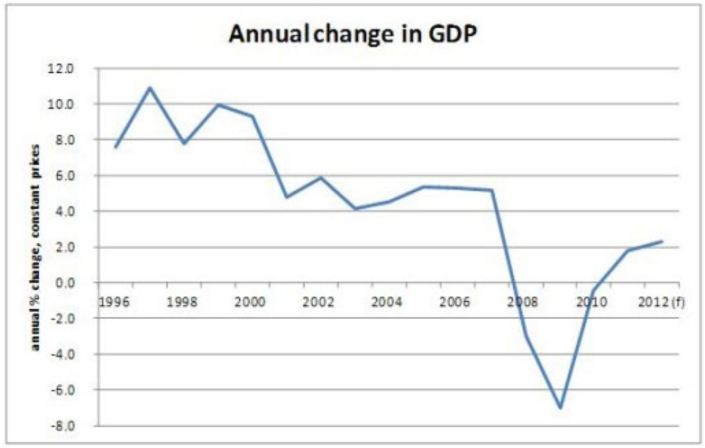


The over reliance on taxes and employment from the property industry meant that the slowdown had a serious impact on the general economy. The economy fell into recession in 2008 and approximately 15% of GDP was lost in the subsequent three year period.

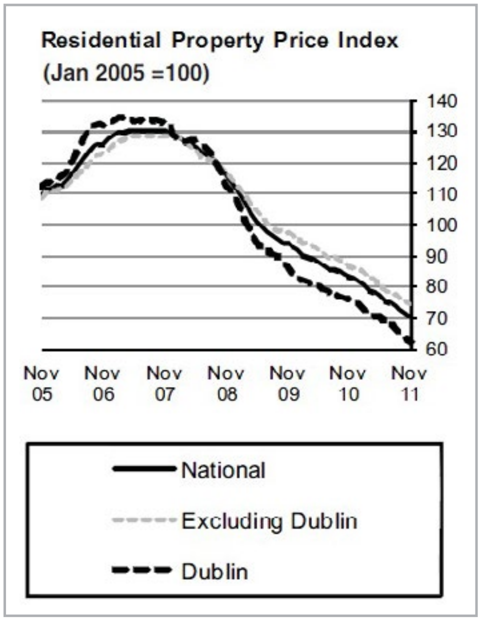
The Irish banking system came close to collapse in late 2008 and the Irish government took the momentous decision to guarantee the liabilities of all Irish banks in an effort to stem the panic. When the economy continued to decline and government support of the banks increased to 32% of the entire Irish GDP, international bond markets began to doubt Ireland´s ability to guarantee such huge liabilities. In late 2010, when the bond yields on Irish debt became unsustainable, an €85 billion bailout had to be arranged with the ECB and the IMF.

Ireland has since gained widespread recognition and praise for its successful implementation of austerity measures and more favorable terms on the bailout were recently negotiated. Since early 2010 the economy has recovered slightly and has registered several consecutive quarters of positive growth.

The Irish government remains majority shareholder in all of the main Irish banks, although a number of foreign owned banks (such as Ulster, Rabobank & KBC) also have major operations in the country.



According to the Central Statistics Office, house prices in Dublin are now 52% lower than their highest level in early 2007 and apartments (condos) in Dublin are 58% lower than their peak. The fall in the price of residential properties in the Rest of Ireland is somewhat lower at 42% and overall, the official national index is 46% lower than its highest level in 2007.

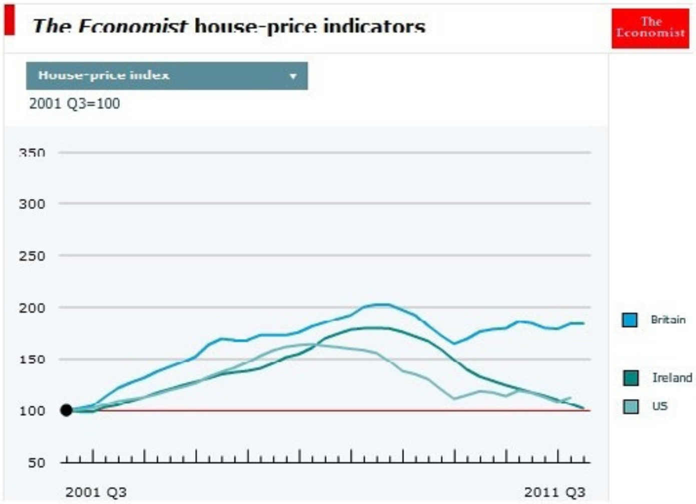


Competing indexes, based on asking rather than sales prices from reputable property websites such as daft.ie, point to even larger falls - that asking prices in Dublin have fallen by 64% from their 2007 peak and Ireland as a whole by 60%. Early indicators from daft.ie in 2012 point to a continued fall in house prices with the asking price of an average home falling 17% in January 2012 compared to January 2011.

Many Irish people, including influential commentators, having no firsthand experience of a property crash, are horrified at these price falls. However, if you think of the fall in house prices as a necessary correction, whose size is determined by fundamental factors, then it is surely better for the prices to race to the finishing line than to crawl there. In my opinion, this holds true for every property market suffering a correction.

International comparison

As the graph to the right illustrates, property prices in both the USA and UK stabilized in 2009 and have remained steady ever since. UK prices are surprisingly close to their 2007 peak, while prices in Ireland and the US are more or less where they were at the start of the millennium.



IRISH AUSTERITY MEASURES

To give you a bit of context, while the USA and most countries in Europe both had major property booms from 1997-2007, the “bust” in parts of the US has been far more severe. For example, in Florida, you have 60-70% discounts and huge amounts of activity. In places like Spain, you have paltry 15-20% discounts, but activity is at record lows. Until recently, Ireland was somewhere in between these two extremes. On top of that, the property crash in the USA started in early 2006, almost two years before the crash in Ireland.

It´s very easy to get carried away in a rising market and it´s even easier to panic in a falling market. That is why making money in the real estate market consistently over a long period of time is so difficult. Most successful investors have developed an ability to distance themselves from the herd mentality and think for themselves.

When I decided to look very closely at the Irish property market in late 2011, I was already fully aware of the boom, bust and recession information outlined in the previous pages. I knew Ireland had experienced one of the largest property booms ever seen, I knew prices were in freefall and I knew the economic contraction would be deep, painful and long lasting.

I advised people not to buy in Ireland during the boom years and I´ve told people who´ve been asking me over the past 4 years to be patient and wait a while longer. In both scenarios, I said no because the prices and yields weren´t at a level which made any investment sense.

However, I think there are strong indications that 2012 could be ripe for property investment in Ireland. Let´s take a wider view of Ireland for a moment and examine some of its impressive fundamentals.

The Irish economy retains many of its underlying strengths, particularly strong flexibility, a highly educated workforce, positive demographics and a pro-enterprise environment. As a result, Ireland’s medium-term growth prospects remain favorable, with average growth of close to 3% per annum forecast over the period 2013 to 2015.

The Irish people (and the government) have showed huge backbone by implementing austerity measures equivalent to €25 billion (or close to 16 per cent of 2012 GDP). These adjustments have been wide ranging and have included reductions in public service pay, social welfare rates and capital expenditure and a significant widening of the tax base. Crucially, only one third of these adjustments have occurred on the revenue side, which should limit the overall impact on growth.

The Government succeeded in completing the recapitalization of the domestic banking sector and significant progress has been made in relation to deleveraging the banking system.

Ireland is well placed to attract inward investment as unit labour costs will fall by a cumulative 13.7% over the period 2009 to 2013. Unit labour costs in the euro area as a whole are forecast to increase by close to 6.7% over the same period. In other words, Irish labor costs will be 20% lower than the European average after spending several years near the very top. That´s an incredibly impressive adjustment.

Real GDP is expected to increase by 1.3% in 2012 and a continuation of growth in 2012 is shared by all major forecasters, both domestic and international. Similarly the private sector consensus also anticipates that growth will average close to 3% per annum over the medium term.

Eight of the top ten global medical technology companies have a manufacturing base in Ireland, while eight of the top ten pharmaceutical companies have operations here.

Almost 1,000 companies, including Google, eBay, Intel, Microsoft and Facebook, have chosen Ireland as the hub of their European networks and each of the above employs several thousand people in Ireland.

Financing in Ireland

Like most countries, financing for first time buyers (never mind investors) in Ireland is extraordinarily difficult. If banks lent too much during the boom, they are lending far too little now and it is a big political problem.

Mortgage levels in Ireland are now an astonishing 93% below their peak. The number of Irish mortgages granted in 2011 (13,000) was the lowest in 40 years. To put that into perspective, 200,000 mortgages were granted in 2006. An obvious consequence of this in a country with a young population is that more people than ever are renting. Rents in Ireland stabilized in late 2009, even though the country was in a deep economic crisis at the time. This combination of stable rents and falling purchase prices is presenting some incredible opportunities for cash buyers seeking tenanted properties.

Ireland is therefore a prime candidate for distressed real estate investment. There is a rub however - Ireland does not have a busy and transparent foreclosure sales market like the USA for three reasons.

The first is that a person who is tempted to walk away from a property in negative equity faces severe consequences (bankruptcy laws are horrendous). Secondly, it´s very difficult to foreclose on a person who is defaulting on their mortgage – it can take 3-5 years. The third and most important reason is that instead of leaving banks to survive or fall on their own, the Irish government forced them to sell their riskiest property loans at a discount to a new Government controlled body called NAMA. The mission of NAMA (National Asset Management Agency) was to take over all of the riskiest loans from the Irish banks (particularly those given to developers) so they could start afresh with healthy balance sheets.

IRISH PROPERTY LANDSCAPE: MAIN PLAYERS IN 2012

NAMA (National Asset Management Agency)

NAMA is the gorilla of the Irish property market. They own most of riskiest property loans of Allied Irish Bank, Bank of Ireland, Anglo Irish Bank, EBS, Irish Life & Permanent and Irish Nationwide.

By some estimates, NAMA is the largest property owner in the world, as it controls €73 billion worth of real estate loans (mostly Irish, but also in the UK and elsewhere). Part 1 of their operation was to take all the risky loans from Irish banks. Part 2 is to get the best possible prices for these loans for the Irish taxpayer. As prices in the UK have recovered quite well, a substantial amount of their UK portfolio has been sold at a modest profit.

As prices in Ireland have not recovered, NAMA seems to be holding onto most of its Irish stock as the value the market is willing to pay for them would often mean registering a heavy loss on their tax payer funded assets. In other words, NAMA has appointed liquidators to sell certain assets and has published basic details on their website, but there is no guide price and many offers submitted by prospective buyers are rejected without an explanation.

There are a lot of frustrated sales agents and investors out there who cannot get a handle on what strategy (if any) NAMA has for disposing of its Irish assets over the next 3-5 years. Anecdotal evidence suggests that even reasonable offers on well located properties with tenants in place are being ignored or rejected.

While NAMA has sold a few trophy buildings (Google bought a huge office block in the city center in 2011 for €100m), it seems to be a different story entirely for regular properties.

There are lots of middlemen out there claiming to have an inside track on securing NAMA properties. In my view, that´s simply not true. I´ve spoken to high net worth individuals, managing partners of liquidators and the bosses of heavy weight sales agents. All have submitted multiple offers to NAMA and have been frustrated by the lack of response.

Banks

Some of the best deals available in Ireland can be sourced via the banks that did not release their risky loan portfolios to NAMA. These guys all had big parent companies to help them out during the Irish banking crisis. They still made crazy loans to individuals and developers during the boom, and so they also have burgeoning distressed property portfolios on their books. All of these banks have appointed liquidators and reasonable offers on their properties are being accepted. In some cases, the banks will bypass liquidators and sales agents by sending their properties directly to auction houses.

The biggest non NAMA banks are as follows:

- Ulster Bank - subsidiary of British giant Royal Bank of Scotland
- Bank of Scotland / Halifax – subsidiary of British bank Lloyds
- Rabobank – subsidiary of Dutch parent of same name
- KBC – subsidiary of Belgian parent of same name

Liquidators/Receivers

The job of a liquidator is to get the highest possible price for an asset. These guys are the gatekeepers to most of the distressed properties in Ireland. Despite gossip to the contrary, they tend not to do backroom deals by selling property at knockdown prices to insiders. That´s not to say insiders often get their hands on the best deals. For example, if a property is publicly advertised for a certain length of time without success, then they might accept a low ball offer afterwards. If an offer is presented for a distressed property that isn´t publicly for sale, then it might be accepted if the seller deems it reasonable.

The biggest liquidators in Ireland include Grant Thornton, KPMG, PWC, RBK and Green Property. I have met with many of them. Many of the major sales agents (see below) have also been appointed liquidators.

Sales Agents

In Ireland, sales agents are the equivalent to Realtors in the USA. They are in business to match buyers with sellers. As you can imagine, many made a fortune during the buying frenzy years of 2001-2006 when entire developments were sometimes sold pre construction over a weekend.

They represent many individual sellers and it´s not an easy job as (a) they often need to convince their clients to sell at a hefty loss and (b) it´s very difficult for prospective buyers to get a mortgage.

They also do business with banks and liquidators and place hundreds of offers every week on behalf of investors on distressed properties all over the country. In many cases they are appointed exclusive agents for foreclosed residential and commercial property developments.

The biggest sales agents in Ireland are DTZ Sherry Fitzgerald, HT Meagher O´Reilly, Savills, Knight Frank, DNG, Hook & MacDonald. I´ve met with them all.

Auction houses

A British based auction specialist called Allsop has been stealing the limelight and infuriating their Irish counterparts by running a series of highly successful property auctions in Dublin. They have held five auctions to date and sold approx €65m worth of property. This in itself is not making a major dent in the Irish property market (about 400 units in total sold over last 12-14 months), but it´s a very impressive operation and they are establishing a price floor and showing that properties will sell at the right price.

The most recent was on 1st March 2012 where 93 properties were offered and 87 were sold. People attending these auctions must register beforehand and need to pay a non refundable deposit on a successful bid on the day and complete within a couple of weeks. This is not for the feint hearted and even if you see a property in the catalogue that catches your eye, it´s not always easy to secure it.

For example, a contact of mine in Dublin spotted a property he liked for €110,000 and was prepared to pay up to €150,000 for it in one of these auctions. He did his research beforehand and knew it would be a great addition to his portfolio. When the final hammer went down he was outbid by another buyer who paid €167,000, almost 50% above the minimum asking price.

Developers / Investors

As you would expect, there are many thousands of individuals in Ireland who built up large property portfolios during the boom which are now seriously underwater. They are struggling to pay their debts and need to deleverage and sell part of their portfolio. Many of these people will engage a sales agent to work on their behalf, and in some cases, deals can be transacted directly with them and/or their lawyers.

My impression is that many of these people are unwilling to sell at discount levels buyers are demanding.

There are also intermediaries who specialize in negotiating debt forgiveness with their banks. For example, a person might owe €800,000 on 8 properties. An intermediary finds a prospective buyer willing to pay €600,000 and this is offered to the bank on a “take it or leave it” basis. If the loans have been unperforming and the owner is illiquid, they might accept. It´s not all that different to the short sale process in the USA, but this is done on an extremely limited and ad hoc basis in Ireland.

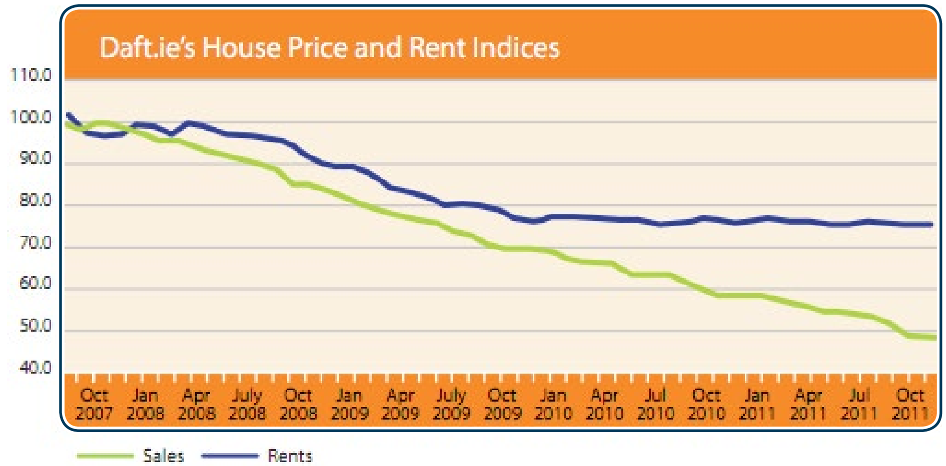
IRISH RENTAL MARKET

The number of properties available to rent nationwide at the start of 2012 is at its lowest level in three and a half years, according to the latest report published by Ireland's largest property website, Daft.ie. The number of properties available to rent nationwide has fallen by 5.7%. This is primarily driven by Dublin, where there are almost 1,000 fewer properties available to rent now than a year ago.

Year-on-year change in rents, Q4 2011
Dublin: €1,057, up 0.3%
Cork: €865, up 2.6%
Galway: €747, down 1.2%
Limerick: €673, down 2.4%
Waterford: €632, down 2.4%

The average rent in the final quarter of 2011 nationwide was €821 / $1070, a fall of 0.7% compared to the same period a year previously. In Dublin, rents were largely static, rising by just 0.3%, while in Cork, the average rent rose by 2.6% over the course of the year. In Limerick and Waterford cities, rents declined by 2.4% while Galway declined by 1.2%. Outside the main cities, rents were 1.7% lower than a year previously.

National rent indices still appear to mask a rural/urban split within the Irish rental market, with rural prices continuing to fall, albeit at a slow pace, and these falls being offset by increasing rents in urban areas.



Daft.ie Snapshot of Rents Nationwide

	1bed	2bed	3bed	4bed	5bed
Dublin 1	€790	€1,055	€1,560	*	*
Dublin 2	€943	€1,296	€2,008	*	*
Dublin 3	€762	€957	€1,193	€1,408	€2,210
Dublin 4	€917	€1,384	€2,166	€2,534	€3,503
Dublin 5	€768	€1,005	€1,087	€1,213	€1,320
Dublin 6	€737	€1,105	€1,576	€1,811	€2,630
North Co Dublin	€764	€876	€1,016	€1,256	€2,081
South Co Dublin	€873	€1,181	€1,550	€2,012	€3,049
West Dublin	€750	€895	€1,016	€1,172	€1,421
Cork City	€608	€771	€842	€988	€1,230
Galway City	€542	€730	€799	€862	€949
Limerick City	€458	€581	€710	€831	€858
Waterford City	€427	€543	€651	€731	€882
Dublin Commuter Counties	€545	€686	€773	€898	€1,139
West Leinster	€406	€490	€592	€644	€730
South-East Leinster	€446	€541	€630	€698	€780
Munster	€426	€522	€640	€698	€775
Connaught	€391	€468	€609	€640	€702
Ulster	€360	€446	€574	€600	€658

PURCHASE AND AFTERSALES PROCESS

There are no restrictions for foreigners purchasing property in Ireland and the investment climate is favorable for foreign businesses.

When a suitable property is selected and a purchase price negotiated with the seller, you will engage the services of a suitable independent solicitor to handle the legal aspects of the sale.

Upon confirmation of this solicitor, a contract for sale is drawn up by the sellers solicitor and is sent across to your solicitor for review. During this time you may arrange for a survey for early detection of any potential problems with the property (approx €200-300). If you are not satisfied or cannot achieve satisfaction to proceed you can withdraw without penalty.

If you are happy to proceed, and once your solicitor has reviewed the sale contract and is satisfied with it and to the title of the property, you will be in a position to sign contracts and pay a 10% deposit.

The contract is then returned to the seller's solicitor along with your 10% deposit for countersigning by the seller. Once contracts have been exchanged, the conveyancing (title transfer) takes place and ownership is transferred to the new owner.

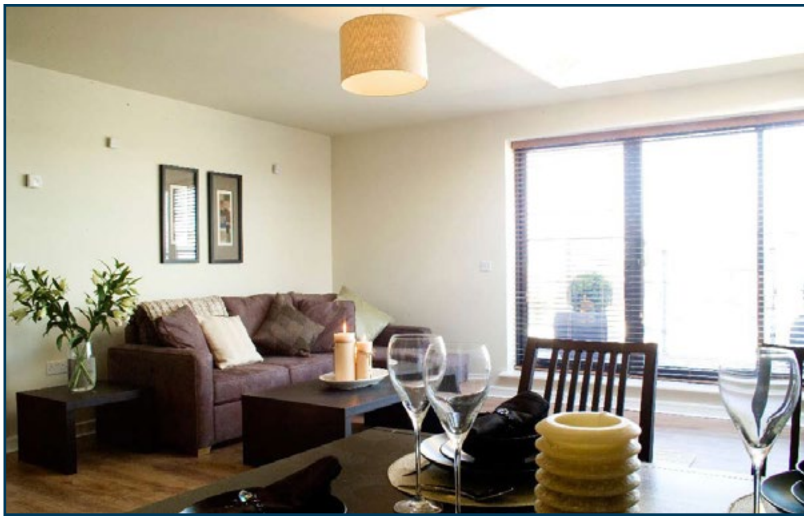
The buyers solicitor will generally collect any stamp duty payments (1% of purchase price up to €1,000,000) on your behalf upon closing of sale. Solicitors fees range from 1-1.5%.

Sample Property	
Purchase Price	€153,000
Monthly Rent	€1,200
Gross Yield	9.4%

Monthly Running Costs	
HOA/Service Charge	€100
Management Fee	€72
Tax	€13
Insurance	€45

Net Income	€971
Net Yield	7.6%

Purchase cost	
Legal Fees	€1,600
Stamp Duty	€1,530
Inspection	€250



CONCLUSION

By most estimates, property prices in Ireland have fallen further and faster than anywhere else in Europe. When you combine that with a dynamic economy, a young population, a high birth rate, a recovering rental market and a stagnant mortgage market – then cash buyers can secure some incredible opportunities this year.

The tough part is finding these deals as the Irish market is not transparent and rigorous due diligence needs to be done with the help of professionals to avoid the obvious pitfalls.

Most people I´ve spoken to believe the Irish market will open up considerably throughout 2012 as banks release larger amounts of distressed stock on the open market and auctions continue to establish price floors in key locations.

Laughable as it might seem, I think many key players in Ireland have only recently realized that “waiting” for the market to recover before selling is not a viable option. As has happened in many countries before, including the US over the past 4 years, the oversupply of properties must be sold at a heavy loss before normality resumes.

These “heavy loss” prices have only just started to appear in Ireland, and those who are prepared to move quickly on the right opportunity will reap the rewards. Purchasing a property in a prime location at the prices last seen in the mid to late 1990s is now a reality. Ireland still enjoys one of the highest GDP per capita´s in the world, and there is a wealth of evidence that the rental market is rock solid and the economy has turned a corner.

Kind Regards

Colin Murphy

> “*You’d have to be nuts not to take advantage of the unique investment opportunity presented by one of the most business-friendly countries in the world, with the youngest, best-educated workforce in Europe.*”

FORMER PRESIDENT BILL CLINTON,
INVEST IN IRELAND FORUM, FEBRUARY 2012

SOURCES & FURTHER READING

www.daft.ie

www.cso.ie

www.finance.gov.ie

www.finfacts.ie

www.irishtimes.com

www.globalpropertyguide.com

www.citizensinformation.ie

www.theeconomist.com

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