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EXPERTS

The property market: No rose-tinted glasses here

Jonathan Davis of ***Armstrong Davis*** dispels a few myths around the property world

How often have I heard "it's different this time", "the economy is fundamentally strong", "employment is high", "interest rates are low", "there's more demand than supply" etc.

No doubt you've heard those statements yourself. Indeed, you might even have used one or more of these myths in your conversations or sales spiels.

First, it's never different. What goes around, comes around. Plus ça change, plus c'est même chose – what goes up must come down.

There is no such thing as a new paradigm when it comes to investing. Look at dot.com. It's a new paradigm they told us. Phooey!

So, what have we heard these past few years, and still hear trotted out like a mantra from developers, agents, loan brokers, lenders etc (anyone with a vested interest, in other words)? All the above.

Let's look at the other myths:

The economy is fundamentally strong. Since when did the following equate to fundamentally strong? One of the highest balance of payments deficits in the Western World (and that includes profligate America); the highest level of household debt in the Western World; 10 percent of residential mortgages are buy-to-let (with a half of those in the last three years, at the top of the 'biggest asset bubble in history' – The Economist); rising repossessions (higher at the start of the house price crash than the same point of the last crash); rising unemployment – notably 10 percent at least to lose their jobs in the City and the three sectors with highest job growth of last several years now letting people go – government, financial services and construction; falling sterling against major trading partners; strongly rising inflation – food, transportation, heat and light, petrol etc; falling GDP, possibly into recession.

No, the economy is very weak.

Employment is high. Covered in previous paragraph. Also, it has been stated many times that the last house price crash was caused by high unemployment. Look at the history – it was the other way around.

Interest rates are low. What utter poppycock. Residential variable mortgage rates were 14 or 15 percent in 1989 and 1990, then they fell consistently until five percent in 2001. But they borrowed only a third of what people borrow today. So, mortgage rates of 6.5 percent are actually more expensive than the last crash. Add to this that now there is a massive amount of unsecured borrowing compared to the last time, and costs of servicing debt is astronomical compared to nearly two decades ago.

There's more demand than supply. I'll tell you a secret, I'd love to buy a Bentley. The problem is no-one will lend me £200,000 so I can't. Just because everyone wants to live in a, say, five bedroom house in the home counties doesn't mean it's going to happen. The only real demand during the last few years has come from economically illiterate buy-to-letters with wads of borrowed money, buying out smiling flat and terrace owners. They could sell at a ridiculous price and pay another ridiculous price for a three-bed semi and so on up the chain. Without BTL, chains wouldn't have completed, and prices would have fallen. And that is exactly what is happening now. Hence prices are crashing. We forecast 30-40 percent fall, on average, from last summer to around 2011/12, nationally. The regions hardest hit will be Northern Ireland, London, South East, East, Midlands, North (West, East and Central), Wales and Scotland. Well, that's everywhere then.

Why? Because all regions experienced economically unreal growth in prices.

So what's all this to do with commercial property? Everything.

The same fallacies have been trotted out to unsuspecting investors these last few years. Retail investors, in particular, were sold property unit trusts like there was no tomorrow and this sector was the most sold on during the last couple of years until recently. What happened? Commercial property values slumped, and most of the big fund managers slapped a six or 12 month delay on when people could get at their money. Well, when you see HSBC selling off its Canary Wharf tower at four percent yield and the Gherkin going for 4.5 percent – when you could get 5.5 percent risk free in an account at HSBC, you know the capital values are in 'cloud cuckoo land'. Or, more likely were the buyers. (Maybe they were fund managers parcelling off to retail investors?)

Property goes up when the economy is coming out recession, not when it's going into one. Hopefully, I've dispelled a few myths and helped you become better investors for the opportunities that will arise in a couple of years, after the recession.