



Review 2011 / Outlook 2012

Irish Residential Market



Summary

The Irish residential property market endured its fifth year of price deflation in 2011 with overall price falls in the order of 16.2% nationwide. A slightly higher figure of 16.9% was recorded in the Dublin market. The latest results from the Sherry FitzGerald index reveal that Dublin house prices have fallen in real terms by 64.2% from peak levels in 2006, while the national market has corrected by 59.8%.

The pace of deflation was strongest in the opening half of the year with a very gradual moderation in price falls as the year progressed. That said, overall deflation levels are still notably ahead of 2010 levels. The latest data available from the Irish Banking Federation reveals that only €1.824 billion euro was drawn down in the Irish mortgage market in the first nine months of 2011, a 51.5% reduction on levels drawn down in the same period of 2010. Clearly the limited availability of mortgage finance is the single greatest contribution to the challenging market conditions. A normal functioning market place would require lending in the order of €11 billion, thus until we see an expansion in lending levels we are unlikely to curb the current pattern of price reductions.

Irish Residential Market



“ The biggest challenge facing the market at the moment lies in the depressed levels of mortgage lending, which are unlikely to have exceeded €2.4bn in 2011. A normal functioning market would require in the order of €11 bn of lending. ”

Marian Finnegan,
Chief Economist, Sherry FitzGerald.



Economic Update

The pattern of economic performance in 2011 was quite volatile and therefore unpredictable. Both measures of growth, Gross National Product and Gross Domestic Product weakened considerably during the year with unfavourable global conditions putting pressure on the speed of Ireland's recovery.

The weakness in the international situation has and will have a big part to play in a return to positive growth in the future.

The 2012 Budget involved some challenging decisions in order to reach the required consolidation amount of €3.8bn. That said, in relation to the property market, there were welcome changes introduced.

“ The Minister for Finance, forecast that the economy would expand by 1.3% in real GDP terms in 2012. ”

In particular, for those who purchase an investment property before year end 2013 and hold this property for 7 years will not be liable for CGT on any profit made in the same period. This should thus lead to an

increase in investor driven transactions. There will also be an increase in mortgage interest relief from 15% to 25% for first time buyers who purchase in 2012 which should provide incentive and stimulate activity in the market. Non-first time buyers will also benefit from relief of 15% rather than 10%. In addition to this, first time buyers who purchased between 2004 and 2008 will see their mortgage interest relief increased to 30%.

The Minister for Finance, Michael Noonan, forecast that the economy would expand by 1.3% in real GDP terms in 2012, which is notably a downward revision from the estimated 1.6% in early November. Real GNP is now expected to expand by 0.7%, down from 1% a month ago. Both Ratings Agency Moody's and The European Commission have contradicted the Dept. of Finance's forecast and predicted the Irish economy to grow by just 1% next year. Moreover, the ESRI have forecast less than 1% (0.9%) growth in GDP and a contraction in GNP (-0.3%); a substantial downgrade from a very optimistic GDP forecast of 2.3% earlier in the year.

The downward revision in forecasting represents the unfavorable global conditions and a deceleration in European economic activity. The lower 2012 forecasts may also be subject to further downward revision. The formation of a fiscal pact, an intergovernmental deal, to manage the euro-zone debt crisis, by controlling budget deficits and debt levels, may lead to a slight uplift in economic activity in 2012.

The volatility in the international situation is reflected through our exports, as such the international environment will play an important role due to the belief that export performance will provide a platform for economic recovery. Quarterly data shows that exports have risen by 0.8% when compared with quarter two and by 2.4% on an annual basis. Simultaneously, data showed imports have declined for the second consecutive quarter with a further reduction of 1.5%.

The unemployment rate continues to increase. The decline in the number of people at work in the Irish economy in the third quarter of the year was the largest in two years, according to the Quarterly National Household Survey (QNHS). The number of persons unemployed increased by 15,700 (+5.3%) to 314,700 in quarter three 2011. The corresponding unemployment rate in the third quarter was 14.4%, up from 14.2% in the previous quarter and an average rate of 13.9% in the first quarter of the year. Worryingly, the long-term unemployment rate increased from 6.5% to 8.4% over the year.

The latest evaluation of consumer sentiment by the ESRI and KBC bank reveals that Irish consumer sentiment deteriorated markedly in December. Sharply increased uncertainty about the future of the Euro, another severe Budget and the threat of a sustained squeeze on household spending power in coming years combined to produce a notably more constrained mood among Irish consumers last month. The Index fell to 49.2 from 60.1 in November. This was the largest monthly drop since August 2001. The outsized decline in December came shortly after an abnormally large rise in the Index in October.

Irish Established Homes Market

The latest results from the Sherry FitzGerald index reveal that Dublin house prices have fallen in real terms by 64.2% from peak levels in 2006, while the national market has corrected by 59.8%.

Having moderated somewhat in 2010, the pace of price deflation increased once again in 2011 in line with a very challenging economic environment. Despite the strength of the overall level of deflation it is worth noting that the pace of deflation did moderate as the year progressed.

Results from the fourth quarter reveal that the average price of a second-hand property in Dublin fell by 3.2%. This brings the total drop in Dublin prices in the full calendar year to minus 16.9%. This, in effect means that prices in Dublin are back at levels achieved in quarter one of 2000.

House prices nationwide fell by 3.5% in the quarter. This brings the total drop in prices to minus 16.2% during the full calendar year. The Cork market saw prices fall by 3.9% in the last three months of the year, bringing the results for the twelve months to minus 13.0%.

There is no doubt now that the market is overcorrecting. That said stability will only be achieved through increased liquidity and renewed consumer confidence in the overall economy.

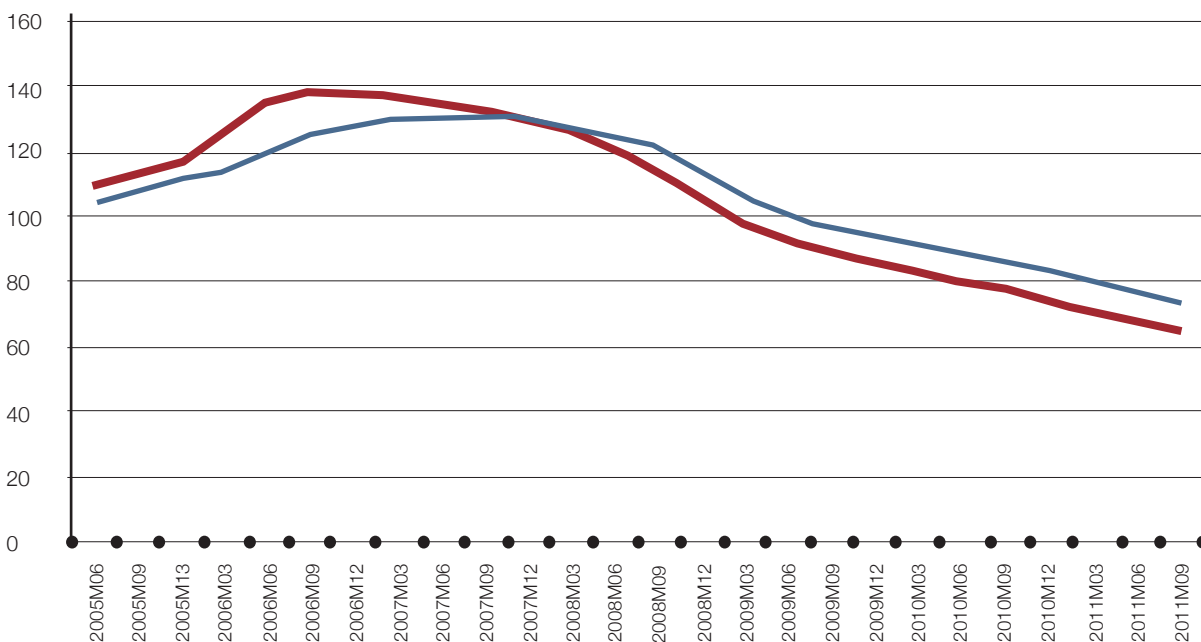
Budget 2012 was perhaps the first step on the road to that stability. Firstly, the tone of the Ministers' speech on December 6th was very important as it served to underwrite the role that property needs to play in the overall economy. While perhaps not calling the bottom

of the market, the Minister has certainly accelerated the recovery process, when it emerges.

The Budget also made some positive announcement in relation to mortgage interest relief and the introduction of a Capital Gains Tax incentive for property purchased between midnight on Budget night and the end of 2013. In particular, the latter is a welcome incentive for potential investors wishing to take advantage of the significant value in the market place at present.

“ Dublin prices are now back at levels achieved in Q1 2000. ”

National Residential Index - CSO & Sherry FitzGerald



Source: Sherry FitzGerald Research/CSO

— CSO Index — Sherry FitzGerald Index

Irish Residential Market

Disappointedly, the Minister did not address the lack of liquidity in the targeted manner that one would have hoped for. However, by introducing lending targets for the SME sector he has perhaps opened the door to a similar initiative in the property sector

Current lending levels are in the order of €2.3bn on an annualised basis, while a normal functioning market would require approximately €11bn of lending.

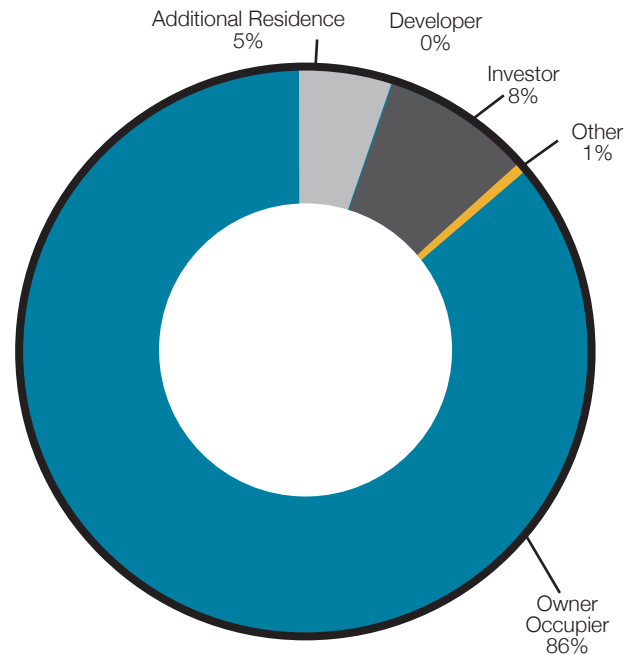
On this point, it is interesting to note that approximately 1,250 active buyers registered with Sherry FitzGerald in Dublin in the closing months of 2011, stated they were cash buyers.

This represents 29% of total active buyers and is a continuation of a trend evident since the beginning of 2011. To date this has resulted in a notable uplift in cash purchases in the market place.

Notably, 86% of the second hand homes transacted in the market were purchased by owner occupiers, this compares to 89% in 2010. Not surprisingly, first time buyers remain a very active cohort in the market accounting for 33% of the properties traded in the year. However, this is a significant fall on the same period in 2010, when it stood at 49.7%, illustrating an increased participation of other owner occupiers such as those trading up and down. This is particularly notable in Dublin.

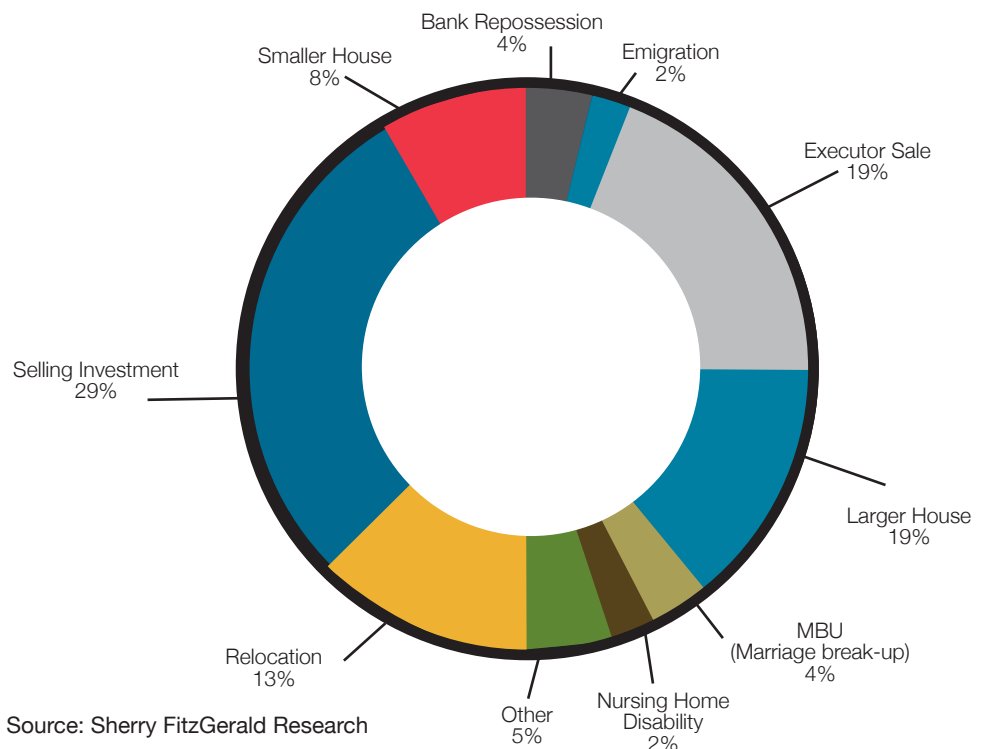
An analysis of the profile of vendors who sold their property through Sherry FitzGerald in the year to date revealed that 29% of vendors were selling investment properties, compared to 27% during the same period in 2010. Approximately 14% of vendors sold with the intention of purchasing a larger property, compared to 17% during the same period in 2010.

Purchaser Analysis - 2011



Source: Sherry FitzGerald Research

Vendor Analysis - 2011



Source: Sherry FitzGerald Research



Supply and Demand for New Property

Latest figures from the Department of the Environment, Community and Local Government show a further tightening in supply levels. Data on the volume of completions for the first eleven months of the year has revealed that approximately 9,630 units were completed.

The corresponding figure for the same period in 2010 was substantially higher at 13,500; representing a 29% reduction. Completions for 2011 are estimated to reach approximately 10,500 units and will represent the lowest level recorded since the series began in 1975. Completions at the peak of the market in 2006 totalled 93,419 units.

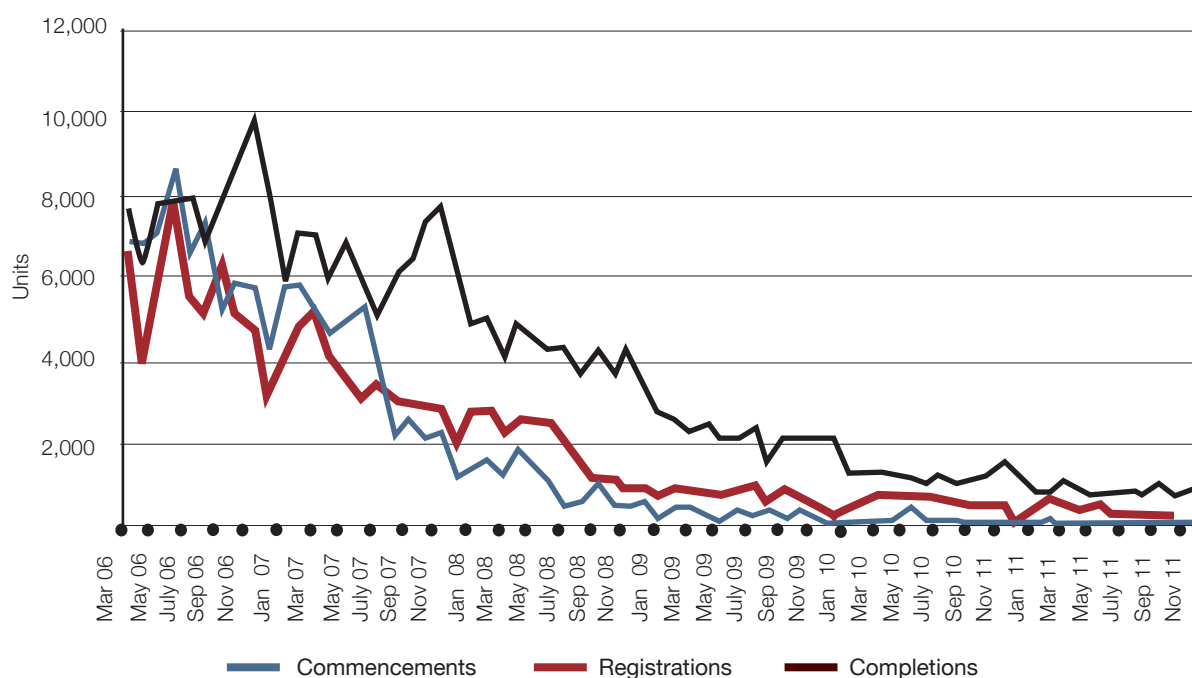
“ Completions for 2011 represent the lowest levels recorded since the series began in 1975. ”

Registrations are a timelier indicator of house building trends, and together with commencement notices are an important indicator of the volume of completions to be expected in 2012.

Approximately 758 registrations were recorded for the first eleven months of the year in comparison to 1,641 in the same period in the previous year, representing a significant reduction of 54%. In addition to this, the quantity of commencements recorded in the first ten months of the year stood at approximately 3,977 compared with 5,878 in the corresponding period in 2010. This represents a 32% reduction.

Furthermore, the latest figures from the Central Statistics Office have shown a reduction of 45.9% in the number of planning permissions granted in the year to September 2011, compared with the previous year. This was a decrease of 930 dwelling units (houses and apartments) being approved, falling from 2,817 to 1,887; also a historically low figure.

Housing Statistics 2011



Source: Department of the Environment, Community and Local Government

Outlook for the Future

Looking into the year ahead there is no doubt that 2012 will remain challenging. That said, we can anticipate some uplift in activity with an increasing number of cash buyers reviewing their investment options, perhaps taking on board the increased DIRT levels for deposits and the contrasting CGT incentive for property investments.

In contrast we would need to see a significant uplift in mortgage lending into the entire market if we are to anticipate an increase in overall activity levels. Property is a leveraged investment and lending is an essential ingredient in a stable market.

Taking all of this on board, prices may continue to deflate on a macro basis in Ireland. However, providing the Euro remains on course, the combination of tight supply and a notable increase in cash purchasers waiting in the wings, there is some potential for greater stability in the best locations in Dublin and other regional centres.



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For any advice on the residential market please contact your local Sherry FitzGerald office or Sherry FitzGerald Research at:

Tel: +353 - 1 - 237 6300

Fax: +353 - 1 - 237 6347

E-mail: research@sherryfitz.ie

www.sherryfitz.ie

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