Ulster Bank

Sell in May 2007 and stay away until…………….September 2011, 2012??

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Timing is everything when investing and this is encapsulated in the famous adage - *"Sell in May and go away. Stay away until St. Leger's Day"*. This suggests that a profitable strategy is to sell equities in May and return to the market after the famous horse race in mid-September. As far as the residential property sector in Northern Ireland is concerned, the primary motive for investing in residential property should be purchasing a home, not an investment. However from an investment perspective, with the benefit of hindsight, selling in May 2007 would have been an ideal time to exit the market just before the property bubble burst. Four years on and the average house price is some 42-50% lower, depending on what survey is used, with the average price ranging from £115k-146k. But, these surveys only measure the nominal falls in house prices. Factoring in the effects of inflation adds a further 13% to the fall in real terms, bringing the peak to trough fall to 55-63% to date.

On the plus side, inflation is also the debtor's best friend with the size of debt shrinking by 13% over the last four years. In monetary terms *(nominal)* the average house has fallen by over £100k and prices are back to 2005 or 2006 levels. To put this into perspective, consider two potential first-time buyer couples back in 2007 facing two lifestyle options. One chose to sell their car to raise a deposit to jump on the property ladder and would forgo luxury holidays for a few years to furnish their new home. Alternatively, the other couple chose to rent a furnished penthouse apartment, continue their annual holidays and lease a Porsche 911 for 4 years. Ironically, the latter's choice would have ended up better financially and they would now be well placed to jump on the property ladder debt free.

In the early to mid 1990s, negative equity was widespread within the UK. Following a peak to trough fall of just 12% it took almost eight years for UK house prices to return to their peak levels of 1989. During this recession, the UK experience with mortgage arrears, repossessions and negative equity has been much more favourable than in the 1990s. Unfortunately the opposite holds true for NI which has experienced a price correction four times greater than that experienced by the UK in the early 1990s. Thankfully, however, interest rates are currently a fraction of their 15% peak in 1990.

Back in 2007 NI's main mortgage lenders had the lowest loan-to-value (LTV) ratios of any UK region in 2007. However, even an extremely prudent 55% LTV interest only mortgage is now in negative equity territory with a 50% fall in prices. According to the Financial Services Authority (FSA), NI now finds itself with the highest rates of negative equity within the UK and more than twice the national average. Whilst negative equity is a concern in NI the fact that the housing boom was so pronounced and telescoped into just a two-year period means a smaller proportion of households were caught in negative equity. Conversely, the challenge is much greater in the Republic of Ireland (RoI) where the boom lasted several years. Average RoI house prices are already back at 2002 levels and set to return to 2000 levels. As a result, a much greater proportion of households have fallen into negative equity in the RoI.

Traditionally at dinner parties the topic of conversation focussed on house prices rather than housing market activity. The latter is much more significant as far as the economy is concerned. The decline in the number of NI property transactions between 2007-09 fell by £10bn in value terms or over one third of NI's total annual economic output. Mortgage activity remains extremely subdued with the current level of activity less than 40% of pre-crisis levels at a time when interest rates are at record lows. Whilst lack of demand remains a problem the lending capacity *(or supply)* of the local banking system is not what it was in 2007. Many mortgage providers *(many of which were not household names)* have left the market altogether. Meanwhile, others have, at times, accounted for up to 50% of the market themselves. Lack of demand has hit the housebuilding sector hard. Last year the number of houses built was 55% below the 2006 peak and the lowest number since 1994. The outlook for 2011 & 2012 is for even fewer house completions. Again the collapse in house building has been more dramatic in the RoI with the number of completions this year expected to be a staggering 90% below 2006's peak. Unlike the South, NI does not have the huge problem of 'ghost estates' to deal with.

Those residential property investors nursing heavy losses may take some comfort that property has not witnessed the same scale of declines as other asset classes. For example, the Irish stock market remains some 70% below its 2007 peak and certain financial stocks have fallen by over 90% or disappeared altogether. In all markets, picking the bottom of the market invariably requires more luck rather than skill. It remains to be seen whether waiting until St. Leger's Day in 2011 or 2012 will mark the bottom of the NI property market. In any event, jumping into the property market now looks vastly more attractive than it did in 2007.

Richard Ramsey,
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