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BUBBLES

Learn from Ireland's housing collapse

Australia's property market shares a number of similarities with Ireland's pre-crash market, writes **Stewart Oldfield.**

Back in 2000, when there was an oversupply of apartments in Melbourne's Docklands precinct, the three big developers involved had sufficient equity to hold on.

So, rather than dump apartments – which had previously sold for $600,000 – for $300,000, they were able to bide their time, put some apartments out to the rental market and generally not destroy their business by dumping apartments at up to half their price. With the passage of time, the oversupply problem eased.

Australia's housing construction industry is now very different from that of the Docklands in 2000. There is a multitude of new players, each with varying degrees of balance-sheet strength.

This means some are well placed to adjust to a downturn, others less so. Rumours of which players have most so-called settlement risk are rife across the market.

Graeme Willis, a former chief credit officer with NAB and later a senior executive with Royal Bank of Scotland, has warned about Australia suffering a bout of what he calls the "Irish syndrome".

About a decade ago, everywhere he went in Ireland, he encountered mini property developers, whether they were part-time taxi drivers or ordinary mums and dads. Enthusiasm for property development was at fever pitch. Mr Willis warns it is these small-scale developers who pose a risk to house price stability because they may not have enough equity to hang on during a downturn, as big property developers do.

If their prized, small-scale development doesn't go to plan, they may be forced to sell it – and perhaps even their own home, which may have been used to finance it – quickly changing the supply and demand equation across the mortgage belt.

What occurred in Ireland's property market should be compulsory education for our policymakers, media commentators and investors but seems to be rarely discussed. Ireland's has been frequently described as the world's biggest housing market collapse, dwarfing anything that occurred in the US following the global financial crisis in terms of the size of the price falls.

After falling more than 50 per cent, house prices in Ireland are still 33.1 per cent lower than at their highest level in early 2007. A drop of 50 per cent in value put the average loss to an Irish household at €155,316 ($230,000). With 1.6 million households across the country, that represented a combined loss of more than €257 billion.

The scary thing is that what happened in Ireland occurred against a backdrop of low interest rates and low unemployment, that is, just the circumstances Australia is enjoying. As is the case with most housing bubbles, Ireland's was fuelled by a number of interrelated drivers: easy credit, speculation and slow-to-respond supply.

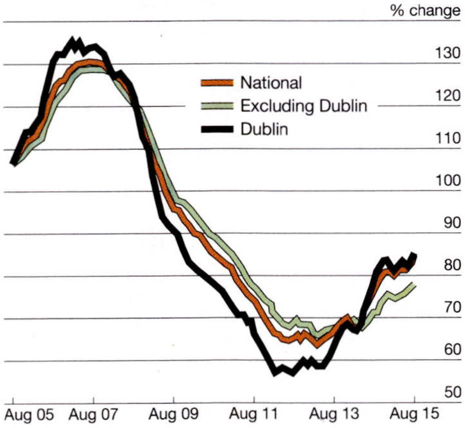
Economist Saul Eslake wrote: "Because Irish interest rates were substantially lower than they should have been for an economy growing as fast as Ireland's was, Irish households and businesses borrowed and Irish banks lent far more than they would otherwise have done, resulting in, among other things, an unsustainable property boom in which Irish house prices more than doubled in less than seven years."

The similarities with Australia go on and on. Economist Leith van Onselen has noted that, just as property investors in Australia rely predominantly on capital appreciation to make an investment work, investors in Ireland did the same. Government finances had become too dependent on property taxes, both capital gains taxes and stamp duties, Mr van Onselen has noted. However, once property prices began to fall, Ireland's overgeared investors rushed for the exits, thus helping to force down house prices.

And just as in Australia, Ireland's central bankers were in denial. In 2007, just as prices were about to start their precipitous decline, the Irish Central Bank declared "the underlying fundamentals of the residential market continue to appear strong" and forecast a soft rather than hard landing.

The rest, as they say, is history.

IRISH RESIDENTIAL PROPERTY PRICE INDEX



Source: Irish Financial Review