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The Turkish real estate after the crunch

The onslaught of the crisis has found the Turkish banking sector in a remarkably good shape. Banks have been skilled at maintaining proper risk controls, reasonable LTVs and keeping a tight lid on speculation. This is why the Turkish Real Estate market is not facing 'distress' as observed in other markets. However, the market will not be completely immune to the crisis. Control of supply is critical for the recovery.

We all remember the 'sub-prime' loans as the harbinger of the end of long bull market in asset prices. Property has been in the forefront of the current crisis. Price corrections of even 35% or more are being observed around the world.

Global real estate markets are squeezed at both ends. The rapidly deteriorating economic situation is putting a strain on the occupational markets. At the same time, the credit crunch has caused the widening of risk premia and the drying up of debt finance. In other words, rents are falling whereas yields have made a violent reversal and are now on an inexorable upward trend.

More fundamentally, the industry is going through a long-overdue shake out. The rampant debt-fuelled speculation is now over. Investing predicated on proper risk assessment and asset management is back. The price adjustment that results out of all these is quite brutal - giving rise to tremendous opportunities. Falling values lead to breaches of covenants or worse; recapitalisations and bail-outs will be an increasing phenomenon. Fund redemptions will 'motivate' the managers to accept lower prices, to generate cash. And of course, it's a unique opportunity to acquire prime assets at prices that, at last, make sense.

The onslaught of the crisis has found the Turkish banking sector in a remarkably good shape. Having learned some very nasty lessons back in 2001, Turkish banks were careful to avoid the excesses that got the world into this mess in the first place: excessive loan-to-values, flippant underwriting and a despicable contempt to risk. Banking practices have been more 'traditional' (e.g. cross-collateralisations) while the market is relatively more fragmented. As a result, there is no 'distress' in the Turkish property sector in the sense that we observe in the US, the UK in Spain etc. There is of course a plethora of distressed assets; but these are distressed because they are 'bad property' they would have been doomed even during the good times due to poor location, poor design etc.

So far, the crisis in Turkey has been more pronounced in the retail and the residential sectors. Few can doubt that the retail sector has been in a precarious position, even before the crisis, with an obvious glut of shopping centers. Turkey has several advantages that transcend the global crisis: its demographic profile, potential accession to the EU, the chronic lack of quality real estate (at least in some sectors) etc. However, while it was hoped that economic performance would still manage to remain in positive territory, the recent news on manufacturing and exports cast a doubt on the short term prospects.

Furthermore, at times of increased risk aversion, issues like the currency volatility, the foreign debt and other structural issues register higher on the investors' agenda. From a pure real estate perspective, the oversupply brought about by the lax planning regime (consider the shopping center sector) may give rise to a deeper and longer rental decline. Also with the global repricing of risk, prices in Turkey need to adjust accordingly, before investors will buy again. There is a risk that the market remains in denial. Economists call this 'sticky prices' and should this happen, transaction volumes would be subdued for some time.

However, if one is in for the long-term (by the way, not many short-termists will survive this cycle..) one needs to consider which market he'd like to go long over the next few years. And I think Turkey is one of the few countries to offer a strong case for investment.

In my view, the single most important factor is controlling supply. The most glaring example is the shopping center sector - just consider the excessive supply in Istanbul, Ankara and even lesser known cities. No matter how strong demand is, if supply always catches up -or, in this case surpasses demand- there is no scarcity. And it's not possible to generate long-term investment returns in a market with no scarcity.

In addition, as the market now enters a new phase, operators should not forget to manage existing assets - not only build new ones! More professionals would need to be trained in applying asset management practices. Many might argue that the Turkish market is volatile enough to enable return generation just by riding cycles. In my view, the years to come will be a period of muted recovery. To ensure consistent performance, assets would need to be worked out.

I think the future for the Turkish property market bodes well. As long as one treads diligently, applies prudent stock selection criteria and then manages assets properly, returns may be expected to be higher than in most other European markets.