8G Capital Partners
Managing Director
Tassos Kotzanastassis

Opportunity, high returns... But not a 'no-brainer'

The Turkish property market has witnessed perhaps its first 'institutional' cycle - one where foreign institutional investors entered, invested, and committed capital in joint ventures with local outfits. During this period, Turkey was one of the most popular 'emerging' property markets.

De-compression, de-leveraging, deflation. Over the last 18 months, real estate markets have seen it all. Starting from the US and spreading to the east, emerging Europe eventually got caught in the spiral. The Turkish property market has witnessed perhaps its first 'institutional' cycle - one where foreign institutional investors entered, invested, and committed capital in joint ventures with local outfits. During this period, Turkey was one of the most popular 'emerging' property markets.

Another 'de-' word that was in popular use was decoupling - the notion that emerging markets would escape unscathed. Instead, Turkey's GDP contracted by nearly 14% in the first quarter as the rest of the world was unable to absorb its exports. Projections for GDP growth in 2009 range from -3% to -6% and most (not all) expect a recovery by 2010. Unemployment is also creeping up. On the positive side, however, inflation dropped dramatically, permitting Turkey's Central Bank to cut interest rates by 850 bps since last November, to levels unseen for many years.

THE STATE OF THE MARKET

When it comes to crises, Turkey is a veteran. Following the near-disastrous one of 2001, the banking system has shielded itself and this time round it has proven remarkably resilient. Coupled with the traditionally low LTVs and the cross-collateralisations, there is no distressed property to speak of. The tsunami of refinancing needs that is expected to hit most property markets is not an issue for Turkey. However, there's no denying that property fundamentals paint a dreadful picture.

The retail market, the darling of foreign institutional investors, has come to an abrupt halt. Retailers are taking stock of their frenzied expansion over the last few years. Rent re-negotiations are widespread (there are reports of drops as high as 30% or even 50% over the last three quarters) while incentives like fixing rents in TRY and rent -free periods are becoming more prevalent. Secondary locations have been hit particularly hard. Meanwhile, supply is rising fast: JLL estimate retail density (retail space /1.000 population) in 2010 to reach 274 sqm in Istanbul and 244 sqm in Ankara. By comparison, the European average is currently around 200 sqm. Investment transactions have come to a standstill. Yields are estimated to be around 9%.

In the office market, the geographical extent of Istanbul creates some interesting dynamics. Scarcity keeps the lid on vacancy in the European prime submarket (it's currently 5% or less) but there's a discernible shift of demand for Class A space from Europe to Asia. Meanwhile, the sprawling de-centralised locations mainly on the Asian side offer an alternative to cost-conscious occupiers but as supply overtakes demand, vacancy rates are extremely volatile. Rental falls manifest themselves from concessions (e.g. TRY fixing of rents, away from Euro or USD) to outright rental reductions in the more decentralised markets. Yields are estimated at around 8%.

The industrial market is perhaps a clearer depiction of the stop-and-go nature of the market. While there's an acute lack of modern stock (which will increase as Turkey is becoming a hub), the sector is currently in a deep cyclical trough - some say it's the hardest hit- with rents down 15% in the last 9 months.

The residential market behaves quite similarly: vast structural demand interspersed with short-term spells of falling prices (currently up to 30% down) and troubled developers.

HOW TO CRACK IT

At a macro level, Turkey is one of the most promising stories in Europe: demographics, economic advancement, rising importance in regional political affairs and an energy hub in the making. All these are exciting enough to dwarf the 'EU accession' story that lured so many of us in former Soviet- bloc markets. However, it's far from being a no-brainer.

There are a few things to remember:

- Don't wait for distress. In all likelihood, very little will transpire
- Sellers' yield expectations are not revised; prices are sticky, especially those of land. This means deadlock and limited transactional activity in the short term.
- Don't be lured by averages. Understand the micro market
- Potential is good but focus on what people need today
- Don't try it alone. Choose a joint venture partner. Choose very carefully
- Make sure you manage what you buy...

And last but not least: take a strategic view of the market. Barriers to entry in development are low, exacerbating cyclicality. Find a sustainable niche and erect those barriers yourself.