

The downturn in housing looks mild when you compare it to what's happening to commercial property. The ECB's latest Financial Stability Review shows that commercial property prices in Ireland were soaring at a 40 per cent annual rate as recently as the first quarter of 2007. This was by far the fastest pace of increase in the euro area. By the third quarter of 2008, prices were plummeting by 40 per cent. Values are falling in most other EMU countries also, but by nowhere near as much as in this country.

As the ECB points out, developments in commercial property markets are important for financial stability because loans for development and investment in commercial property are often an important component of banks' assets. That's certainly true for Irish banks. As of December 2007, a whopping 32 per cent of Anglo Irish Bank's total loan book was exposed to Irish commercial property. This compares with 12 per cent for AIB and 5 per cent for Bank of Ireland. Anglo also has a considerable exposure to the faltering UK property market and residential development.

For sure, loans for investment in commercial property are less risky than for development. The distinction between the two categories can be blurry, however -- as evidenced by Anglo's recent reclassification of loans. Moreover, tumbling prices put at risk investors in commercial property such as property funds that may have to sell properties to finance redemptions. Loan covenants based on loan-to-value ratios are also likely to be breached on properties purchased in recent years. That probably applies to a large chunk of properties, since data from the Central Bank show that a half of Irish banks' loans to property (excluding mortgages) were made during the years 2006 and 2007. Losses on these loans will be huge.