

Savills Research – Q2 2022

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MARKET
IN
MINUTES
Savills Research

Ireland Investment Market

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Macro view • Investment flows • Sectoral analysis

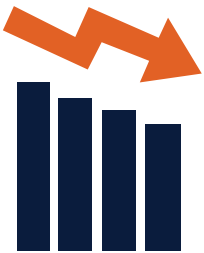


€2.3bn

worth of deals
transacted in Q2



Relatively strong spread
between Irish property
yields and borrowing costs



Market sentiment softening
in some sub-sectors



€45m

average multi-family lot size

Macro view

Record investment volumes in H1 despite negative headwinds and softening sentiment in specific sub-sectors.

Monetary tightening in the eurozone

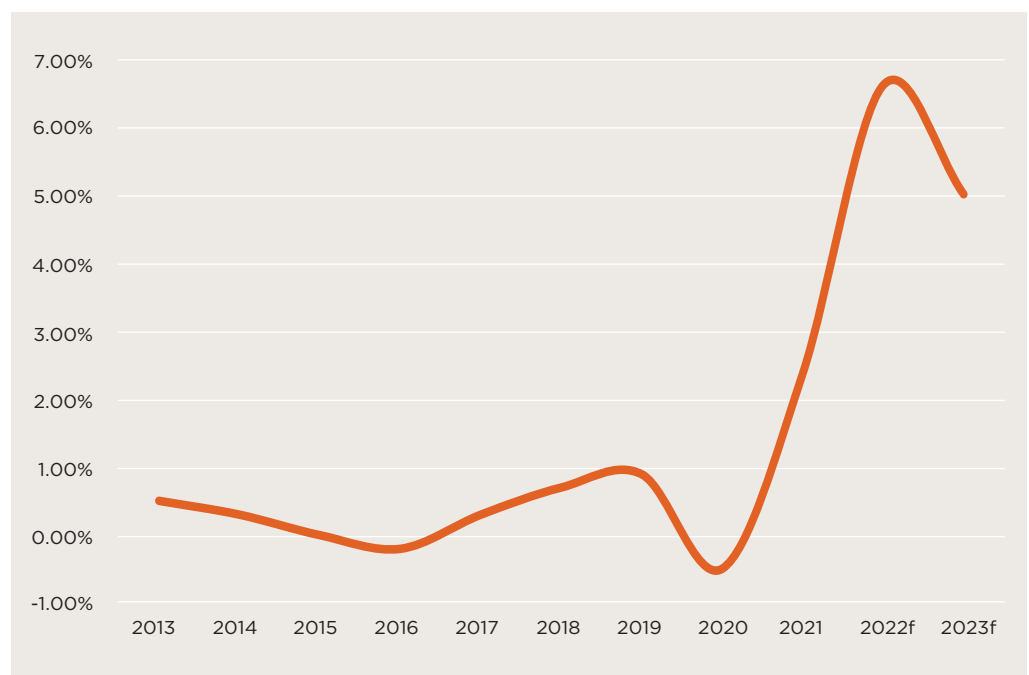
Ireland's inflation rate (HICP) reached 9.6% y/y in June, 100bps above the eurozone's average of 8.6%. The OECD now expects the eurozone's inflation rate to average 7.0% in 2022, falling in 2023 to 4.6%, with Ireland's prices forecast to grow by 6.6% and 5.0% over the same period, respectively. Faced with the highest rates of inflation in a generation, the ECB has started the process of monetary tightening, increasing its rate on main financing operations from 0.0% to 0.5% in July. The E.C.B., in this regard, has been slower to react than the U.S. Fed, who up until the end of June have raised rates three times since the beginning of the year. The Federal-fund target rate now ranges between 2.25%

and 2.50%, 225bps higher than where it was in 2021. Christine Lagarde and the E.C.B have confirmed a slower pace of increase than the U.S., as Europe's proximity to the conflict in Ukraine brings with it greater macroeconomic fragility. Central Banks are in a challenging position to navigate inflationary pressures, which largely remain outside of their control, and guide the macroeconomy through higher interest rates without tipping economic growth into negative territory. Recent research from the Federal Reserve Bank of San Francisco shows that demand-side factors only explain a third of the rise in core inflation, with supply-side and other factors explaining the majority of inflation.



Central Banks are in a challenging position to navigate inflationary pressures, which largely remain outside their control.

Figure 1: Inflation forecast (HICP)



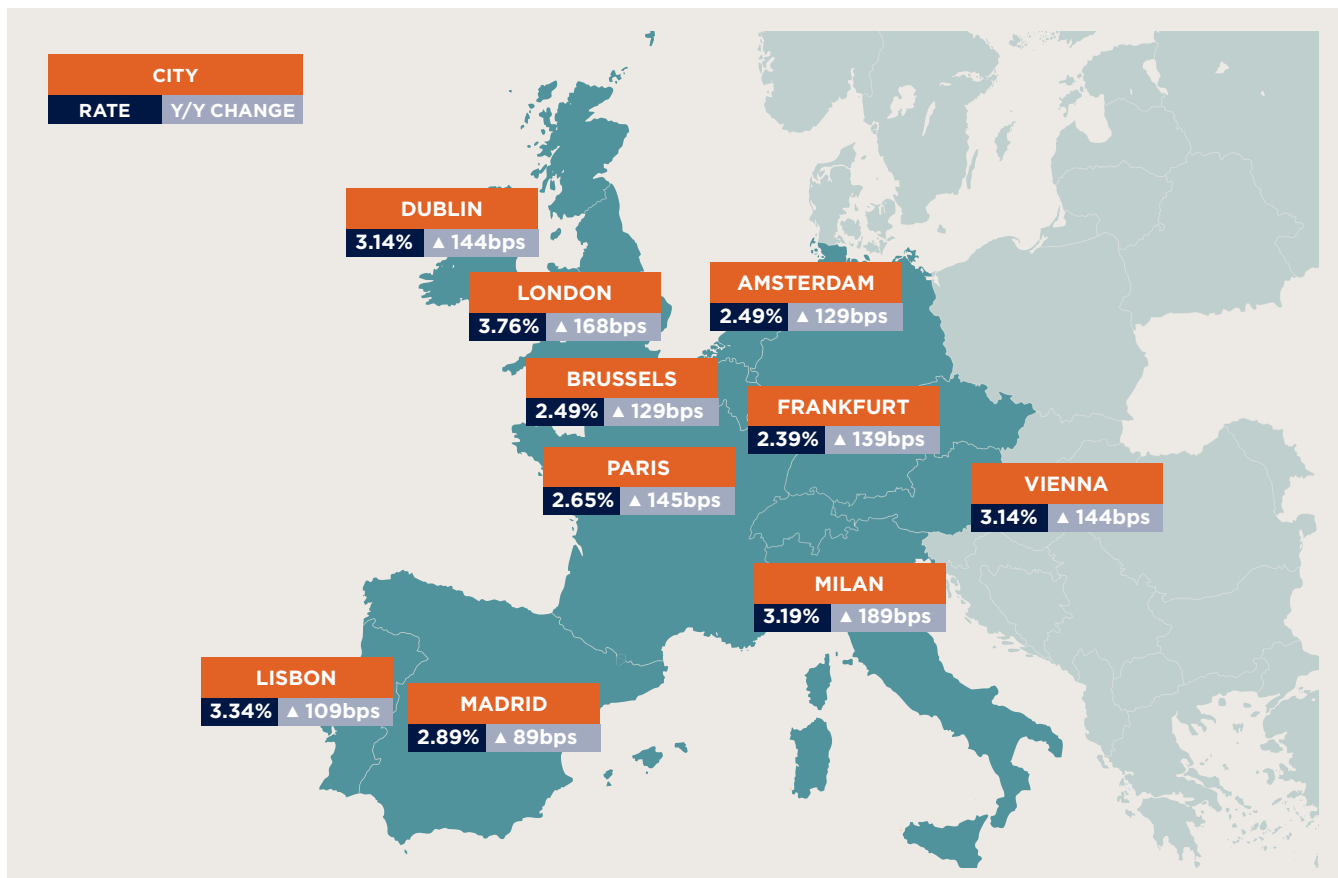
Source: OECD-June 2022

European financing environment

This hawkish market environment is impacting borrowing costs across Europe with the 5-year EURIBOR swap rate - after years of negative rates - is now firmly in positive territory. This is a fundamental indicator for real estate financing, used by lenders to hedge borrowing costs exposure by swapping the uncertainty of the floating Euribor rate for a fixed-rate payment. This is then

built into the total cost of finance for borrowers. The impact on borrowers has meant the all-in lending cost in some locations has more than doubled on an annual basis. Dublin has fared slightly better than some in broad percentage change, but has still seen the all-in rate increase by 144 bps from 1.70% to 3.14% in the 12 months to May 2022.

Figure 2: European debt costs



Source: Savills Research, calculated on an annual basis as of May 2022

After a prolonged period of cheap capital, the commercial real estate sector must adjust to these growing financing costs. The largest impact will be seen by those buyers that rely heavily on leverage, which could also influence development opportunities and funds that are already heavily effected by sustained build cost inflation. Within core strategies, where purchase yields are tighter, the increase in financing costs across Europe means that debt is no longer accretive to total returns at current asset pricing levels, putting upward pressure on property yields.

It might not just be the rising cost of finance but access to the finance that may cause problems for investors and developers,

especially those in the SME space. For traditional lenders, a risk-off attitude may limit lending in the face of macroeconomic headwinds. Ulster Bank and KBC's retraction from the market may further exacerbate problems. Alternative lenders now play a significant role in financing Irish real estate, mostly in the form of uni-tranche and mezzanine finance. These non-bank lenders that provided €1.8bn between 2019 and 2020 (CBoI) to real estate SMEs may struggle to provide access to funds as the cost of equity has increased.

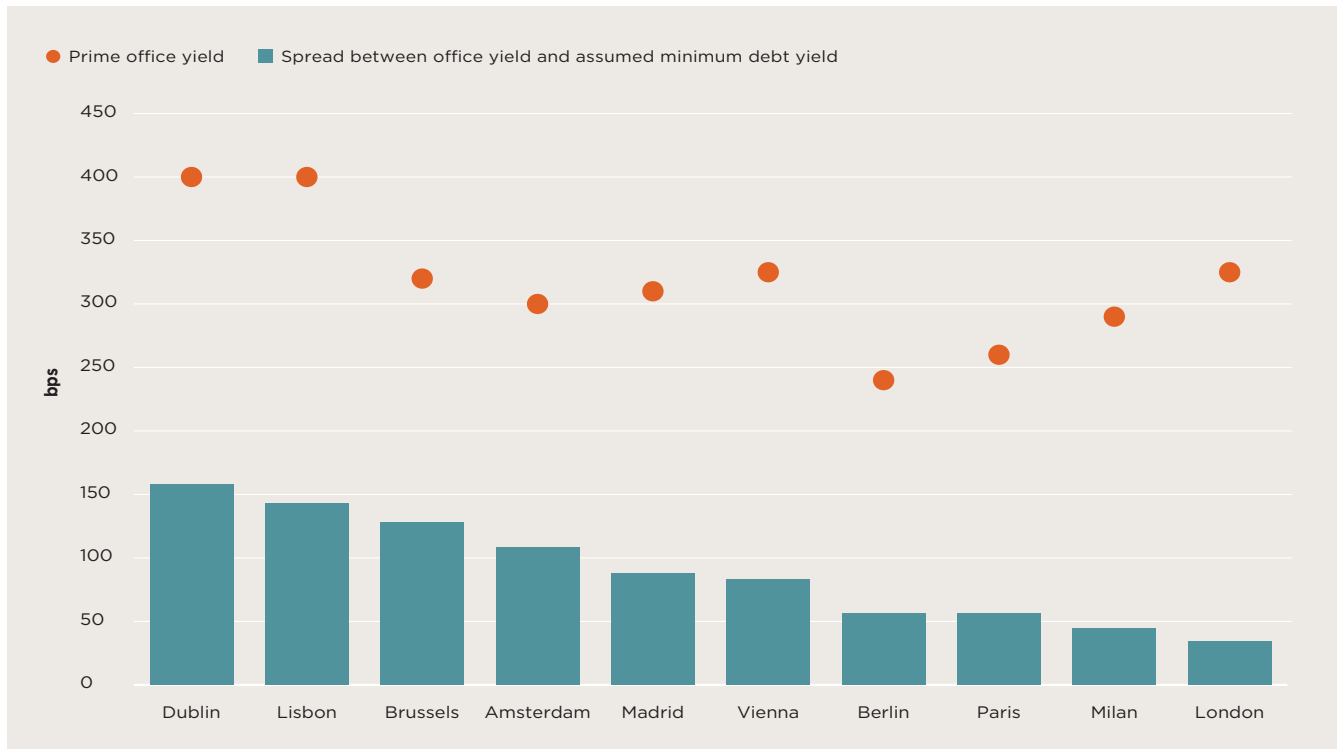
“ Market debt is no longer accretive to total returns in many locations across Europe. ”

Higher financing costs and property markets

How a country's property market responds to growing financing pressures depends on several macro and micro property fundamentals. We have, however, compared how European office markets may respond to higher financing costs by computing the

minimum yield needed to meet an assumed interest cover ratio (1.4x) at a moderate LTV (55%), considering new financing rates and the current prime transaction yield.

Figure 3: Spread between property yields and assumed minimum debt yield



Source: Savills Research

Dublin has the largest spread when comparing the yield needed to meet our assumed interest cover ratio to the current transactional prime office yield, with a spread of around 150bps. Increasing financing costs will impact the available returns on all properties across the continent, and different countries need distinct levels of returns based on their baked-in risk premium. But having a

large spread over the minimum yield suggests there is less upward pressure on transaction yields as investors aren't as pushed to meet debt covenants with the new higher costs of financing. Tight spreads indicate where transactional yields are under the most pressure to rise as investors struggle to meet growing financial costs.

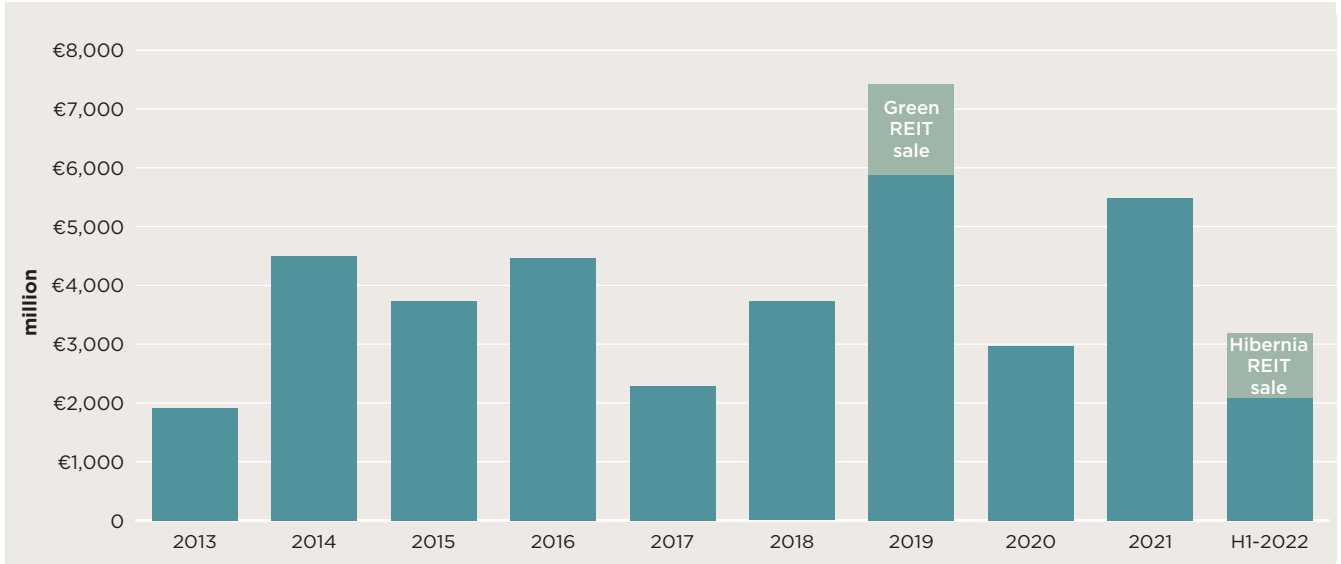
“Irish property, therefore, has greater headroom in property yields, allowing the sector to carry greater financial pressures and may make the sector comparatively more resilient to shocks.”

Ireland is in this relatively fortunate position in dealing with growing financial pressures in the real estate sector as debt markets have shown that the perceived risk associated with the Irish economy has reduced significantly since the GFC. This is largely down to how the Irish economy has performed in recent years, as budget control and a growing economy have seen a reduction in the debt burden. As a result, the all-in cost

of finance in Ireland is comparable to that of Vienna and Milan. However, property yields haven't tightened in the same way as many countries on the continent. Irish property, therefore, has greater headroom in property yields, allowing the sector to carry greater financial pressures and may make the investment markets comparatively more resilient to shocks.

Investment flows

Figure 4: Investment volumes



Source: Savills Research

Despite negative headwinds from increasing inflation and interest rates, Q2 saw strong investment activity of more than €2.3bn, bringing the half-year total to €3.2bn. This is the largest H1 total on record, 17% higher than 2021 and 11% higher than the previous record in H1 2016. Even after controlling for the Hibernia REIT

sale, transactions totalled €1.2bn in Q2 and €2.1bn in the first half of the year. This half-yearly total would still be considered a strong start to the year, as it remains 26% higher than the H1 average transactional volume witnessed over the last five years.



Savills Market Comment

Market sentiment has started to soften within certain sub-sectors in recent months, as the cost of money has increased. Transactions are increasingly becoming harder to underwrite, with volatility in the public debt and equity markets particularly elevated at the end of H1, leading

to increased borrowing costs. Buyers who rely heavily on leverage to complete transactions will be the most impacted by higher financing costs. This is a further blow to developers who are already dealing with sustained build cost inflation.

“ Transactions are increasingly becoming harder to underwrite, with volatility in the public debt and equity markets particularly elevated at the end of H1, which has led to increased borrowing costs. ”

This softening sentiment has and will impact transaction volumes. There is anecdotal evidence that some buyers are seeking to price chip on transactions, with sellers largely acknowledging some willingness to be flexible on pricing. This highlights that the Irish market is more interlinked with global markets than in previous cycles, as international investors raising funds worldwide and from multiple sources

have brought their concerns to our shores. But buyers and sellers are also adapting quicker to the changing market conditions than in previous cycles. So far, the market is acting in a rational manner given the changed dynamic to the cost of money and the need to have this reflected in asset pricing.

“ Anecdotally, buyers are asking for pricing adjustments on transactions, furthermore, sellers generally have quickly acknowledged the need to be flexible on pricing. ”

Of course, these headwinds are a global rather than local issue. The reversal from the long-run norm of falling interest rates and quantitative easing creates a changing market dynamic. This has driven up bond yields. For real estate markets, the growth of these yields provides capital allocation headwinds. The TINA (there is no alternative) era for risk assets, including real estate, appears to have adjusted, as bonds now offer alternatives to the stable cash yield that many investors have sought in real estate markets. Although, as highlighted in our Q1 2022 investment market view, real estate historically outperforms bonds in inflationary environments due to increasing replacement costs and growing rents.

Whilst the macro environment is changing rapidly, the Irish macroeconomy and commercial real estate sector remain in a relatively favourable position. Employment in the country is at record levels, and in the European Commission's latest forecast, Ireland is expected to be the fastest-growing

economy until the end of 2023. Ireland's young population and the undersupply of residential units, ESG-compliant offices, and modern industrial assets will continue to propel investment transactions in the commercial real estate market over the longer-term. The Irish market may also benefit from U.S. dollar strength. The USD v EUR rate has increased 11% since the start of the year, benefiting inbound U.S.-based funds to the eurozone, as purchase prices are effectively discounted when purchased in Euros. While most European countries' real estate markets would benefit from this broad-based dollar strength, Ireland may see a disproportionate amount of attention. As highlighted in the macro view, Irish property yields remain higher than European alternatives, with greater headroom to absorb borrowing costs and higher yields from bonds. Additionally, US-based investors have increased their exposure to the Irish market over the last couple of years. Many have set up operational platforms in Ireland, making deployment easier.



Investor nationality and type

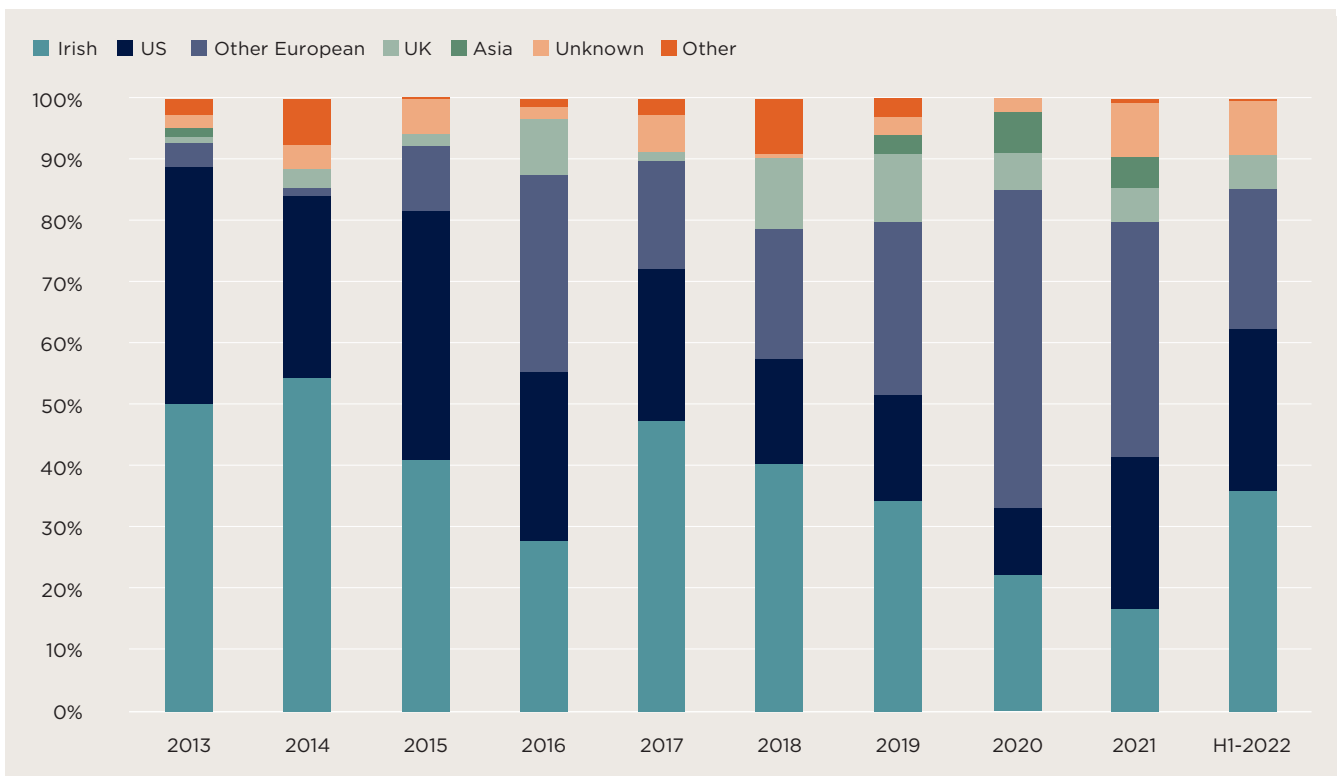
* From this point in the report, we have removed the transaction of Hibernia REIT from the analysis. A transaction of the scale of taking a REIT private at this point in the year tends to impair insight that could be deducted from the market. We have also removed the sale of Green REIT from the analysis in 2019 for consistency and comparability between years.

After accounting for a diminishing share over the last five years, domestic investors have increased their share of spending in 2022. Irish investors accounted for 36% of transactions across the year so far. Several well-capitalised domestic funds have conducted

large transactions in multi-family and mixed-use assets. Having a domestic partner helps with capital deployment and the intensive operational management of PRS activities which continues to take a more significant percentage of market transactions.

🍋 Domestic investors have increased their share of spending in 2022, with Irish investors accounted for 36% of transactions across the year so far. 🍋

Figure 5: Investment turnover by nationality



Source: Savills Research

U.S. funds have continued to increase their activity in the Irish market, as this cohort accounted for 24% of the quarter and 27% of the transactions in H1 2022. This group has slowly grown its interest, with U.S. buyers making up 11% of transactions in 2020 and 25% in 2021. At the same time, higher borrowing costs for

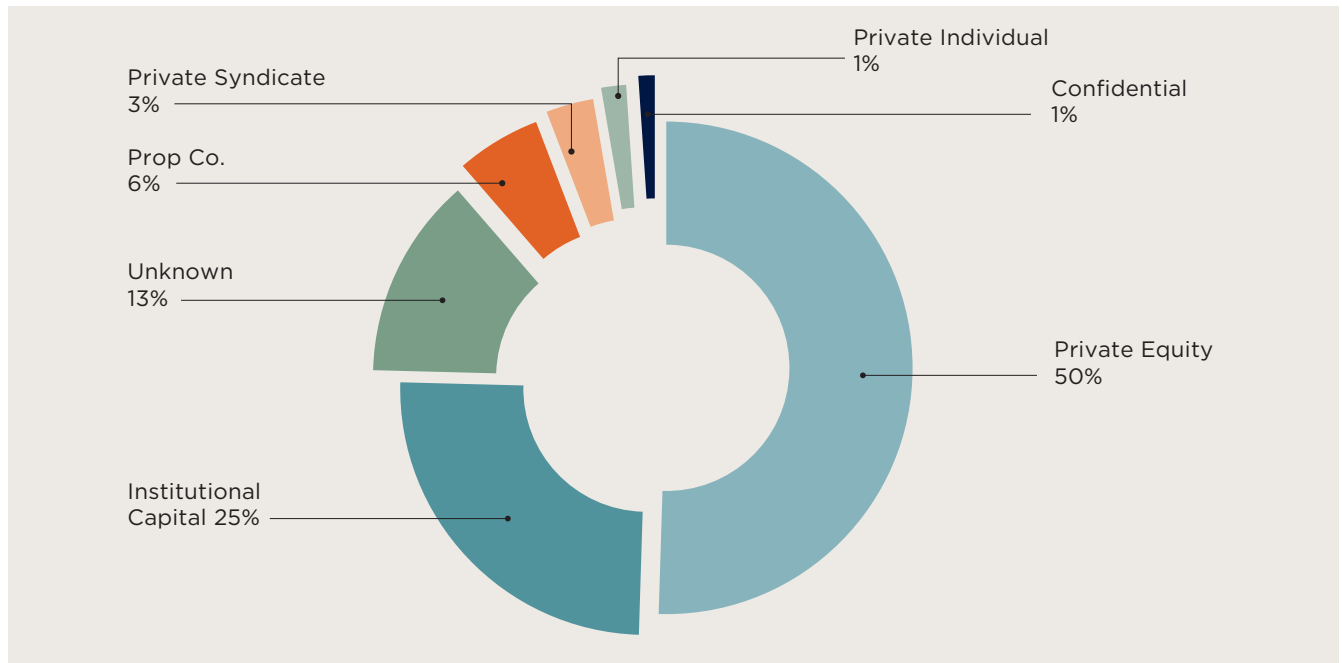
those raising funds in the U.S. compared to the E.U. may impact transactional volumes going forward. However, the strengthening U.S. dollar may provide tailwinds for U.S. buyers looking to deploy outside their own market.

🍋 The strengthening U.S. dollar may provide tailwinds for U.S. buyers looking to deploy outside their own market. 🍋

Private equity and institutional capital continue to take the vast majority of market share, with 75% of all commercial real estate transactions featuring one of these two buyer types in the year's first half. The Irish market is seeing fewer transactions but

larger average lot sizes, a dynamic which tends to favour pools of capital and institutional funds, explaining why we are seeing a diminishing presence of individual buyers in the market.

Figure 6: Investment turnover by buyer type H1-2022

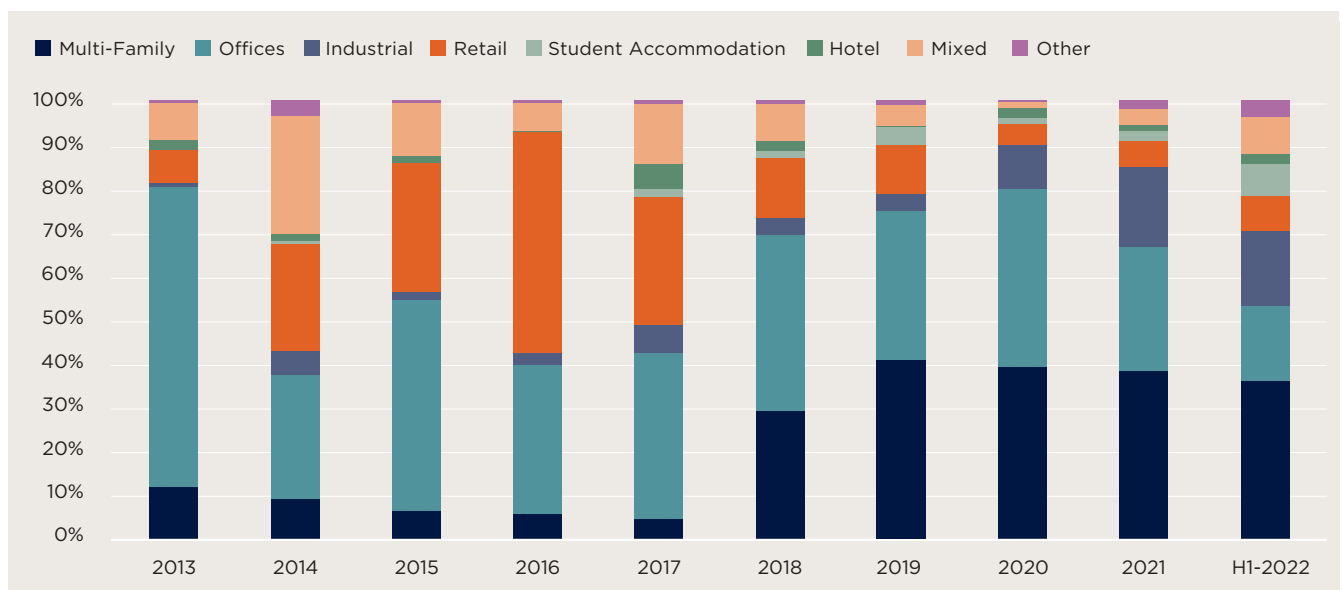


Source: Savills Research

Multifamily assets continue to attract a significant investment share in the market, accounting for 35% of investment volumes this quarter and 36% in H1. Office and industrial assets have both commanded 17% of transactions in 2022 so far. Retail has improved its market share this year with 8% of transactions

after registering 5% and 6% in 2020 and 2021. The retail parks sector has contributed more to the total retail transaction in 2022 than in any year in the last decade after a strong operational performance during the pandemic. With this in mind, investor interest is increasing.

Figure 7: Investment share by sector



Source: Savills Research

Multi-family market

Multi-family assets continue to attract a large investment share in the Irish market, totalling €396m in the quarter and €591m across the first half of the year. There were five multi-family transactions in the quarter and 13 across the year so far. The average transaction value in 2022 of €45m is comparable to the average value achieved in 2019 - €48m, 2020 - €48m, 2021 - €44m. But these values remain elevated compared to the long-run average of €27m, as lot sizes have increased with the greater attention the PRS sector now commands.

Whilst sentiment across commercial property has started to soften in Q2, the PRS sector looks more resilient as investors remain keen on assets with short underlying lease lengths, despite the 2% rental cap, to combat some of the underlying inflation pressures in the market. Towards the end of the quarter, we saw a prominent U.S. investor raise significant funds for a pan-

European value – add fund focused on PRS opportunities. The oversubscribed offering provides evidence of stability in investor confidence in this sub-sector of the market.

However, the shortage of availability in prime stock will likely restrict the sector's growth in investment volumes as many assets in prime areas of the market are held by institutional capital and are on longer-hold strategies. This tightness in standing assets coming to the market will likely promote the use of forward funding structures to bring new supply to the market. This quarter, 80% of multi-family transactions used either a forward funding or forward purchase agreement to acquire stock. However, build cost inflation and financing cost increases may impact the market's feasibility in providing these structures as it becomes harder to make a project stack.

“Multi-family assets continue to attract a large investment share in the Irish market, totalling €396m in the quarter and €591m across the first half of the year.”

The two largest transactions of the quarter were purchased by Ardstone Capital for a combined €227m, with the purchase of Magna Drive in Citywest and Phase 3 St Edmunds Palmerstown in West and Southwest Dublin suburbs. Both assets were purchased in the 4.25-4.35% range and will provide 573 units to the market. The third largest transaction of the quarter was Round Hill Capital's acquisition of 238 BTR units on Malahide Road from developer GEM

Group for €98m. The fourth largest transaction was a private and confidential transaction. A portfolio of multi-family assets sold to New Beginnings was the fifth largest transaction of the quarter. New Beginnings is an Irish based investor providing housing to the affordable and social sectors and has deployed over €100m+ so far this year.

Table 1: Top multi-family deals

Property	Vendor	Buyer	Price
Magna Drive, Citywest, Dublin 24	Glenveagh	Ardstone Capital	€122.0m
Phase 3, St Edmunds, Palmerstown, Dublin 20	P&C	Ardstone Capital	€105.0m
14-17 Malahide Road, Dublin 17	GEM Group	Round Hill Capital	€98.0m
P&C	P&C	P&C	€40.0m
Project Haven	Allied Irish Property	New Beginnings	€30.8m

“This quarter, 80% of multi-family transactions used either a forward funding or forward purchase agreement to acquire stock.”

Office market

The office investment market saw €277m transact in the second quarter (after stripping out the Hibernia REIT transaction). This is a significant improvement on Q1, where just €80m transacted in the sector. But combined, this is the slowest H1 since 2017.

Regarding its contribution to overall transaction volumes, the office sector's rolling two-quarter total is the smallest percentage of transactions on record at 17%.

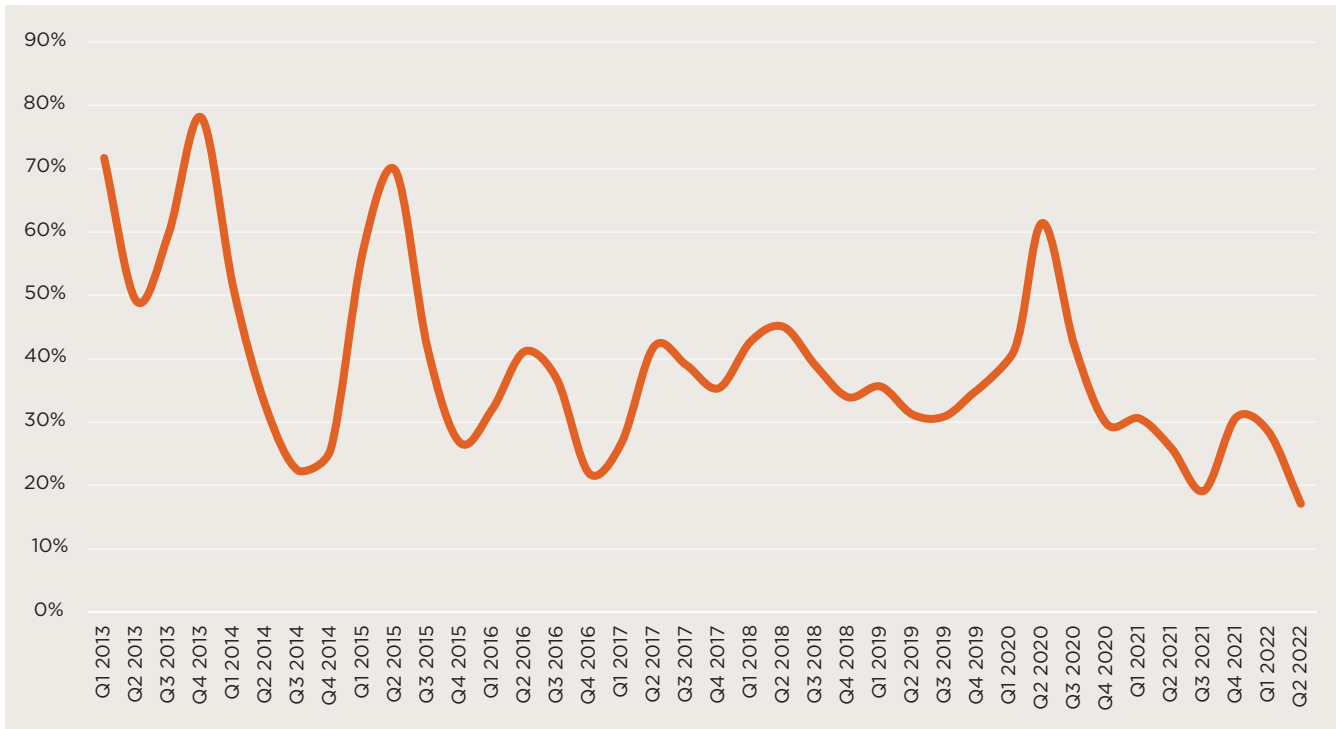
“ The office sector's two-quarter total is the smallest percentage of transactions on record at 17%. ”



The growth of both the multi-family and industrial sectors has taken market share away from the office sector. Furthermore, there's a growing separation in demand for prime and secondary office stock, with the definition of what is considered prime getting tighter. Investors and occupiers are demanding prime offices that are new or recently refurbished, with space configurations that encourage group collaboration while meeting ESG requirements, all in very selective city centre locations. When these offices are coming to the market, they are achieving strong interest. In 2022 there has been a lack of this narrower definition

of prime office stock available for sale, which has held back transactional volumes and the sector's market share. Brookfield Asset Management's acquisition of Hibernia REIT for €1.1bn and Blackstone's interest in the Salesforce campus provide evidence that investor and occupier sentiment is stable in the prime market, backed by the conviction that the long-run future of these offices remains positive. Brookfield has been keen to increase its presence in the European office sector this year, as it also bought German Alstria office REIT for \$4bn, bid \$1.5bn for Belgian office REIT Befimmo as well as building-up its stake in British Land PLC.

“ In 2022 there has been a lack of this narrower definition of prime office stock coming to the market, which has held back transactional volumes and the sector's market share. ”

Figure 8: Rolling two-quarter office investment market share

Source: Savills Research

Aside from the takeover of Hibernia REIT, the largest office deal in the quarter was Spear Street Capital's sale of Blocks 1,2 and 3 of the Founders District in Dublin 4 for €97.5m. The asset, which is the headquarters of the global betting giant Flutter Entertainment, was bought by LCN Capital Partners, a US-based firm that specialises in the sale-and-leaseback of properties. Whilst the property was built in the late 1990's, it has undergone significant refurbishment in recent years after Spear Street Capital purchased the asset in 2017. Spear Street Capital remain active on the acquisition side, as highlighted by their purchase of the Forum in the IFSC in Q1 2022 for €30.8m. The third largest office transaction of the quarter was REInvest's purchase of 4-5 Harcourt Road, in their first transaction in the city. The office,

which was completed in 2018, is fully let to WeWork on a long lease and has a LEED Gold sustainability accreditation, which helps the new investors' ESG compliance and provides stability in shifting market sentiment. The fourth largest office transaction of the quarter was Fine Grain Property's purchase of Building 7,000 on the Westpark Innovation Campus in County Clare. This gives the investor sole ownership of the campus, as it had purchased all other assets in the scheme in 2019. The asset was purchased in a sale-and-leaseback arrangement with AXA partners in a €20.0m transaction. The fifth largest transaction in the sector was the purchase of 5 Schoolhouse Lane in Dublin for €17.3m by a private buyer.

Table 2: Top office deals

Property	Vendor	Buyer	Price
Hibernia REIT	Hibernia REIT	Brookfield Asset Management	€1.1bn
Blocks 1,2 and 3 of Founders District, Dublin 4	Spear Street Capital	LCN Capital Partners	€97.5m
4-5 Harcourt Road, Dublin 2	Henderson Park	REInvest	€65.0m
Building 7,000, Westpark Innovation Campus, Co. Clare	AXA	Fine Grain Property	€20.0m
5 Schoolhouse Lane, Dublin 2	Artesian Property Partnership	P&C	€17.3m

Industrial and Logistics market

The industrial market saw €176.6m transact in Q2 adding to the €178.4m witnessed in Q1. The first-half of the year total of €355m represents a 14% drop compared to this point in 2021's record-breaking year. However, 2022's total remains over four times above the long-run average, clearly showing the weight of demand for industrial assets over the last two years. There's also a large amount of stock currently in negotiation or on the market in the sector, suggesting that these elevated levels of transactions will continue across the year.

The year's largest transaction was a confidential transaction valued at €68m. The second largest industrial transaction of the quarter was for the North Ring Business Park, comprising 205,000 sq ft across 20 units, as a confidential buyer purchased the scheme from Rohan Holdings in a €50m transaction. International

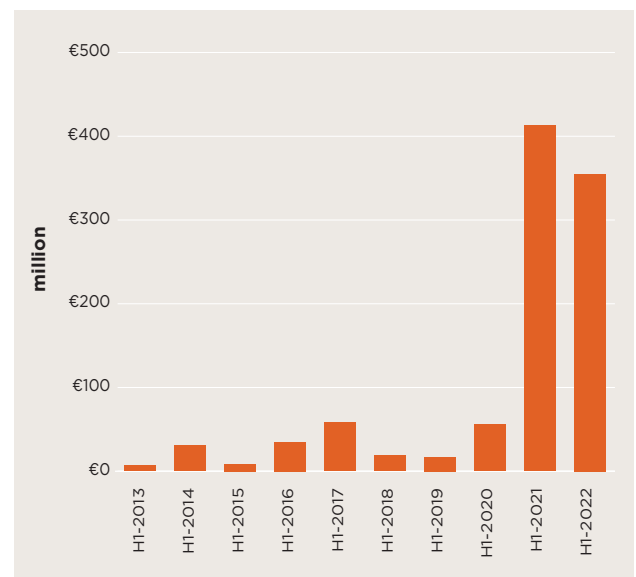
investors are increasingly looking for a wider variety of industrial asset types from standalone warehouse opportunities to multi-tenant light industrials. The third, fourth and fifth largest transactions of the quarter featured private and confidential purchasers but saw a portfolio in Cork trade for €30m, Unit 2 Kylemore Park in Dublin 10 trade for €7.9m and Unit 507/508 in Northwest Business Park trade for €6.0m.

€355m

Transacted in the year's first half, four times the long-run average.



Figure 10: Industrial H1 transactional values



Source: Savills Research

Table 3: Top industrial and logistics deals

Property	Vendor	Buyer	Price
Confidential	P&C	P&C	€68.0m
North Ring Business Park, Dublin 9	Rohan Holdings	P&C	€50.0m
Industrial Portfolio, Cork	P&C	P&C	€30.0m
Unit 2, Kylemore Park, Dublin 10	P&C	P&C	€7.9m
Unit 507/508 Northwest Business Park, Dublin 15	Park Developments	P&C	€6.0m

Other significant transactions

Table 4: Other top deals

Property	Vendor	Buyer	Price	Sector
Manor West Shopping Park, Kerry	Private	Marlet / Melcorpo	€55.2m	Retail
Premier Inn, Gloucester Street, Dublin 2	Red Rock Development	Aviva	€37.0m	Hotel
Independent House, Dublin 1	CARA / Chartered Land	Sofidy	€36.5m	Mixed
Care Home, Crumlin, Dublin 12	Private	Aedifica	€32.0m	Other
East Gate Retail Park, Cork	O'Flynn Group	Harvey Norman	€24.3m	Retail

Source: Savills Research

The largest retail transaction of the quarter was Manor West Shopping Park which transacted for €55.2m. The asset provides a gross floor area of 350,000 sq ft and features a tenant profile that includes Tesco, Woodies, TK Maxx, Harvey Norman, Smyths Toys and The Range, whose combined rent makeup 56% of the passing income. Marlet and Melcorpo jointly purchased Manor West Shopping Park at an approximate yield of 8.9%, further highlighting the Irish investor's optimism in the sector after it purchased the Parks Collection at the end of 2021 for €74.1m. Retail parks have recently enjoyed greater market sentiment as operating resilience over the pandemic, and comparatively high passing yields provide strong opportunities for investors looking up the risk curve for returns.

There has also been an increase in medical and healthcare facility transactions in the second quarter, with five assets trading for a combined value of €78.2m. The largest was a purpose-built care home currently under construction in Crumlin, Dublin which will cater to 149 residents when built. The asset was purchased

by Aedifica, a European REIT, for €32m at an initial yield of 5.5%. Aedifica were also the purchaser of two other care home facilities this quarter in Meath and Kildare, as the REIT, which has a portfolio of €5bn, increased its European platform and is now present in eight countries. As Ireland's population ages, this sector will benefit from this long-run demographic trend. In the CSO's 2016 population and labour force forecasts, Ireland is forecast to see those aged 65+ increase from 629,800 in 2016 to between 1.5-1.6m in 2050. This will undoubtedly put greater pressure on healthcare infrastructure and medical real estate.

€78.2m

There has also been an increase in medical and healthcare facilities transactions in the second quarter with five assets trading for a combined value of €78.2m.



Premier Inn, Gloucester Street, Dublin 2 – Sold by Savills.

Table 5: Yields by sector
(based on transactions up to the end of Q2)

Sector	Q2	Annual Change
Offices - Prime CBD Yields	4.00%	0.00%
Offices - Secondary CBD Yields	5.00%	0.00%
Industrial and Logistics - Prime Yield	4.00%	-0.25%
Industrial and Logistics - Secondary Yield	4.50%	-1.00%
Shopping Centres - Prime Yields	5.75%	0.00%
Shopping Centres - Secondary Yields	9.25%	0.00%
Warehouse Retail - Prime Yields	5.00%	0.00%
Warehouse Retail - Secondary Yields	8.50%	-1.00%
High Street - Prime Yields	4.50%	0.00%
High Street - Secondary Yields	7.00%	0.00%
PRS - Prime Yields	3.60%	0.00%
PRS - Secondary Yields	4.50%	-0.50%

Source: Savills Research



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