Investment Report 2017

Savills World Research
Ireland Investment

savills

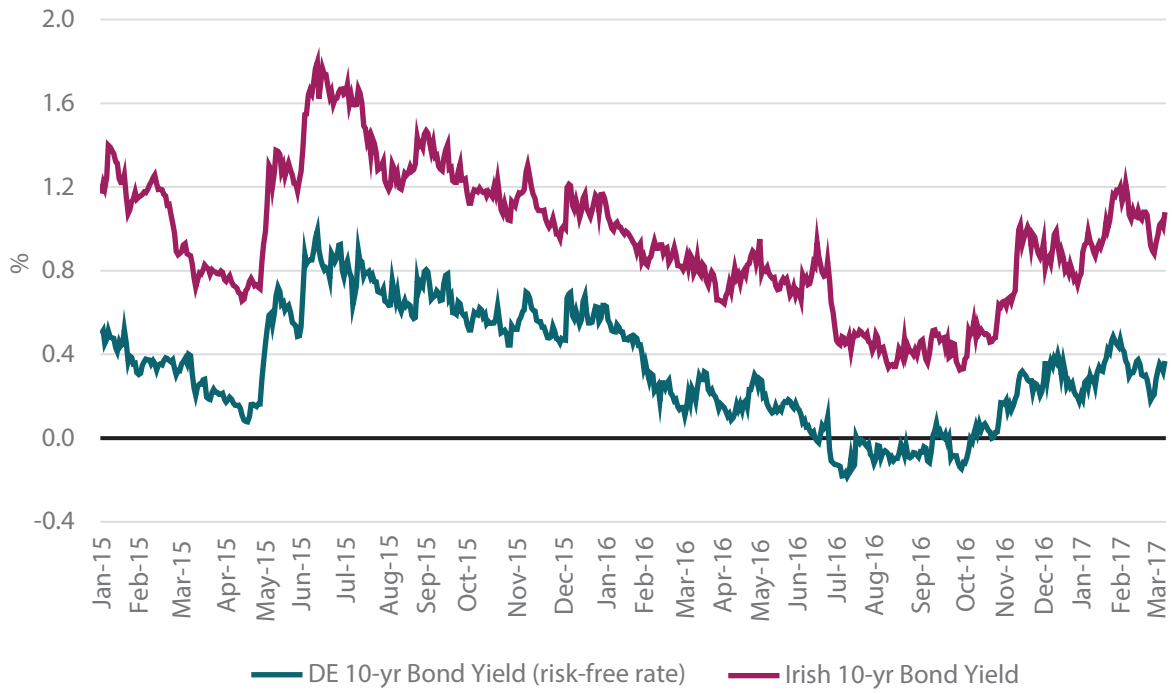
Economic Overview

In many ways 2016 was a transitional year for the Irish property investment market. Admittedly, critical elements of the landscape remained largely unchanged from 2015. For example the Irish economy continued to perform very strongly with output expanding by 5.2%. This makes Ireland the fastest growing economy in the European Union. The labour market also continued its recovery contributing to a further improvement in the public finances. Reassuringly, according to consensus forecasts, these positives look set to remain in place for the foreseeable future.

However while interest rates remain low it is becoming increasingly clear that the period of ultra-loose monetary policy is drawing to a close. The US rate cycle has already turned with the Fed tightening for a second time in December 2016. Unemployment is falling across the Euro Area and, with oil prices rising, inflationary pressures in Europe are building. As a result there is now a growing expectation that the ECB will also begin to tighten its monetary policy in the medium term. Indeed the first tentative signs of this are already evident with December's announcement that the ECB will reduce its monthly bond-buying target from €80bn to €60bn from April 2017. In keeping with this the yield on Euro Area sovereign bonds has started edging out and the Irish 10 year rate has risen from 0.33% last September to 1.08% by mid-March 2017.

FIGURE 1

Irish and German 10 Year Government Bond Yields



Source: Investing.com

For now the outward drift in bond yields is being contained by the continuation of the ECB's Quantitative Easing (QE) programme - while monthly bond purchases are being reduced the overall programme has been extended by nine months to December 2017. Consequently the monetary cycle has not led to a perceptible slowdown in Irish property investment. In our view, however, the direction of monetary policy does limit the scope for further yield compression in the current cycle.

2016 also saw a number of global developments that could potentially impact on the occupational demand for business space in Ireland. In August the European Commission ruled that Apple's tax deal with Ireland amounted to improper State aid - a ruling that the Irish Government is appealing. Brexit and the surprise US election results also have the potential to impact on the market. The implications of these factors are difficult to predict in advance. However, although they introduce additional uncertainty, the consensus view is that Ireland's economic growth prospects remain very favourable and this should continue to underpin the demand for business space.

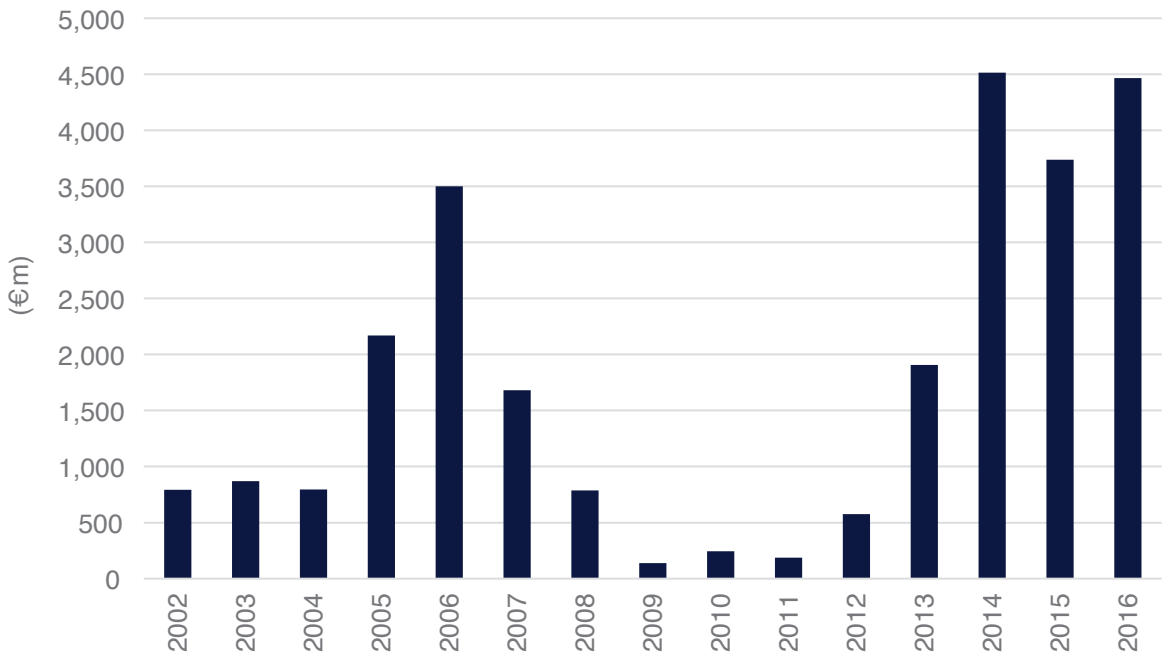
Market Activity

In total €4.47bn of income-producing property assets were sold in Ireland during 2016, involving 292 separate transactions. Officially this makes 2016 the second busiest year ever with turnover falling just a whisker below the 2014 record of €4.51bn.

Although headline metrics show the value of deals was up 20% on 2015 it worth noting that Project Jewel – a €1.8bn transaction backed by prime retail assets - was not included in the 2015 totals because it was a loan sale. Furthermore the two largest deals of 2016 – the €950m and €630m purchases of Blanchardstown and Liffey Valley Shopping Centres respectively – accounted for 35% of the year's total turnover. Allowing for these factors 2016 actually felt like the beginning of a return to more normalised trading after several years of furious deleveraging activity.

FIGURE 2

Investment Turnover By Year

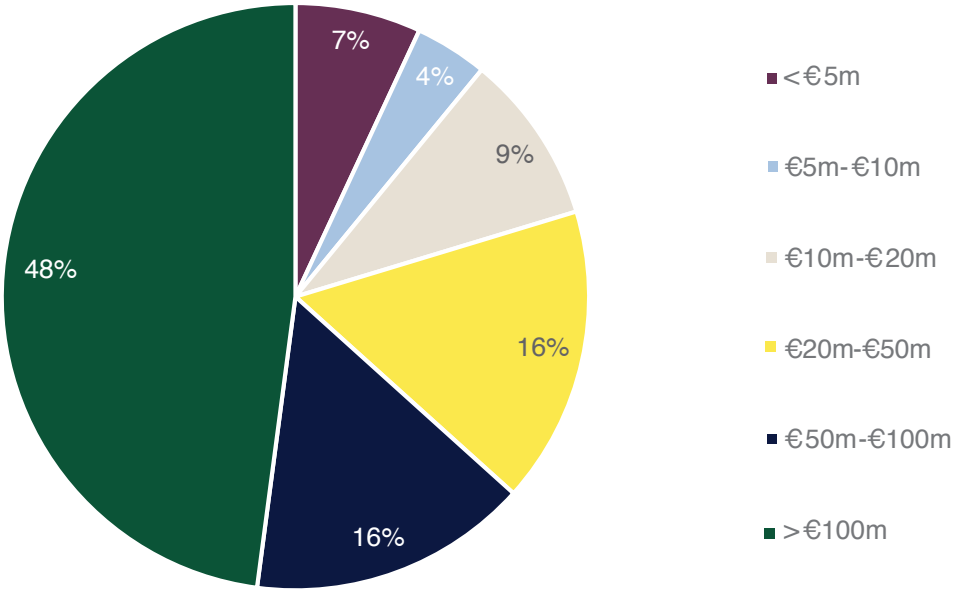


Source: Savills Research

Investment By Lot Size

FIGURE 3

Percentage of Investment Turnover by Lot Size



Source: Savills Research

On the face of it there was a familiar pattern to the distribution of investment spending by lot size in 2016. For the fourth year in a row bite sizes of €50m+ accounted for the majority of total market turnover. However, the proportion of spend at this upper end of the market in 2016 was heavily skewed by the two megadeals referenced above. Perhaps a better measure of the underlying trend is the percentage of deals (rather than spend) in the €50m+ category. This fell from 9% of transactions in 2015 to 5.1% in 2016. The declining number of large deals reflects the fact that loan books and portfolios which were traded earlier in the cycle are now being broken up and re-traded as individual assets – a dynamic we first flagged in 2015 that has continued to gather pace.

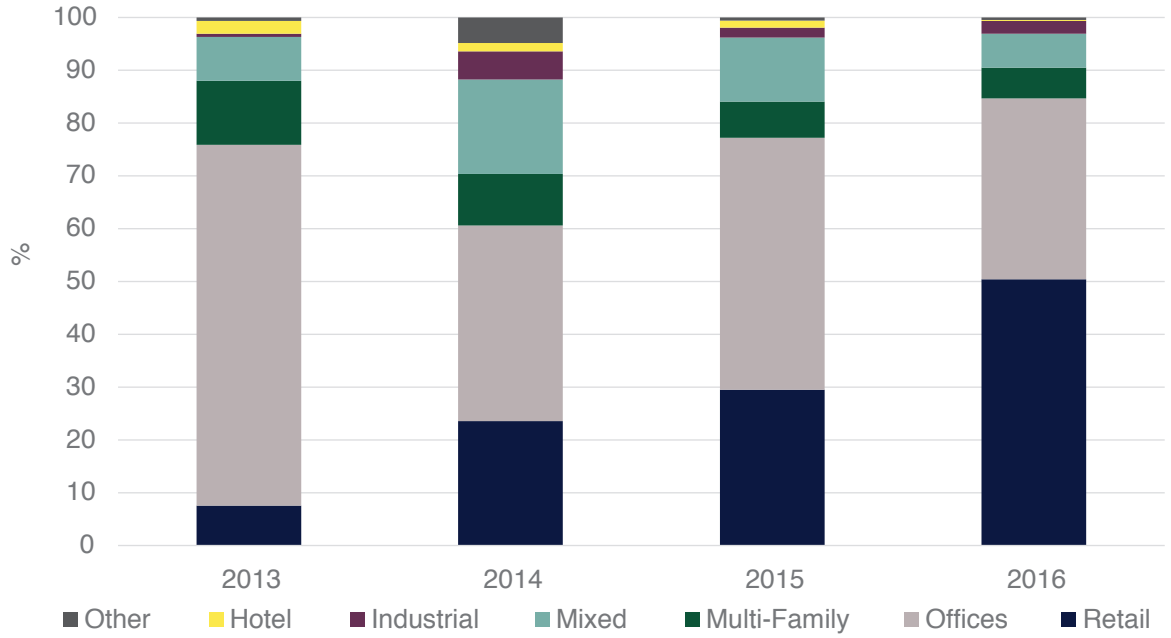
Investment By Sector

Unsurprisingly, given the size of the Blanchardstown and Liffey Valley transactions, retail overtook offices as the biggest investment sector by turnover in 2016. Leaving aside the obvious impact of these megadeals in 2016, the increased weighting of retail in recent years (see Figure 4) arguably reflects the sequence in which different sectors of the economy recovered after the crisis. Given the dominance of global multinationals in Information and Communications Technology (ICT) and Financial Services, office-based employment fell less sharply during the crash and was quicker to recover. Relatively speaking this underpinned occupier demand for office space, making office investments more marketable in the early stages of the recovery. While the multinationals drove an export-led recovery from mid-2013, it took time for this to percolate down to an uplift in personal consumption expenditure. As a result the market for retail investments initially lagged behind but is now catching up.

35 Henry Street - Sold by Savills in Q4 2016 for approx. €9.5m

FIGURE 4

Investment Turnover by Sector



Source: Savills Research

After very active trading in offices between 2012-2015, and with the construction pipeline only now beginning to deliver new-builds, fewer prime office investment opportunities came to the market in 2016. Consequently offices slipped from 48% of turnover in 2015 to 34% in 2016 – well below the European average of 45.4%.

Spending on multifamily residential has also been constrained by supply-side limitations. Multifamily investment first emerged in 2012 when a surplus of build-to-sell apartments was left overhanging the market. This provided the opportunity for investors to block-purchase residential assets at a discount, and almost three-quarters of a billion Euros of investment flowed into the sector between 2012-2014. However, as these schemes were bought-up opportunities to invest in standing multifamily assets have become scarcer, and investment flows have eased from €439m in 2014 to a steady run-rate of around €260m in both 2015 and 2016.

A more detailed analysis of investment within the major real estate segments is provided below.

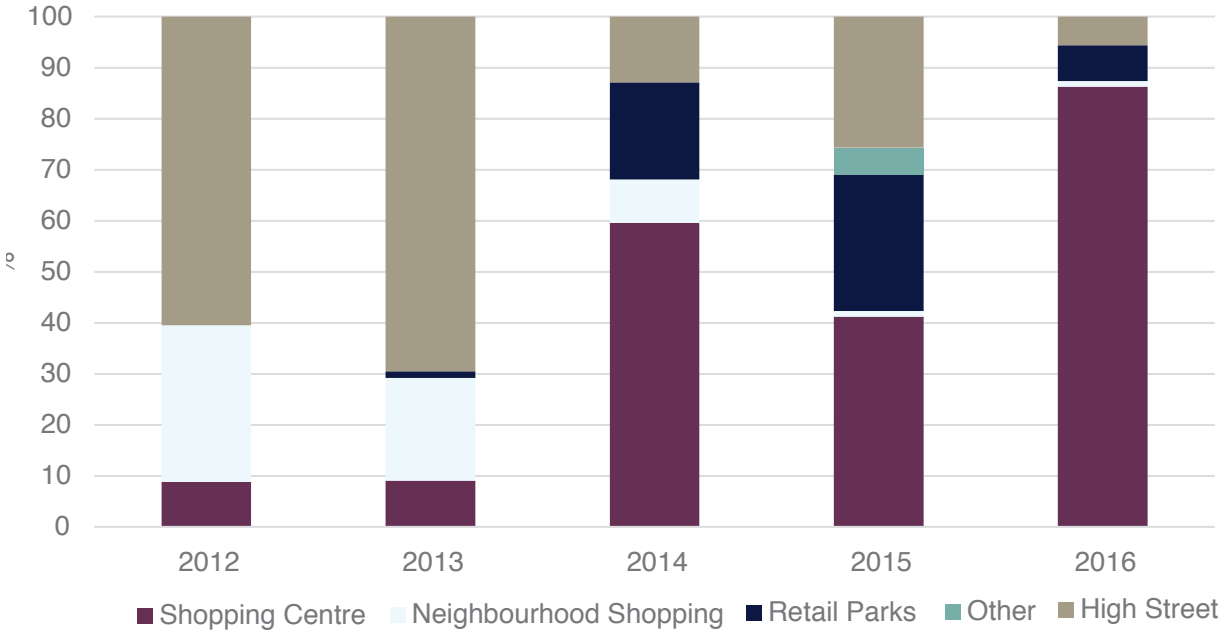
Retail

Retail's share of Irish property investment has been steadily rising since 2013. As outlined above, this trend is underpinned by a sustained recovery in the Irish consumer economy. Analysis by economists at Savills and the Economic and Social Research Institute (ESRI) has established that jobs growth, in particular, is a strong leading indicator of growth in retail rents. Nearly 200,000 net additional jobs have been created in the Irish economy since the start of 2013 and, reflecting this, MSCI data indicate that prime retail ERVs in Dublin have increased by 31%. This continued to attract capital into the sector in 2016.

42-43 Henry Street, Dublin 2 – Guiding €18m

FIGURE 5

Share of Retail Investment by Sub-Sector



Source: Savills Research

In total, over €2.25bn was invested in retail property during 2016, with the sector accounting for just over 50% of total market spending (compared with 30% in 2015 and a European average of 23.1% in 2016). High street stores and shopping centres have consistently accounted for over two-thirds of total retail investment since 2012. However, as shown in Figure 5, the balance between the two has steadily shifted in favour of shopping centres. As much as anything else this reflects the relatively limited opportunities to invest in Irish high street assets. Many of the shops in prime city centre locations are now in stable long-term ownership and seldom come up for sale. To illustrate this point, just three shops traded on Dublin's Grafton Street in 2016, while only one investment traded on Henry Street. And, in all four cases, the purchasers were long-term institutional owners.

In contrast to this, 21 shopping centres traded in 2016 for an overall spend of more than €1.9bn. Indeed shopping centres accounted for 86% of total retail investment turnover last year. The two standout deals were Blanchardstown Town Centre in west Dublin which was bought by US institutional investor Blackstone for €950m last Spring and Liffey Valley Shopping Centre, also in west Dublin, which was bought for €630m in December by Bayerische Versorgungskammer (BVK) – Germany's largest public pensions group. Outside the capital, Whitewater Shopping Centre in Newbridge Co. Kildare, was also bought by a German fund - DEKA Immobilien - for €180m last March. Meanwhile Golden Island Shopping Centre in Athlone Co. Westmeath was bought by Credit Suisse for €43.5m.

Retail Parks attracted the second biggest flow of retail investment with more than €157m worth of assets changing hands in 2016. Of the 14 assets sold, the majority were outside Dublin, including the top three deals by value; Childers Road Retail Park in Limerick (€44m), Globe Retail Park in Kildare (€25.45m), and Kilkenny Retail Park (€23.5m).

Kilkenny Retail Park – Acquired by Savills in Q2 2016 for in excess of €24m

TABLE 1

Top 10 Retail Transactions - 2016

Property	Location	Sub Sector	Sold	Price (€)
Blanchardstown Town Centre	Dublin	Shopping Centre	Q2	950,000,000
Liffey Valley SC	Dublin	Shopping Centre	Q4	630,000,000
Whitewater Shopping Centre	Kildare	Shopping Centre	Q1	180,000,000
Childers Road Retail Park	Limerick	Retail Park	Q2	44,000,000
Golden Island Shopping Centre	Westmeath	Shopping Centre	Q1	43,500,000
Lucan Supervalu (SV4 collection)	Dublin	Shopping Centre	Q4	43,500,000
Bridgewater Shopping Centre	Wicklow	Shopping Centre	Q2	32,328,000
Globe Retail Park (Portfolio Sale)	Kildare	Retail Park	Q2	25,450,000
Kilkenny Retail Park, Kilkenny City	Kilkenny	Retail Park	Q2	23,500,000
Waterford Retail Park	Waterford	Retail Park	Q4	17,000,000

There is a perception that the retail sector cooled somewhat through 2016 with several indicators, including retail sales and VAT receipts, growing less strongly than previously. Unsurprisingly in light of the political uncertainties that emerged in 2016, consumer sentiment was also less upbeat. However our econometric modelling indicates that jobs growth has a far stronger statistical relationship with retail rents than any of these variables over the long run. Given the fact that employment growth accelerated further in Q4 2016, and the fact that consensus forecasts point to further gains over the coming two years, our view is that retail rents will continue to rise – albeit at slower rates than we have seen over the last three years. According to MSCI, Grafton Street ERV growth eased from 21.8% per annum in March to 11.3% in December. Our forward-looking model predicts a further gradual moderation in the rate of growth as base effects continue to compound. Nonetheless, growth in prime rents of around 6.5% is expected in 2017.

While monetary liquidity and the income story will underpin continued demand for retail assets, in common with what is happening across much of Europe, the supply side of the market is becoming more of a constraint. There are already some indications that the scarcity of product is beginning to curtail retail investment activity. Had Project Jewel traded as a direct asset sale in 2015 the value of retail investment would actually have fallen in 2016 – despite the two big shopping centre deals. Our view is that, with many of the larger retail assets now having been traded, and with limited new development scheduled in the immediate future, expenditure on retail property is likely to ease back somewhat in the coming years.

The Grafton Collection (Lot 1 - 21-23 Grafton Street and 24 Duke Street) – Sold by Savills in Q4 2016 for in excess of €38.5m

Offices

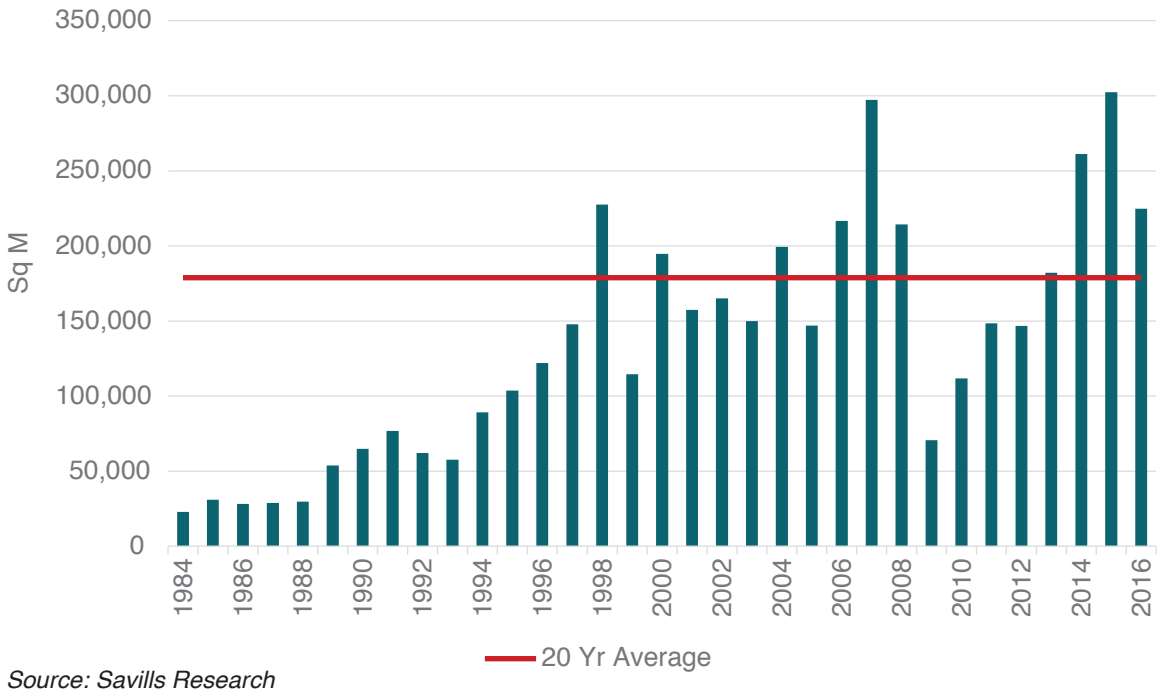
With office-based employment in Dublin growing at a spectacular 5.5% in 2016, occupier demand for business space remains strong. Just under 225,000 sq m of purpose-built space was let in Dublin last year – 26% above the 20 year average (see Figure 6). Although this total contains 47,400 sq m of development pre-lets and a significant amount of churn, nearly 42,000 sq m of space was digested in net terms during the year. This brings total net absorption since the cyclical trough in Q2 2010 to more than 520,000 sq m. As a result the overhang of vacant space has been reduced to approximately 325,000 sq m – or 9% of the standing stock (compared with 22.8% at the trough).

With vacancy tightening prime headline rents have been rising since 2012. In Savills' view the tone of rents at the top of the market stood at €646 per sq m (€60 per sq ft) per annum in December 2016. Rental inflation has slowed from a peak of 21.1% in 2015 to around 5% last year. However, to a large extent, this reflects the growing influence of pre-lets which are currently trading at a discount to rents on space for immediate occupation. It should also be noted that reduced rent-frees have led to faster growth in net effective rents than is indicated by the movement in headline rents.

Reflecting the continued strength of the occupational market offices remain firmly on many investors' buy-lists. More than €1.5bn of office assets were sold in 2016 – accounting for over a third of the year's investment turnover. Including office properties traded within portfolios, and mixed use buildings with a substantial office element, 109 assets changed ownership last year. Four fifths of these were located in Dublin.

FIGURE 6

Gross Letting Activity Dublin Office Market



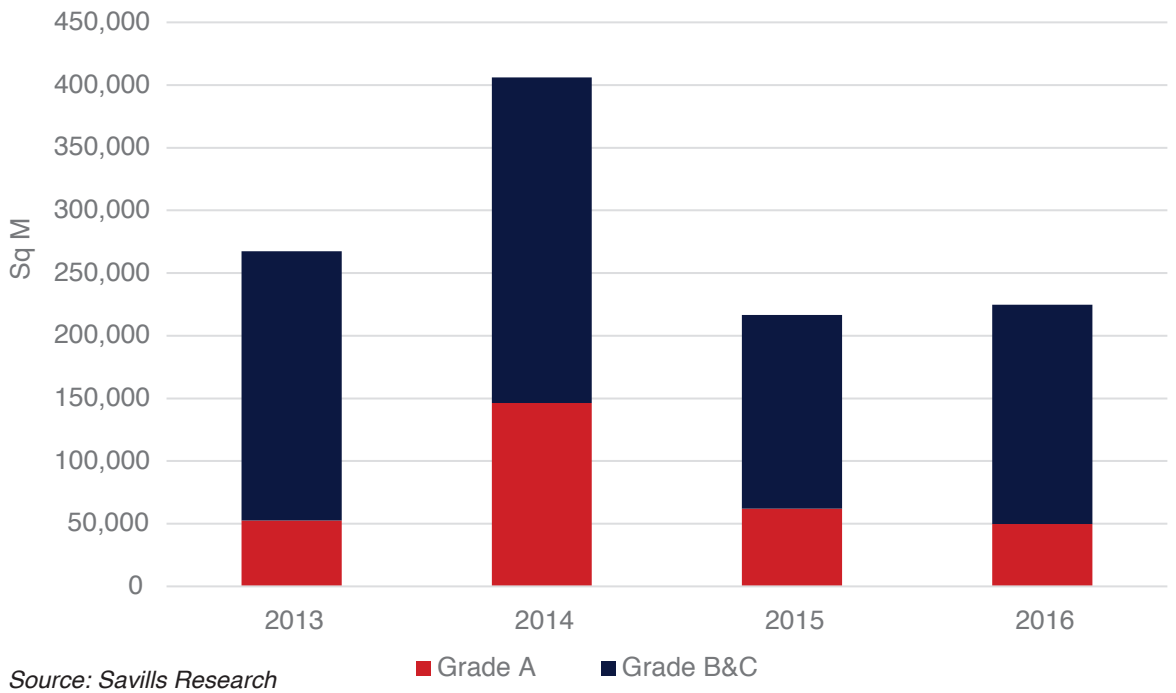
Source: Savills Research

Within Dublin, 87 office buildings were traded – eleven more than in 2015. Seventy six of these were modern purpose-built blocks which, in aggregate, accounted for almost 225,000 sq m of space. This brings the total of modern office space traded in Dublin since the beginning of 2013 to more than 1.1 million sq m – almost one-third of the total standing stock. Over 700,000 sq m of this has been within the Central Business District (CBD) meaning that 42% of all the purpose-built space in Dublin's prime business district has been traded in a hectic four year period.[1]

[1] Although, as noted below, this figure does include some buildings that were traded more than once during this period.

FIGURE 7

Dublin Office Investment Sales by Grade of Building



Source: Savills Research

Of the 76 modern office sales in Dublin last year, twelve were re-trades of assets bought earlier in the cycle. This brings to almost 30 the number of purpose-built Dublin offices that have been re-traded since the beginning of 2013, and most of these are now believed to be in the hands of longer-term owners. Given the increasingly stable ownership of prime properties, Grade A space has become harder to buy and accounted for a smaller share of the traded stock - 22% in 2016 compared with 29% in 2015 and 36% in 2014 (see Figure 7). This trend also reflects the aging profile of Dublin's office stock. While newly completed space is beginning to emerge, and some older buildings are being refurbished, 83% of Dublin's purpose-built office blocks are now more than ten years old. As a result, the average age of the purpose-built properties being sold has risen from 17.1 years in 2014 to 20.5 years in 2016.

One Spencer Dock – Sold by Savills in Q2 2016 for approx. €242m

TABLE 2

Summary of Dublin Modern Office Investment – 2016

Location	Asset Sales	Total sq.m.	Average sq.m.	Grade A (%)	Grade B (%)	Grade C (%)
Central Dublin	45	170,604	3,791	26	39	35
Suburbs	31	54,108	1,745	9	46	45
Total Dublin	76	224,712	2,957	22	41	37

As shown in Table 2, three-fifths of the modern offices traded in the capital last year were located in Central Dublin,[2] with just under half of these in Dublin 2 – the city's premier business address. The remaining 31 were located in the suburbs. Suburban activity was markedly up on 2015 due to four portfolio sales which together contained 16 suburban office assets – the majority of which were located in south east Dublin. However many of the suburban assets that traded were smaller buildings. Consequently the suburban share of total space traded fell from 26% in 2015 to 24% in 2016.

TABLE 3

Top 10 Office Deals – 2016

Property	Location	Sold	Size (sq.m.)	Price (€)
One Spencer Dock	Dublin 1	Q2	5,515	240,000,000
The Oval	Dublin 4	Q1	13,800	140,000,000
Project Kells	Dublin 2	Q2	7,664	93,000,000
LXV Buiding, St. Stephen's Green	Dublin 2	Q2	5,709	85,000,000
Wilton Park House	Dublin 2	Q4	12,356	62,300,000
Block B, Allianz Building	Dublin 4	Q2	9,322	57,000,000
Harbourmaster 2, IFSC	Dublin 1	Q4	5,667	53,745,000
Liffey Collection	Dublin 2	Q2	11,008	53,691,000
Central Quay, Silicon Docks	Dublin 2	Q1	5,500	51,300,000
Blocks 1,2 and 5 Clanwilliam Court	Dublin 2	Q2	8,723	51,000,000

Includes office buildings traded directly and as part of portfolios. Also includes mixed-use buildings with a significant office element.

8 Hanover Quay – Sold by Savills in Q1 2016 for approx. €32m

[2] Postcodes 1-4, 7 and 8.

Forward Funding

While standing investments represent the bulk of the mainstream market, forward funding arrangements which enable investors to acquire development assets are now re-emerging. There are several reasons for this. On the demand side, such structures enable core-plus investors to obtain better returns while avoiding most of the development risk. On the supply-side, while there are numerous proposed office schemes in Dublin, their promoters often lack funding to build them out. This has made the promoters of such schemes particularly receptive to forward funding transactions. The detailed structure of these arrangements varies from case-to-case but they generally conform to two common models;

Traditional Pre-Fund

- Developer owns site, obtains planning
- Investor buys site with up-front payment
- Investor funds developer to build-out the scheme
- Developer pays investor ongoing interest charge on development costs
- Developer completes and lets building, receives final payment from investor
- Investor retains income-producing investment
- Advantages for developer – Equity release from site holding. Can benefit from rent overage and developer profit
- Advantages for investor – Potential to acquire asset at slightly discounted yield. Interest payments generate cash flow from day one

Examples –

- The Exchange, IFSC; IPUT (investor) funding Cosgrave (developer).
- Vertium, Burlington Road; Union Investment (investor) funding Development Securities (now U+I), Colony Capital and Ronan Group (developers)

Forward Purchase

- Investor commits to buying a property, delivered to a particular specification by a certain date
- This contract enables developer to obtain funding if required
- Advantages for developer – De-risks future sale of an asset. Enables developer to action schemes that otherwise might not be fundable
- Advantages for investor – Potential to acquire an asset at a slightly discounted yield. Execution risk lies with developer. Particularly suitable when investor has a tenant already lined-up

Examples –

- Albert Quay, Cork; Green REIT (investor), John Cleary Developments (developer)

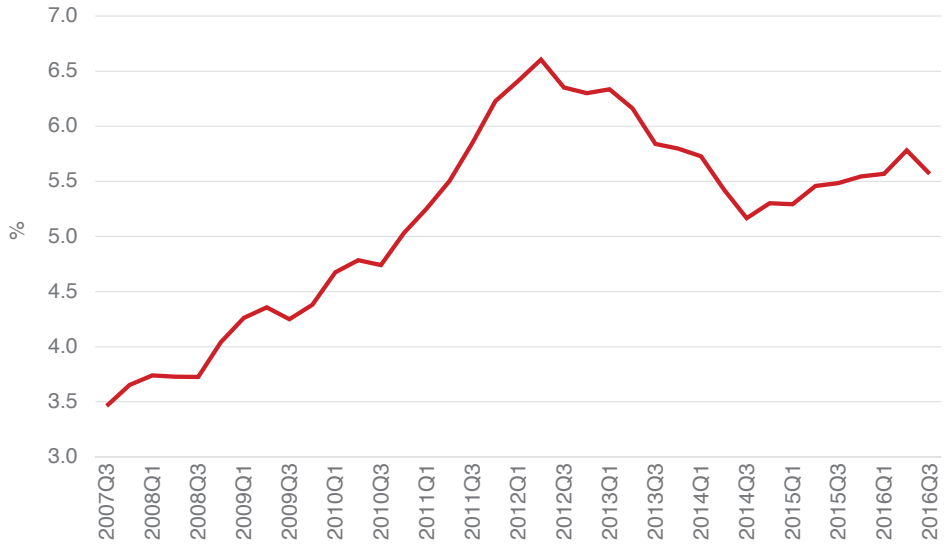
Multifamily

Based on an analysis of CSO data which Savills sourced by special request, there has been a 64.5% increase in the number of households renting privately in Dublin since Q1 2011. On one hand this reflects rapid population growth – Dublin's headcount is currently rising by 1.4% per annum. But it also reflects a tenure shift towards private renting due to owner-occupied housing in Dublin having become less affordable in recent years. This arises from a combination of house price inflation, more restrictive mortgage lending and sluggish incomes growth.

While the stock of privately rented units in Dublin has expanded by 45,600 this has not been enough to keep pace with the rise in demand. Consequently vacant units have been filled-up and the vacancy rate has been driven below 2%. Unsurprisingly this has fuelled strong rental growth – according to the latest Daft.ie report average rents in Dublin rose by 14.5% per annum in 2016. Strong rent inflation has, in turn, prevented residential yields from narrowing in the way that they have in other segments of the property market (see Figure 8).

FIGURE 8

Average Residential Property Yields – Dublin



Source: Savills Research based on PRTB, PTSB, CSO

These dynamics led to a steady flow of capital into the multifamily sector last year. As outlined above just under €260 million of multifamily assets were bought in 2016, accounting for 6% of total investment turnover by value. Including mixed use buildings with a substantial residential element, a total of 21 blocks traded.

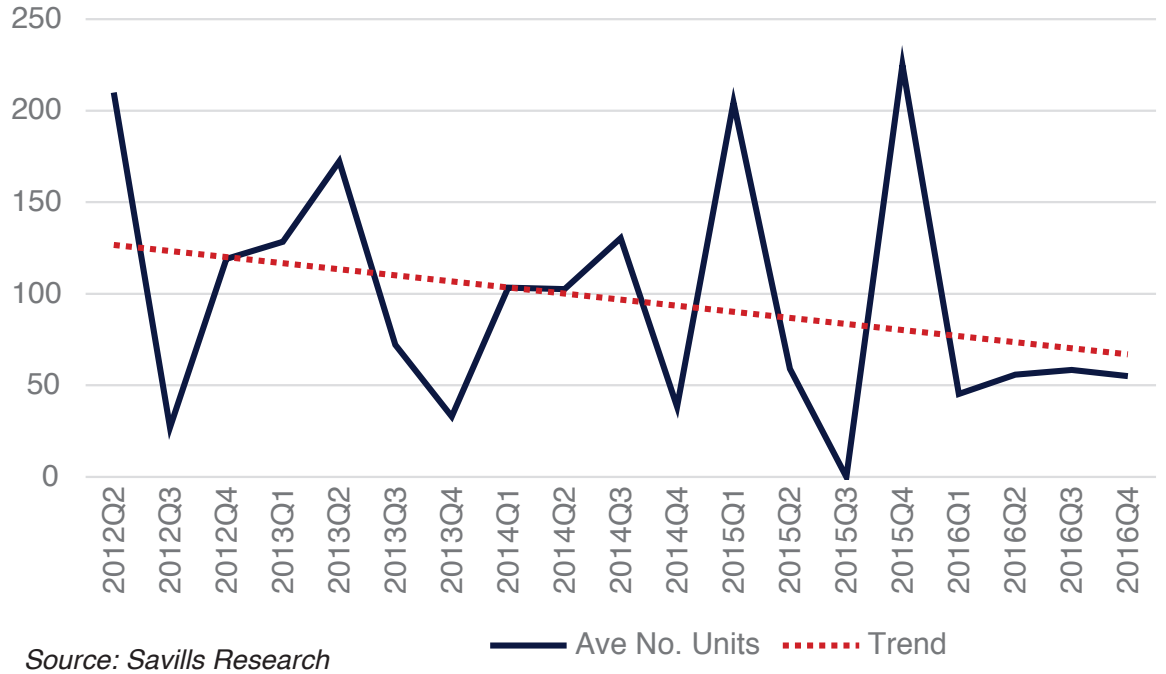
Although residential building activity is beginning to pick up it will clearly take some years before housing output reaches the levels required to match demand. This should help to underpin occupancy and rent levels in the Private Rented Sector (PRS) and means that investors continue to have a strong appetite for multifamily assets. However it is already evident that supply-side constraints are beginning to affect the market. Although the number of multifamily deals in 2016 was nearly twice the 2015 number, the average deal size fell from 116 units in 2015 to just 54 last year (see Figure 9). While investors would like to do bigger deals, fewer large blocks are now available than was the case back in 2014.

42-76 St. Augustine Street, Dublin 2.
Sold by Savills in Q1 2016 for approx. €25m

Coldcut Park, Clondalkin, Dublin 22. Sold off-market by Savills in Q3 2016 for approx. €18.3m

FIGURE 9

Average Number of Dwelling Units Per Multifamily Transaction

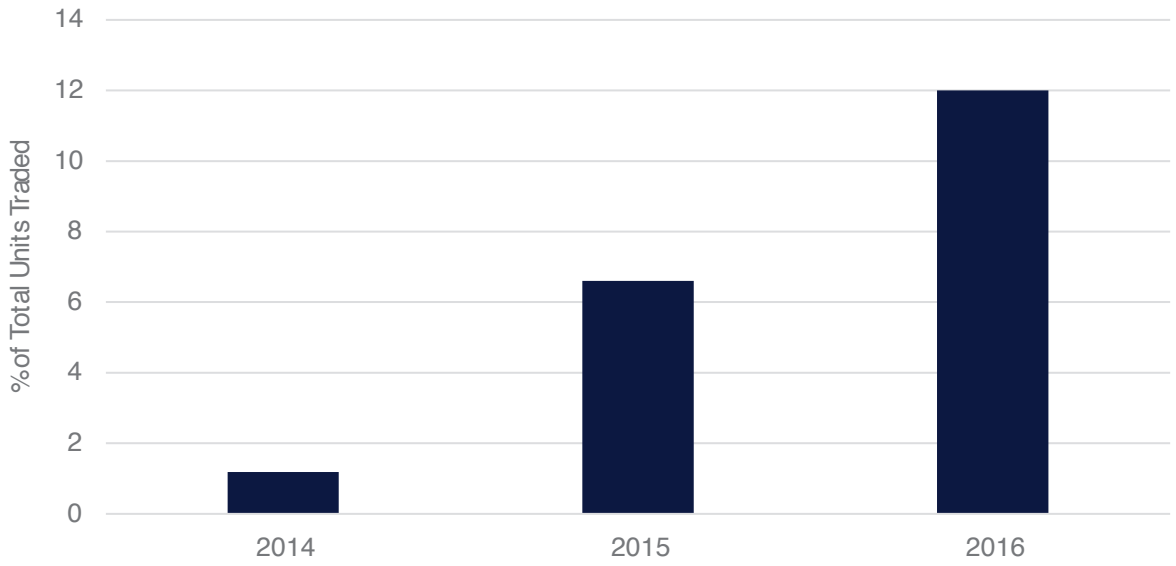


Source: Savills Research

Further evidence of supply-side constraints is seen in the fact that investors have become increasingly willing to look outside Dublin for multifamily opportunities as the availability of standing investments in the capital has diminished (Figure 10).

FIGURE 10

Ex-Dublin Share of Multifamilv Investment

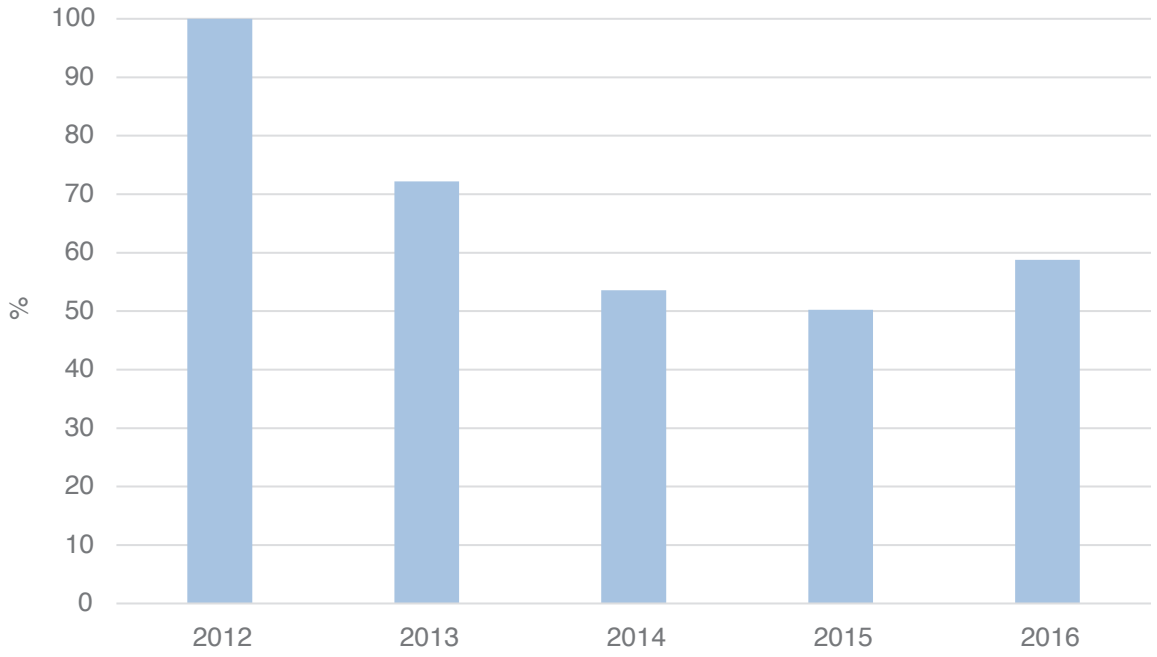


Source: Savills Research

Finally, as shown in Figure 11, investors in the multifamily space have also become more willing to settle for fractured ownership within schemes as the availability of blocks offering 100% ownership has dwindled.

FIGURE 11

Units Purchased as Percentage of Total in Scheme



Source: Savills Research

TABLE 4

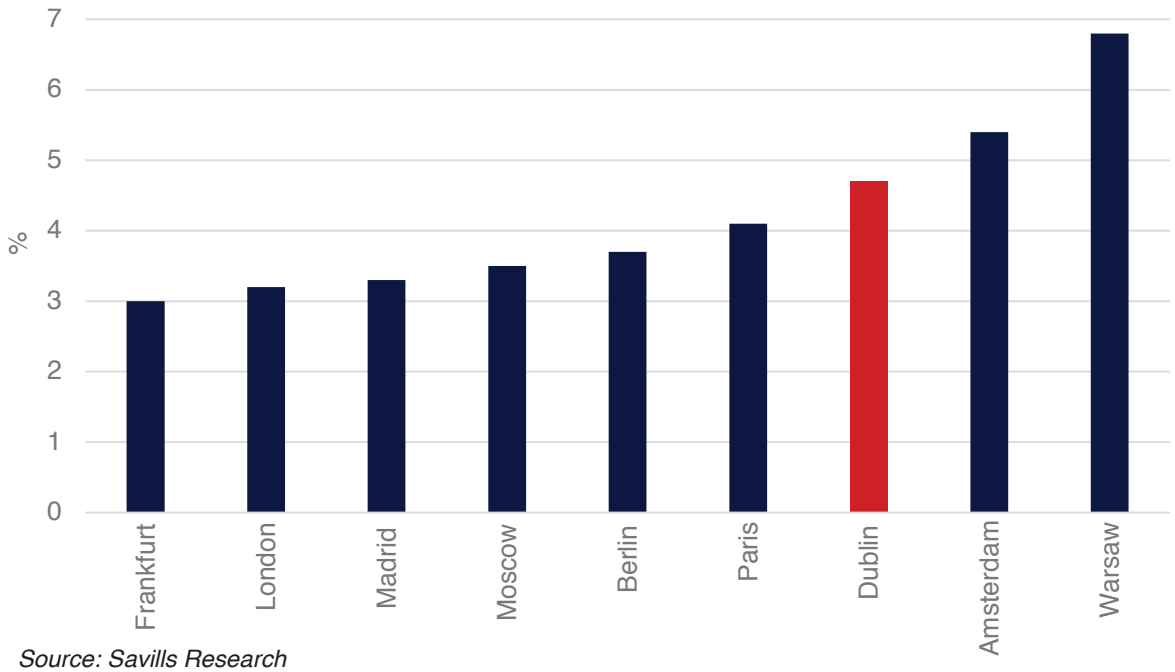
Top 10 Multifamily Deals in 2016

Property	Location	Sold	Price (€)	Units
Neptune Building, Dun Laoghaire	Co. Dublin	Q3	72,500,000	197
Elm Park Apartments, Merrion Road	Dublin 4	Q2	59,000,000	201
St. Edmunds, St. Lomans Road	Dublin 20	Q4	36,000,000	160
42-75 St. Augustine Street	Dublin 8	Q1	25,000,000	110
Coldcut Park, Clondalkin	Dublin 22	Q3	18,300,000	90
Abbey Glen, Cabinteely	Dublin 18	Q1	10,500,000	44
Xavier Court, Sherrard Street	Dublin 1	Q2	7,800,000	41
Robswall, Malahide	Co. Dublin	Q1	6,330,000	27
Stafford House, Wolfe Tone Street	Dublin 1	Q2	6,000,000	43
Belmont Court, Middle Gardiner Street	Dublin 1	Q1	3,060,000	18

As shown in Figure 12 the yield profile of prime residential property in Dublin looks favourable compared with other major European cities and this will continue to attract investors to the sector. However, given the increasing scarcity of opportunities to buy standing investments, more and more of this capital will flow into the market through design-and-build projects. The Government recently issued design guidelines which will facilitate development of build-to-rent apartment schemes,[3] and a number of parties are already developing these assets on their own lands. These include Kennedy Wilson Europe which is building at three locations – Capital Dock, Clancy Quay and The Vantage in Leopardstown. US company Hines is also proposing to develop build-to-rent product at nearby Cherrywood in Dublin 18. As an alternative to developing assets themselves investors will also find opportunities to deploy capital in this sector through forward commitment arrangements. The Neptune building in Honeypark, Dun Laoghaire provides a good example of this. This purpose-built block of 197 rental units was forward-purchased by SW3 Capital / Tristan Capital Partners for €72.5m in advance of construction and the delivered units are now being let on the market.

FIGURE 12

Prime Residential Yields in Major European Cities – Q4 2016



Source: Savills Research

Late last year the Government designated certain locations as Rent Pressure Zones and has limited rent increases in these areas to a maximum of 4% per annum for the next three years. With Dublin rents averaging €1,647 per month and prime multifamily blocks trading at yields of 4.5% our view is that this will not deter investors and we continue to see very strong appetite for this product.

[3] Department of Housing, Planning, Community and Local Government Circular PL11/2016, 19th October 2016.

Industrial

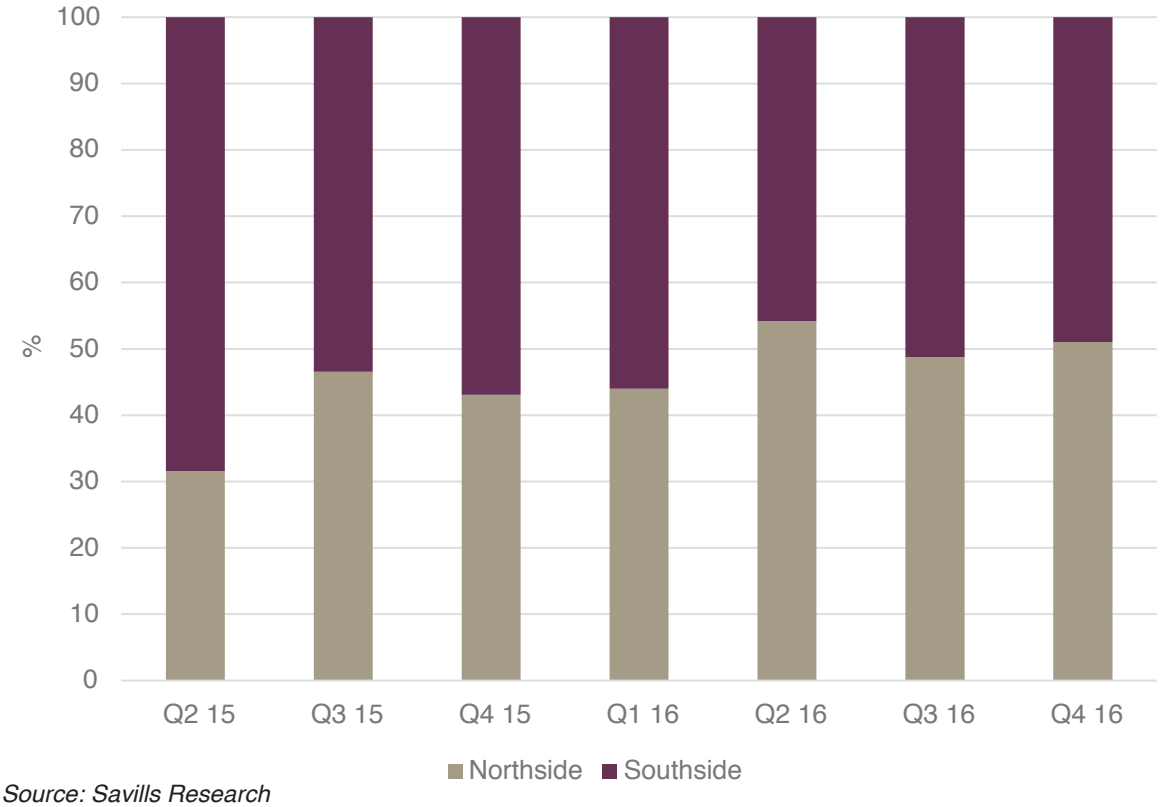
Industrial property has traditionally only accounted for a small share of the Irish investment market. However, investment in the sector rose by 53% in 2016 to €106m. There is currently a strong appetite among investors for industrial and logistics facilities. This reflects two factors. Firstly, relative to other real estate sectors and relative to bond rates, the yield profile is attractive; net initial yields in the MSCI basket of industrial properties currently stand at 6.7% compared with 4.3% for offices and 3.3% for Grafton Street shops. Secondly, there is an increasing awareness that logistics space, in particular, offers investors the opportunity to tap into the potential upside of e-commerce. As goods are increasingly traded on-line occupational demand for logistics property is likely to follow a rising path. While industrial is firmly on many investors' buy-lists, sourcing good quality product from within the standing investment stock is a challenge. Much of the older space that is available does not conform to current standards in terms of eaves height, loading facilities etc.. However developers are now speculatively developing industrial property in North Dublin – a location that occupiers are increasingly being drawn to because of access to major road infrastructure, the Port Tunnel and Dublin Airport (see Figure 13). This will provide good investment opportunities. In addition, where good quality covenants are in place, sale-and-leaseback opportunities will be a possibility. It is also possible that institutional money could flow into industrial development assets over time.

Rohan Holdings to spec build 7,000 sq m at Dublin Airport Logistics Park in 2017

Kuehne & Nagel facility, Turvey Business Park, sold by Savills in Q2 2016

FIGURE 13

Industrial Take-Up by Location



Source: Savills Research

Investment by Buyer Type

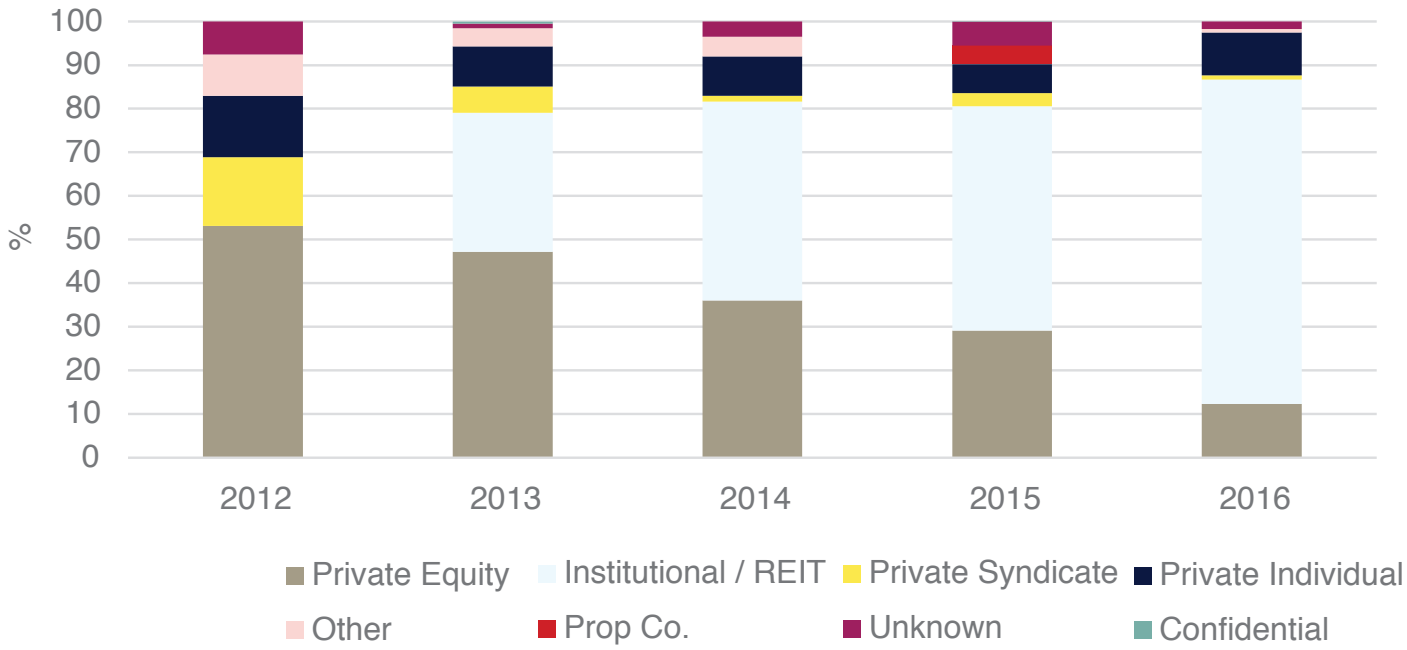
Last year we highlighted how Ireland's economic recovery has re-established the country as an investable core market, and the impact of this in driving down yields. As yields have compressed the profile of buyers in the market has inevitably changed. Private equity players with higher funding costs have become less active and have had to look elsewhere for higher returns.

These trends continued in 2016. Private equity (PE) buyers have fallen from 53% of turnover value in 2012 to just 12% in 2016. While PE was on the buy-side of two €50m plus deals in 2016, as general rule this source of capital is now more focused on mid-priced assets yielding higher returns. For example private equity accounted for 67.5% of the spending on neighbourhood shopping investments last year and 24.3% of the spend on offices outside Dublin's CBD.

Meanwhile, however, the positive income story has continued to attract long-term institutional buyers who are happy to pay lower yields for prime assets. The institutional share of market turnover has risen from nil in 2012 to 74% last year and institutions and REITs were behind nine of the top 10 deals in 2016.

FIGURE 14

Investment Turnover by Buyer Type



Source: Savills Research

One other notable trend has been the virtual elimination of private syndicates as buyers in the market. This group accounted for almost 16% of turnover in 2012 but its share has gradually fallen to just under 1% in 2016. The most likely explanation for this is the emergence of the Irish REITs following enabling legislation in 2013. By providing a straightforward and liquid means of investing in Irish property assets these structures have largely replaced syndicates as a vehicle of choice for small investors in the market.

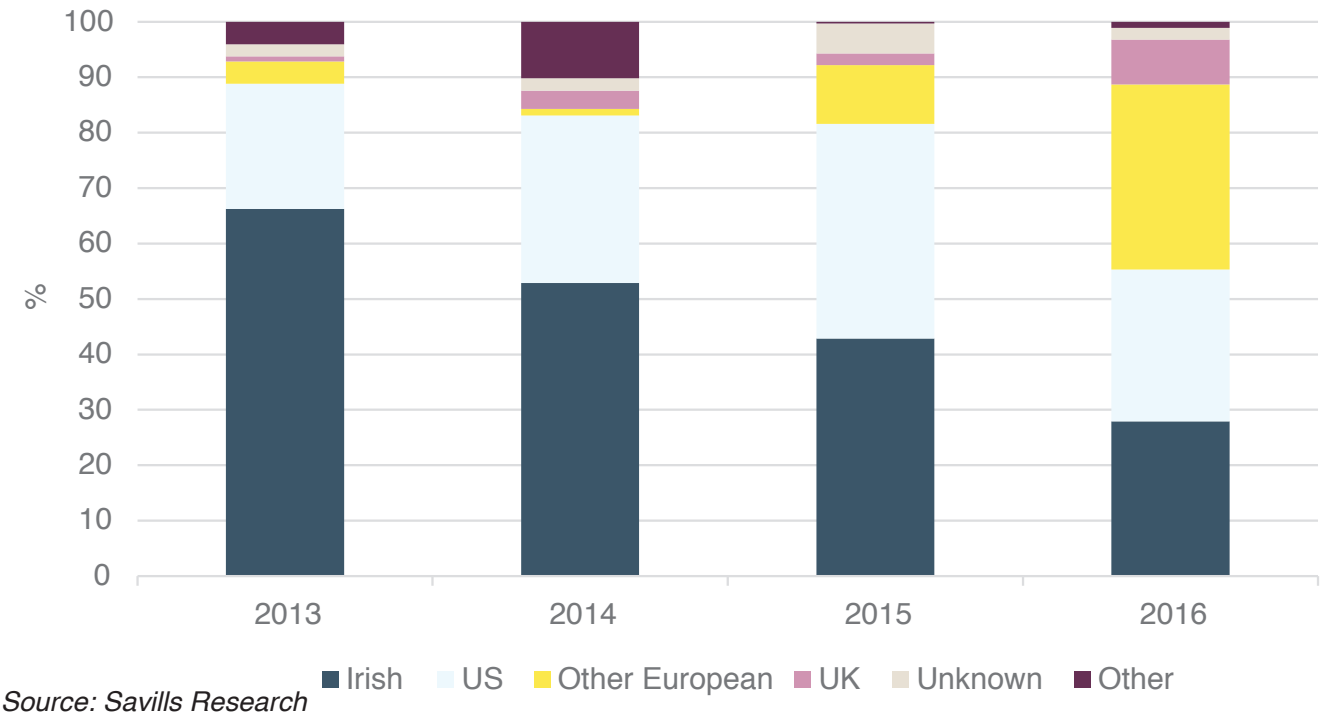
Investment by Buyer Nationality

As perceptions of risk around the Irish economy have receded the investment market has become increasingly international. US buyers have been active since the early stages of the recovery and have maintained a relatively consistent one to two-fifths share of the overall annual spend. Unsurprisingly however, given the discussion above, the profile of these investors has evolved over time. Whereas all of the American investment in 2012 came from private equity buyers, 81% of the US investment in 2016 was by institutions.

The other obvious trend that can clearly be seen in Figure 15 is that a reduced domestic share of investment is being offset by a sharp increase in spending by investors from other parts of Europe (excluding the UK). Whereas this group accounted for only 4% of turnover in 2013 its share has risen to one third of the market in 2016 and, in total, investors from continental Europe spent almost €1.5bn on income producing Irish property assets last year. The vast majority of this capital (94%) came from REITs and institutions such as pension funds.

FIGURE 15

Investment Turnover by Buyer Nationality

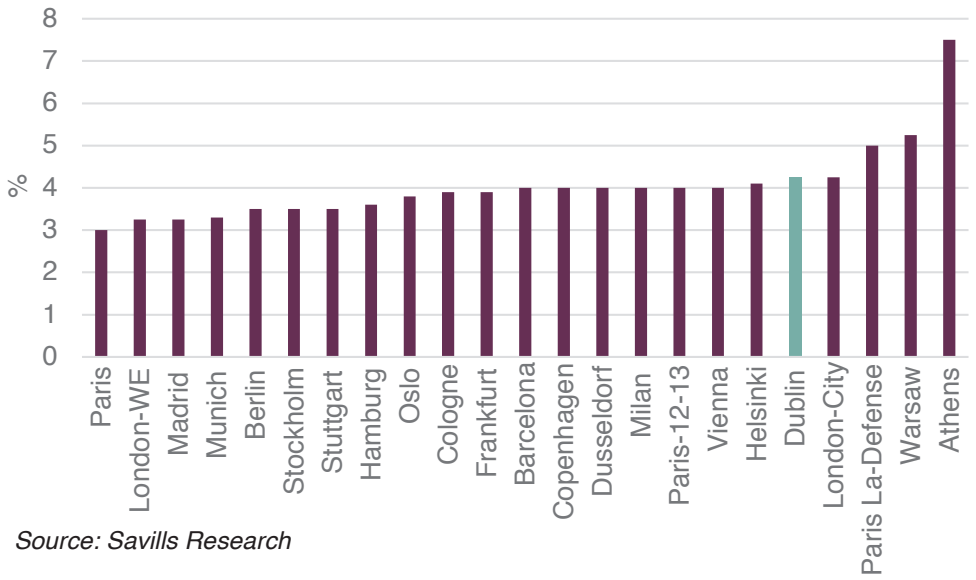


Source: Savills Research

Consistent with this three of the top five deals in 2016 were accounted for by European institutions. Liffey Valley Shopping Centre was purchased by German pension fund BVK for €630m, while two additional German investment houses, DEKA and Patrizia, acquired Whitewater Shopping Centre for €180m and The Oval office block in Dublin's Ballsbridge for €140m respectively. The increase in investment activity by European institutions may reflect several factors. On one hand there are the general attractions which make Ireland a target for international capital. These include positive fundamentals in the occupier markets and a still relatively attractive yield profile (see Figure 16 (a) 16 (b)). In addition, since the result of Britain's EU Referendum, some European funds have shifted portfolio allocations from the UK to the rest of the EU and the Irish market is benefiting from this.

FIGURE 16 (a)

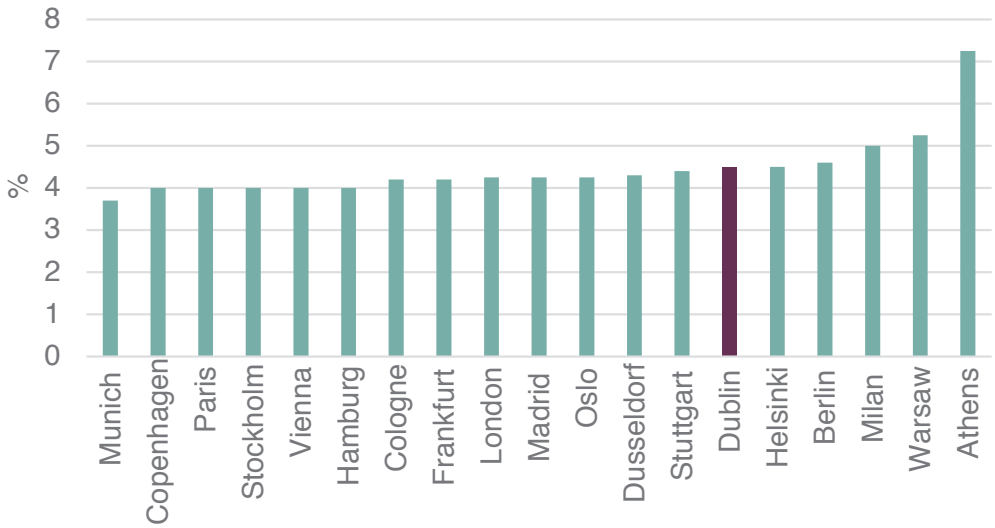
Figure 16a Prime Office Yields in Europe - Q4 2016



Source: Savills Research

FIGURE 16 (b)

Figure 16b Prime Shopping Centre Yields in Europe - Q4 2016



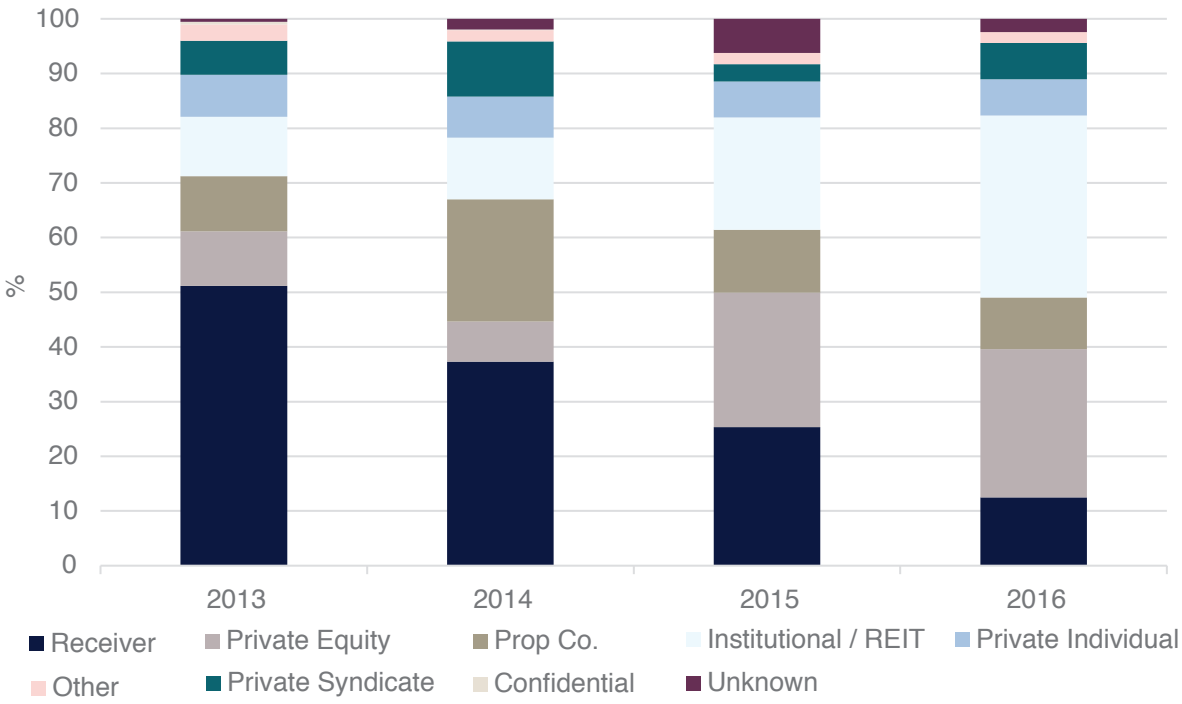
Source: Savills Research

Turnover by Seller Type

With the majority of prime assets once held on the balance sheets of NAMA and major credit institutions having already transferred to the hands of investors, an important source of liquidity in the Irish investment market through the earlier stage of the cycle is disappearing. Reflecting this, only one receivership sale – One Spencer Dock – traded within the €50m plus category last year, and the share of turnover accounted for by receivership sales has continued to fall (see Figure 17).

FIGURE 17

Investment Turnover by Seller Type



Source: Savills Research

However, while this source of liquidly is evaporating, another has been emerging. Many of the PE players which moved quickly to buy destressed property assets and loans at the early stages of the recovery are now seeking an exit and re-trading properties into the hands of their longer term institutional owners. In net terms private equity divested €660m from the Irish market last year.

While institutional sales accounted for one third of investment turnover last year, more than 85% ended up back in the hands of other institutional buyers. This included the sale of Blanchardstown Town Centre by Green Property to Blackstone for €950m.

The Neptune Building, Honeypark, Dun Laoghaire. Purpose-built residential investment forward purchased by SW3 Captial / Tristan Capital Partners for €72.5m

Summary and Outlook

Several themes have clearly emerged in the market over the last 18 months. First and foremost, there is no shortage of demand for Irish property assets. Even adjusting for loan sales and outliers, 2016 was another very active year in the market with almost €4.5bn of assets being purchased. This reflects several factors. At a global level the low interest rate environment is continuing to drive money into higher yielding assets, including real estate. Ireland remains a particularly attractive target for this capital for two reasons. Firstly, the fundamentals of the occupational markets are quite compelling. With a rapidly growing economy demand for both business space and professionally managed residential housing is strong. At the same time, in the post Global Financial Crisis economy, development funders have become extremely selective. This has ensured that the supply-side response to this underlying demand has been well contained. Inevitably the combination of strong demand and measured supply has driven up rents and led to expectations of further rental growth.

Secondly, capitalisation rates on Irish prime real estate investments remain attractive relative to competing markets. Prime office and retail yields have halved since the cyclical low point in 2012 due to monetary liquidity, falling bond rates and expectations of rental growth. Nonetheless at current levels yields remain highly competitive with other core European locations.

While the demand for Irish property investments remains robust a second clear theme to emerge is that the opportunities to buy standing investments have contracted. Large-scale deleveraging in the aftermath of a deep economic crisis has led to forty-two percent of Dublin's CBD office space being traded over the last four years. Similarly the majority of major Shopping Centres in-and-around the city have been sold in the current cycle. Obviously this cannot continue indefinitely - mass deleveraging is drawing to an end and many of the assets that have been traded are now in the hands of long-term investors.

Nonetheless there will continue to be opportunities for investors to buy re-trades of stock that was picked-up by short-term money earlier in the cycle. Investors will also have opportunities to buy speculatively developed properties, particularly in the Dublin office sector. And some institutions will continue to develop their own future investment assets. Prefunds and forward-purchase arrangements will also continue to feature and will provide additional opportunities for investors to access the market. Nonetheless we expect that supply constraints will see trading settle at more normalised levels of €2.5bn-€3.5bn per annum over the coming years.

With yields for prime offices and retail having narrowed, industrial property is on many investors' buy lists. This will continue and, where opportunities arise, we expect to see competitive bidding. Multifamily residential is also a hot sector. Given current yields, and the attractions of stable income and diversified tenant risk, investors have not been deterred by legislation which limits rental growth within designated areas to a maximum of 4% per annum until 2019.

It is clear that the era of ultra-low interest rates which have driven capital into property is coming to an end. In the long run property and bond yields are positively correlated so, ultimately, this can be expected to have an impact on asset pricing. However, given expectations of further rental growth across-the-board in 2017 and 2018, our view is that pricing for Irish commercial property assets will remain well underpinned for the foreseeable future.

APPENDIX 1

Prime Yields By Sector, Current and Outlook

	%	Dec 2017
Office	4.25	↔
Retail H/S	3.50	↔
Industrial	5.75	↔
Residential	4.50	↔

Navan Town Centre – Guiding €62m

Fairgreen Shopping Centre, Mullingar – Guiding €11.5m

Supervalu, Castlestreet Shopping Centre, Bray – Guiding €8.4m

Grange Clinic, Donaghmede – Guiding €3m

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