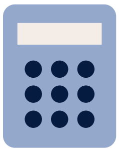
Savills Research – Q3 2021

MARKET IN MINUTES
Savills Research

Ireland Investment Market

Macro view • Investment flows • Sectoral analysis



0.02%
Irish ten-year bond yield at end of Q3, in-line with France

€793m
transacted in Q3, €3.5bn year-to-date

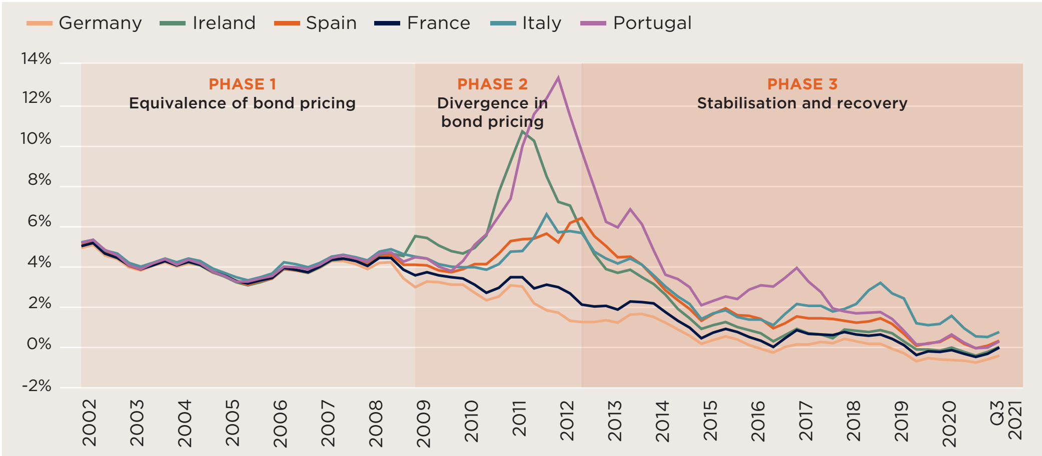
64%
of volumes was by institutional capital

48%
of volumes were executed by European buyers

Macro view

Ireland's property risk premium looks elevated compared to European peers, suggesting relative value on that basis.

Figure 1: 10-year bond yields



Source: Eurostat

Background

The yield spread of a country's real estate over the pricing of its sovereign debt is a key valuation metric. In this macro view, we argue that Ireland represents good value when compared against other European countries when viewed through this lens.

In order to understand the pricing of Irish government debt, we must examine the dynamics of European government debt since the introduction of the euro in 2002. As illustrated in Figure 1, the European sovereign bond market has experienced three distinct phases:

Phase 1 (Q1 2002 - Q4 2008)
Equivalence of bond pricing

During the early stages of the eurozone, there was great confidence in the stability of the new common currency, such that the perceived risk of sovereign debt default was low and believed to be broadly similar across nations. As a result, government debt issued by different countries was effectively priced as equivalent with only a minor spread differential existing between countries.

As we can see from Table 1, changes in bond yields across countries were highly correlated between 2002 and 2008. Where 1.00 is perfect correlation, Ireland exhibited 0.99 correlation with Italy and Portugal, 0.97 with France and 0.94 with Germany.

Phase 2 (Q1 2009 - Q2 2012)
Divergence in bond pricing

This quiet confidence in the eurozone lasted just six years and was broken by the Global Financial Crisis (GFC). As the crisis shook investor confidence in the eurozone project, bond yields uncoupled to reflect the relative risk of sovereign default by country.

During this time, Irish government debt ballooned from 24% of GDP before the crisis to 120% following the nationalisation of much of the banking sector. This caused Irish bond yields to spike along with other countries with similarly challenging debt outlooks – such as Italy and Portugal – while Germany and France saw their yields compress due to their status as safe havens.

Table 1: Bond correlations showing equivalence of pricing between Q1 2002-Q4 2008

	Ireland	Germany	France	Italy	Portugal
Ireland	1.00	0.94	0.97	0.99	0.99
Germany	0.94	1.00	0.99	0.94	0.96
France	0.97	0.99	1.00	0.97	0.99
Italy	0.99	0.94	0.97	1.00	0.99
Portugal	0.99	0.96	0.99	0.99	1.00

Source: Eurostat, Savills Research

Table 2: Bond correlations showing divergence in pricing between Q1 2009-Q2 2012

	Ireland	Germany	France	Italy	Portugal
Ireland	1.00	-0.30	-0.20	0.58	0.72
Germany	-0.30	1.00	0.85	-0.73	-0.81
France	-0.20	0.85	1.00	-0.33	-0.54
Italy	0.58	-0.73	-0.33	1.00	0.90
Portugal	0.72	-0.81	-0.54	0.90	1.00

Source: Eurostat, Savills Research

Putting this in quantitative terms, Irish government debt had a correlation of 0.72 and 0.58 with Portugal and Italy but a correlation of -0.20 with France and -0.30 with Germany. The latter negative correlation indicating that Irish bonds moved in an opposite direction to Germany and France during this period.

Phase 3 (Q3 2012 - now)
Stabilisation and recovery

The restoration of confidence in European bond markets can be traced to the aggressive interventions made by the European Central Bank. There was an initial stabilisation stage which started with the then ECB chief Mario Draghi's 'Bazooka' speech in the summer of 2012, in which he vowed to do 'whatever it takes' to ensure the survival of the euro. This transition phase lasted until the quantitative easing (QE) programme commenced in Q1 2015, which marked the start of the true recovery phase of the eurozone area.

Since QE started in Q1 2015, Ireland's sovereign debt has progressively moved away from peripheral European countries and become more aligned with the European core. This movement reflects Ireland's success – compared to Italy and Portugal – in achieving fiscal consolidation and strong economic growth, improving its sovereign risk profile. As we can see from Table 3, Irish government bond yields have exhibited a very strong correlation of 0.96 with both Germany and France over this period, but just 0.66 and 0.80 with Italy and Portugal respectively.

0.02%
yield on 10-year Irish government debt at the end of Q3

Ireland's economic performance through the pandemic has further enhanced its reputation. While Ireland had performed strongly since the broad European recovery phase started, there was lingering skepticism as to how the economy would perform in the event of an economic shock. During the pandemic, Ireland's economy continued to be the best performing in Europe, recording a budget deficit of 2.4% in 2020 and a forecast of 3.1% for 2021. Compare this with Italy's budget deficit for example, where the corresponding figures are 9.5% and 10.0% respectively. As a result of this robust performance, the yield on Irish Government debt at the end of Q3 was 0.02%, in-line with France (0.02%), and well below Italy (0.87%) and Portugal (0.36%).

Table 3: Bond correlations showing Ireland's movement with European core since QE started in Q1 2015

	Ireland	Germany	France	Italy	Portugal
Ireland	1.00	0.96	0.96	0.66	0.80
Germany	0.96	1.00	0.98	0.63	0.76
France	0.96	0.98	1.00	0.66	0.80
Italy	0.66	0.63	0.69	1.00	0.45
Portugal	0.80	0.76	0.80	0.45	1.00

Source: Eurostat, Savills Research

> "The restoration of confidence in European bond markets can be traced to the aggressive interventions made by the European Central Bank."

Figure 2: Office versus bond yields

Source: Eurostat, Savills Research

Real estate pricing

However, despite Ireland's acknowledged macroeconomic stability and fiscal responsibility – which has been captured in the bond market pricing – property yields have failed to evolve in tandem. When looking at property yields in comparison with bond yields, the risk premium offered by Dublin real estate is higher than many cities on the continent. This suggests there are opportunities for better returns in Irish property, or is it the case that investors require these returns to compensate for a perceived greater risk. Which view is more justified?

Looking at the office market in the capital cities of each of the countries just discussed, we can see that Dublin has the highest spread at 398 bps, given a prevailing Q3 office yield of 4.00% and ten-year bond yield of 0.02%. While Berlin has the tightest office yield at 2.40%, its spread over the ten-year bond rate of -0.2% offers better value at 260 bps when compared against Milan, which has a spread of just 214 bps, given its office yield of 3.00% and a bond yield of 0.86%. Lisbon has the nearest spread at 364 bps, but is still 34 bps below Dublin.

Point Square, North Docks, Dublin 1, mixed-use office and retail building with a guide price of €75m

When looking at current spreads, we must also look at the historical trends to compare the present with past performance. Table 4 provides a summary of these bullet points:

1. It is interesting that office yields for all the cities under examination are at all-time lows except for Dublin, which is still trading 25 bps above its previous low of 3.75% recorded just before the GFC.

2. It is perhaps more useful to examine changes in yields over the last five years, the period where we have already showed how Ireland moved towards a core European country in sovereign debt pricing terms. Despite seeing bond yields come in significantly, Dublin office yields contracted by just 25 bps, well below all the other cities under examination. For example, Berlin contracted by 130 bps while Lisbon contracted by 125 bps.

3. In terms of relative percentage movement, the movement from 4.25% to 4.00% represented a contraction of just 6% for Dublin, but Berlin's and Milan's changes were 35% and 25% respectively. Even Paris' contraction of 40 bps represented a relative change of 13%, or double that of Dublin.

4. Looking at the relative spread of Dublin's office yield over its bond yield gives an indication of its risk premium. Currently, that risk premium stands at 398 bps, which is close to its all-time high of 425 bps recorded in Q4 2020 when Irish government bonds yields were -0.25%. In contrast, the other cities under consideration saw their risk premium at its largest between Q4 2014 and Q1 2015 and have substantially contracted since then, with Berlin and Milan's office yields both contracting by over 100 bps or four times that of Dublin. In other words, while office yields reacted to the new pricing situation in Europe as quantitative easing began in Q1 2015 driving down government yields, this never really occurred in Dublin.

5. Lastly, looking at the correlation of returns shows that Dublin has had a weak relationship with government bond movements of just 0.44 over the last five years, as bond yields moved towards the European core but Dublin offices did not. This is in contrast to Lisbon, (0.91) Berlin (0.86), Paris (0.82) – and to a lesser extent Milan (0.70) – which exhibited a strong correlation between movement in office and bond yields.

Table 4: Various relative valuation metrics

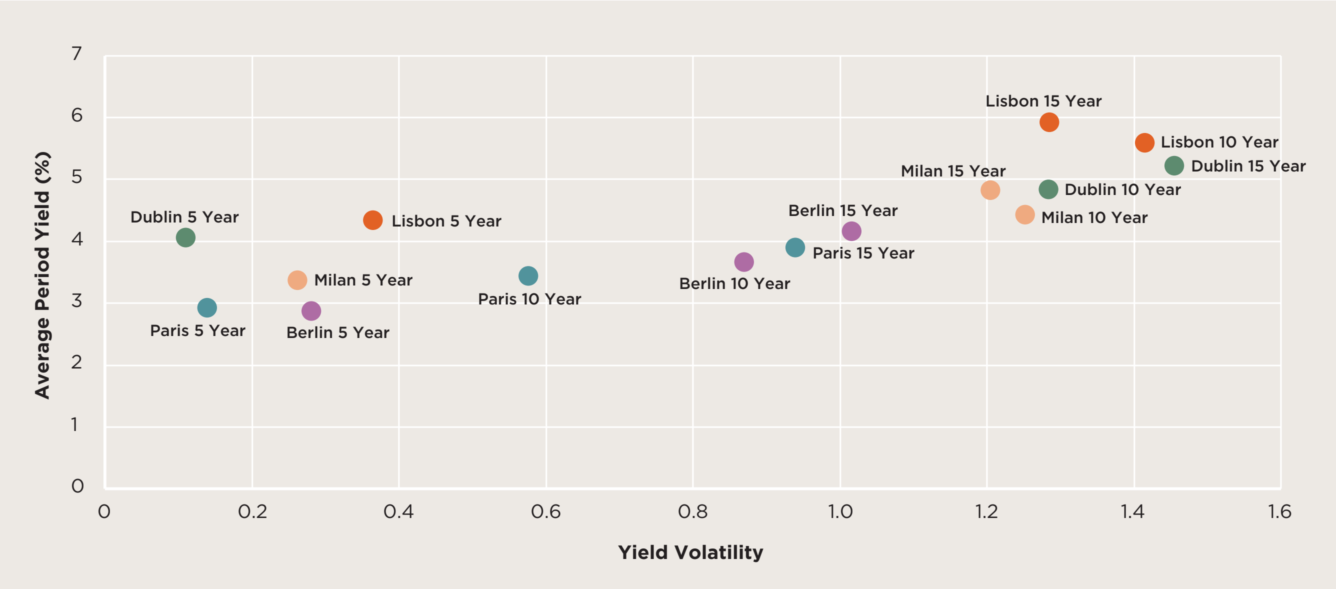
Bullet point legend		1	2	3	4				5
	Current office yield	When lowest yield achieved	Absolute change in yields in the last five years	Relative change in yield over the last five years	Current spead over bond	Max spread	Date of max spread	Current difference between now and max spread	Correlation of office and bond yield changes (last five years)
Dublin	4.00%	Q1 2009	-25 bps	-6%	398 bps	425 bps	Q4 2020	-27 bps	0.44
Berlin	2.40%	now	-130 bps	-35%	260 bps	389 bps	Q1 2015	-129 bps	0.86
Paris	2.60%	now	-40 bps	-13%	258 bps	316 bps	Q1 2015	-58 bps	0.82
Milan	3.00%	now	-100 bps	-25%	214 bps	337 bps	Q4 2014	-124 bps	0.70
Lisbon	4.00%	now	-125 bps	-24%	364 bps	432 bps	Q1 2015	-68 bps	0.91

> **"Despite seeing bond yields come in significantly, Dublin office yields contracted by just 25 bps, well below all the other cities under examination."**

Why haven't office yields contracted?

The persistence of the valuation discount in Dublin offices compared to its European peers is unusual. It may be explained by historical yield volatility, with the severity of the downturn during the last cycle still impacting current valuations. If we look at Figure 3, we see that over the last 15 years, the Dublin office market has had higher volatility than any of the other markets examined. As a result, investors may still be factoring this into their current valuations. It is also worth noting that Dublin has transitioned to having the lowest volatility over the past five years. Whilst the true risk and volatility of a market is not necessarily seen in a five-year window, but throughout the entirety of an economic cycle, this fall in volatility does correspond with a perception that the market is maturing and becoming evermore appealing to foreign institutional capital. During 2020 and 2021, non-Irish European buyers accounted for 50% of total investment transaction volumes, significantly up from the 22% average witnessed over the preceding five years.

Figure 3: Return – volatility performance



Source: Savills Research

> **The persistence of the valuation discount in Dublin offices compared to its European peers is unusual.**

Macro view outlook

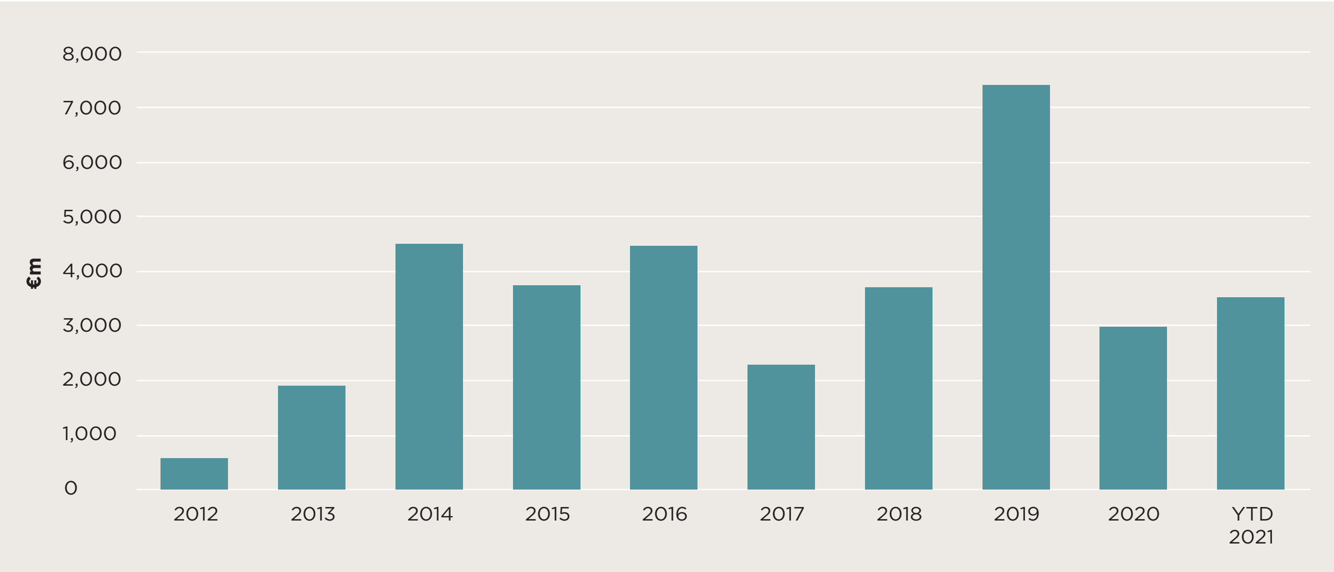
The downward pressure on bond yields has highlighted the spread available on Irish property. The Irish market is becoming less volatile and increasingly attractive to foreign investors. This could translate into further downward pressure on property yields.

Dublin's office market still appears to be paying for the severity of its downturn during the last cycle. In this respect, the robustness with which the Dublin office market has withstood the major market shock brought by the pandemic should help change perceptions. Ireland has been the best performing economy in Europe during the pandemic, largely driven by the multinational sector, including the tech companies that drive Dublin's office market. The covenant of Dublin's underlying office tenant base has substantially improved during the pandemic due to its exposure to the tech sector, with the market value of the largest of these firms doubling since the pandemic hit in Q1 2020.

Based on past performance, investors have held a relative valuation discount for Dublin offices due to the uncertainty of how it would perform during a downcycle. The robustness of Ireland's economy and the Dublin office market through the pandemic should offer evidence that the persistence of such valuation discounts are not warranted based on recent evidence.

Investment flows

Figure 4: Investment volumes



Source: Savills Research

€793m transacted in the Irish market in Q3 2021, 25% higher than the five-year average. There are encouraging signs that investors are starting to have more clarity on the post-pandemic world as government restrictions continue to loosen. Total investment for the year-to-date is €3.5bn, 15% above where 2019's record-breaking year was at this point. Full-year volumes are unlikely to surpass 2019 levels, however, as the final quarter of 2019 saw the sale of Green REIT, which boosted volumes considerably. In sum, we expect to see year-end totals between €4.75bn and €5.25bn in 2021, the second strongest year this cycle.

> **€793m transacted in the Irish market in Q3 2021, 25% higher than the five-year average.**

Primark Distribution Centre, Newbridge, Kildare

PRS market

The PRS market continued to take the lion's share of investment volumes in Q3 2021 with €414m transacting, equating to 52% of the total investment volumes. The PRS market also accounted for three of the top five largest deals in the quarter, the largest of which was a confidential deal for a PRS asset in West Dublin. The second-largest deal was Urbeo's forward purchase of 211 units in Clonsilla for €73m. The scheme is due for completion in 2022 and will be nZEB (nearly Zero Energy Building) rated, indicative of a growing trend in the PRS and wider real estate market.

Hines' €63.5m purchase of 110 apartments in Rostrevor Place, from Cairn PLC, was the third-largest residential transaction. This prime asset which is close to completion received a number of bids from interested parties and ultimately traded at a tight yield. The rents achieved are expected to be strong given the project's location in Rathgar, a short distance from Darty Park and Milltown Golf Club. This transaction was undertaken for placement in the Hines European Core Fund, demonstrating a strong commitment to the city from this large Pan-European focused fund after their completion of the Chatham & King mixed-use scheme in July.

€414m

the PRS market accounted for three of the top five largest deals in the quarter and accounted for 52% of total investment volumes

By providing security of exit through forward commit and forward fund structures, the private rented sector continues to be the primary market mechanism for delivering much needed new residential supply. Especially in times of construction inflationary pressures, these deal structures provide clarity for developers and yield benefits for investors. This quarter 79% of units sold used these structures.

One notable smaller transaction was M&G's social housing purchase of the Butter Yard in Blackrock which traded for a net initial yield of 3.6%. Whilst the market for social housing product is relatively new, the security and stability of the income stream is resulting in assets with these leases in place to trade at tighter yields compared to the PRS market.

Table 5: Top PRS deals

Property	Price	Vendor	Buyer
Confidential - West Dublin	€110.0m	P&C	P&C
Windmill Scheme, Clonsilla, Dublin 15	€73.0m	Kimpton Vale	Urbeo
Rostrevor Place, Orwell Road, Rathgar, Dublin 6	€63.5m	Cairn PLC	Hines European Core Fund

Butter Yard, Blackrock, South Dublin, acquired for €32.5m

Retail market

The retail sector accounted for €110m in investments in the third quarter, equivalent to 14% of all volumes, the first time it's accounted for more than 10% of sales since the first quarter of 2019. There's growing interest in this sector as there appears to be a recent shift in perception and sentiment. The acquisition of Nutgrove Retail Park by German fund AM alpha for in excess of €66m, is the first major retail park to trade in Dublin since the sale of The Park, Carrickmines in Q4 2018. AM alpha have recently expanded their focus to include retail, having transacted on Northside Shopping Centre in November 2019. Historically they've been active in Dublin's prime office market, but we're increasingly seeing investors look to retail due to the favourable income-risk profile this sector is presently offering.

Meanwhile in the core market, the sale of 26/27 Grafton Street to Deka is a clear indication that institutional funds with a longer-term focus have also started to view Irish high street retail as an attractive proposition once again. This modern asset's strategic location at the corner of Grafton Street and Lemon Street, combined with its favourable WAULT helped mitigate short-term risk whilst providing a strong passing yield with future rental growth potential.

€110m

of investments completed in the retail market in Q3, equivalent to 14% of total volumes

Table 6: Top retail deals

Property	Price	Vendor	Buyer
Nutgrove Retail Park, Rathfarnham, Dublin 14	€66.3m	Davidson Kempner	AM alpha
26/27 Grafton Street, Dublin 2	€25.4m	Aviva	DEKA
Bridgewater Shopping Centre, Ferrybank, Arklow, Co. Wicklow	€18.2m	Goldman Sachs	Urban Green Private

"There's a growing interest in this sector as there appears to be a recent shift in perception of these assets."

The Parks Collection, a portfolio of three established retail parks with a guide price of €78m

Office market

In the office market, there has been a greater movement back to the office, even if a full return has been pushed back to spring of next year. While the €127m worth of offices transacted in Q3 is down on the Q2 and Q1 figures, sentiment in the sector is improving which should see deal flow pick-up over the next six months.

The largest office deal of the quarter was Block 1, Ballsbridge Park in Dublin 4. Core Capital paid Eircom Pension Fund €32m representing a NIY of 5.4%. The second-largest deal of the quarter was Block A & B, Parkgate Business Centre, Dublin 8 which traded for a NIY of 4.95% as Union Investment purchased the asset from Blackstone for €24m. Meanwhile, French investor Sofidy completed their first acquisition in Dublin with the purchase of 76-78 Harcourt Street from Henderson Park. This highlights that new international investors are looking at the sector because of the strong tenant base and yield opportunity in Dublin, as emphasized in the macro view above. The office sector has seen its share of overall investment eroded to 16% in Q3. The office market's investment share has been impacted by the strong growth in the PRS sector and the uncertainty surrounding the full return to the office. Prime yields however, remain at 4.00% but could tighten further as discussed in the macro view.

Table 7: Top office deals

Property	Price	Vendor	Buyer
Block 1, Ballsbridge Park, Dublin 4	€32.0m	Eircom Pension Fund	Core Capital
Blocks A & B, Parkgate Business Centre, Dublin 8	€24.3m	Blackstone	Union Investment RE
76-78 Harcourt Street, Dublin 2	€21.2m	Henderson Park	Sofidy

76-78 Harcourt Street, Dublin 2 sold by Savills in Q3 for €21.2m

Other significant transactions

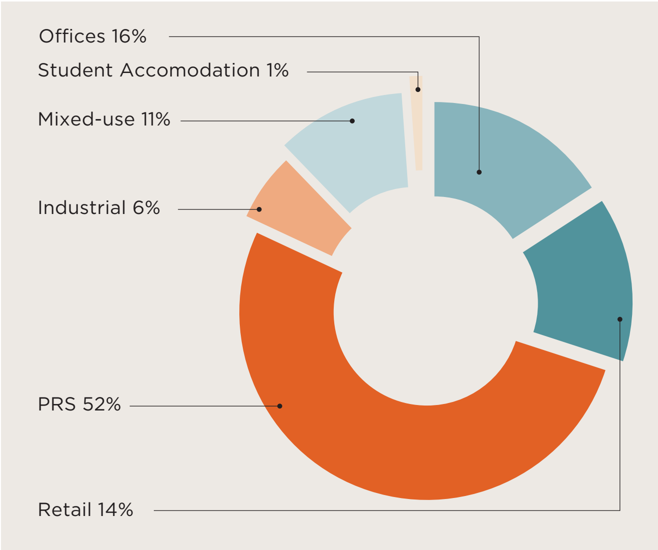
Royal Hibernia Way in Dublin 2 was the second-largest transaction of the quarter at €74m. This mixed-use property is made-up of 78% office space and 22% retail space, with 92% of the office space leased to the Davy Group. The asset provides a combination of medium-term income certainty alongside immediate asset management opportunities and revisionary ERV potential allowing the asset to trade at a tight net initial yield of 3.54%. The largest industrial and logistics transaction of the quarter was a €30m private off-market deal that accounted for 68% of total sector investment. There were five transactions in the industrial and logistics sector in Q3, three of which were characterised by their small lot size, with each asset transacting for under €2m. The sector accounted for €44m of investment spend in Q3, representing 6% of total volumes, as the shortage of stock continued to constrain transactional volumes in the sector.

€30m
was the largest industrial and logistics transaction of the quarter

Table 8: Top other deals

Property	Price	Vendor	Buyer	Sector
Royal Hibernia Way, Dublin 2	€74.0m	Aviva	Private Individual	Mixed-use
P&C	€30.0m	P&C	P&C	Industrial and Logistics
East Douglas Village, Cork	€11.0m	Receiver	Private Individual	Mixed-use

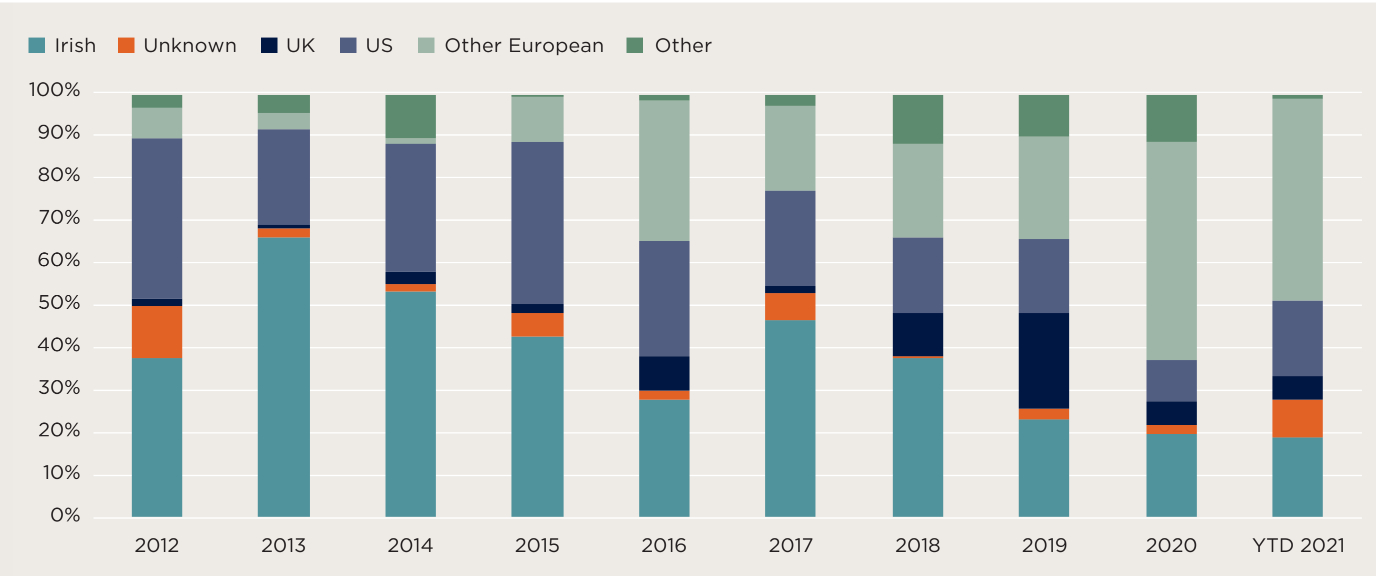
Figure 5: Investment share by sector



Source: Savills Research

Investor nationality and type

Figure 6: Investment turnover by nationality



Source: Savills Research

Institutional capital comprised 64% of investment volumes this quarter and now make up 48% of year-to-date volumes. In contrast, private equity purchasers had a relatively quiet quarter with just 8% of transactions, but still accounted for 37% of year-to-date transactions. With regards to disposals, property companies were the most active in trading out their positions or developments as they made up 46% of quarterly volumes and 47% of volumes year-to-date in 2021.

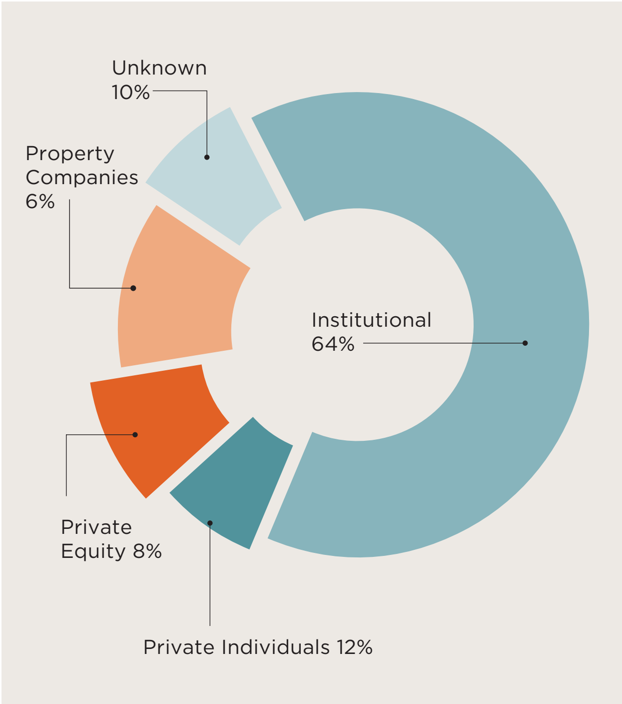
European investors are once again the most active this quarter and annually with 48% of volumes. Irish investors were also particularly active this quarter, with 37% of transactional volumes.

Table 9: Yields by sector

Asset	Yield Q3	Annual Change
Offices – Prime CBD Yields	4.00%	0.00%
Offices – Secondary CBD Yields	5.00%	0.00%
Logistics – Prime Yields	4.00%	-0.75%
Logistics – Secondary Yields	5.00%	-1.50
Shopping Centres – Prime Yields	5.75%	0.25%
Shopping Centres – Secondary Yields	9.25%	0.25%
Warehouse Retail – Prime Yields	5.00%	0.00%
Warehouse Retail – Secondary Yields	9.50%	0.00
High Street – Prime Yields	4.50%	0.25%
High Street – Secondary Yields	7.00%	0.25%
PRS – Prime Yields	3.60%	0.00%
PRS – Secondary Yields	5.00%	0.00%

Source: Savills Research

Figure 7: Investment turnover by buyer type



Source: Savills Research

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