Lisney

INVESTMENT REPORT

Q3 2022

MARKET TURNOVER

€1.77bn

AVERAGE LOT SIZE

€37.7m

€34.8m

FOR TRANSACTIONS OVER €1M

LARGEST DEAL

€500m

SALESFORCE HQ, SPENCER PLACE, DUBLIN 1

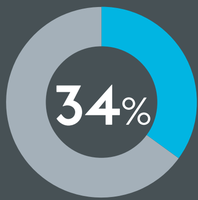
THREE GRADE A OFFICES AND A HOTEL

BUSIEST SECTORS

38% OFFICE

34% PRS

OFF-MARKET



OF THE MARKET TURNOVER

LOCATION

OVER 94% IN DUBLIN

INVESTMENT

SIXTY ONE, THOMAS STREET, DUBLIN 8

INVESTMENT

OVERVIEW

A lot changed in the investment market over Q3. With adjustments in the global economic outlook along with rising interest rates, the market went into a period of price discovery. In the majority of cases there was a disconnect between vendors price expectations and what purchasers (and their credit committees) were willing to pay. Demand was generally split between investors that are willing to buy assets now, but at discounted prices, and those who have adopted a wait-and-see approach for the next 12 months. Some properties that had deals agreed earlier in the year, underwent price chipping; generally by between 5% and 15%. The impact of the European Green Deal and the resultant EU Taxonomy Regulations on purchasing or funding properties also came into greater focus. Investors became more interested in BERs and they often sought reports on how ratings could be improved for buildings of B3 or below.

ACTIVITY

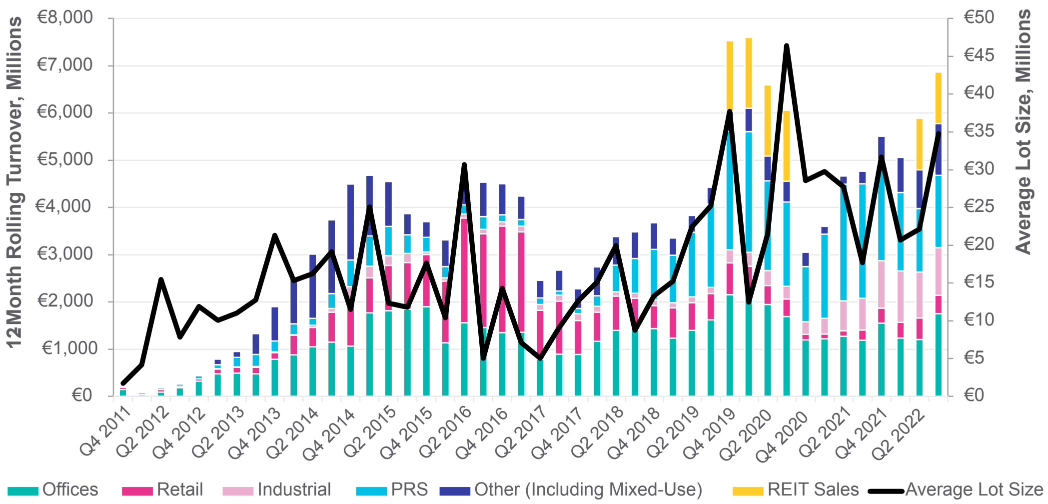
In spite of the evolving environment, turnover in the Irish investment market in Q3 2022 was exceptionally strong, reaching €1.77bn (well above the €1bn quarterly average for the past five years), and driven by some very large deals which could be viewed as distorting activity, notably the sale of Saleforce's HQ at Spencer Place (reportedly sold for €500m). Q3 figures bring the year-to-date turnover to €3.77bn (just ahead of the same period last year at €3.5bn). If the €1.09bn sale of Hibernia REIT to Brookfield Asset Management in Q2 is considered, then turnover in the opening nine months of 2022 was almost €4.87bn, significantly ahead of the same period last year. However, this transaction was completed by way of a company sale rather than the acquisition of individual property assets, hence why it is generally excluded, but is nonetheless significant.

The 12-month rolling turnover figure to the end of September was the third largest on record, at over €5.77bn. However, if the sale of Hibernia REIT is included (despite being a company sale) the 12-month rolling figure was €6.86m at the end of September.

In Q3 2022, Dublin remained the dominant location for investment, accounting for an estimated 94% of the turnover (39 deals). This was followed by Cork at 3% (three transactions), and further 3% across the rest of the country. Off-market sales processes continued to make up a large part of activity, particularly for opportunities priced at over €20m, and in Q3 such deals accounted for one third of all transactions.

When confidential deals are excluded, overseas purchasers accounted for 90% of turnover. They remained most active in the larger lot sizes in Q3, while private Irish investors were most active in the market for assets priced up to €6m.

QUARTERLY 12-MONTH ROLLING TURNOVER BY SECTOR & AVERAGE LOT SIZE (Q4 2011 – Q3 2022)



Source: Lisney

PRS

Despite the often-negative media attention and government intervention, Ireland remains in the midst of a housing crisis with occupier demand for rental accommodation at record levels. The PRS sector remained busy in Q3 with some large transactions completed, often on a confidential, off-market basis, and it accounted for just over one-third of market turnover.

OFFICE

The office sector was the busiest in Q3, accounting for 38% of market turnover. Activity levels in the office investment sector is being impacted by the changes occurring in the occupational market. Many office assets due to be sold have been delayed coming to the market because vendors are waiting on lettings to be completed first. Some of the delays on the occupational side are due to changing economic conditions in major economies, a slower return to the office than anticipated, and consequently businesses taking longer to assess their needs. Despite this, there are several high-profile office blocks due to be launched in the coming months. These will be important indicators for establishing market pricing in the current economic and interest rate environment.

INDUSTRIAL

The extremely strong, record levels of demand experienced in the industrial investment market in the past 18 to 24 months has reduced. While demand is still good, there are fewer buyers with active requirements as many have adopted a wait-and-see approach for the next six to 12 months. Sustainability and energy use is also coming into greater focus in this sector, especially in new builds. In Q3, the industrial sector accounted for 5% of market turnover.

RETAIL

Investor interest and demand for retail investment assets is mixed and very price sensitive. While there continues to be demand for well-performing retail parks, for deals to complete vendors and purchasers must be aligned in pricing. There is less demand for shopping centres as they are currently considered less favourable. However, like retail parks, at the right price there is demand. Some high-profile high street deals are ongoing, including the €75m receiver-let sale of the former Debenhams stores on Henry Street in Dublin and Patrick Street in Cork. These will provide important evidence on pricing in the coming months. In Q3, the sector accounted for just 2% of market turnover.

ACTIVITY ANALYSIS

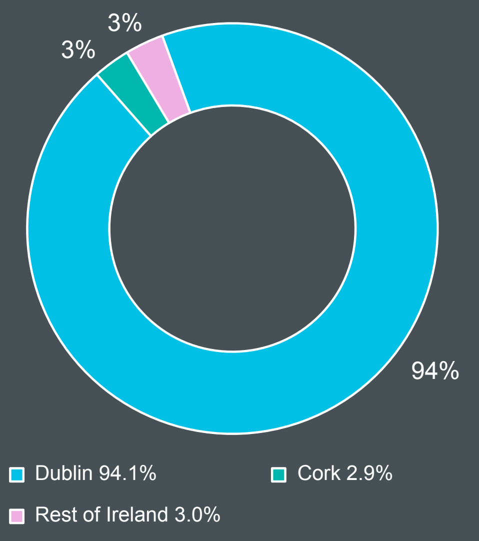
TOP 10 INVESTMENT TRANSACTIONS Q3 2022

OPPORTUNITY	LOCATION	SECTOR	REPORTED PRICE
Salesforce HQ, Spencer Place, Dublin 1	Dublin	Office and Hotel	€500,000,000
Project Sapphire	Dublin	Other - Healthcare	€161,000,000
P&C	Dublin	PRS	€123,500,000
P&C	Dublin	PRS	€110,000,000
Watermarque Building, Ringsend, Dublin 4	Dublin	Office	€92,250,000
P&C	Dublin	PRS	€90,000,000
Staycity, Little Mary Street, Dublin 7	Dublin	Other - Hotel	€80,000,000
Newtown Park Avenue, Blackrock, Co. Dublin	Dublin	PRS	€76,250,000
The Eight Building, Newmarket Square, Dublin 8	Dublin	Office	€58,100,000
Station Road, Raheny, Dublin 5	Dublin	PRS	€56,000,000

Source: Lisney

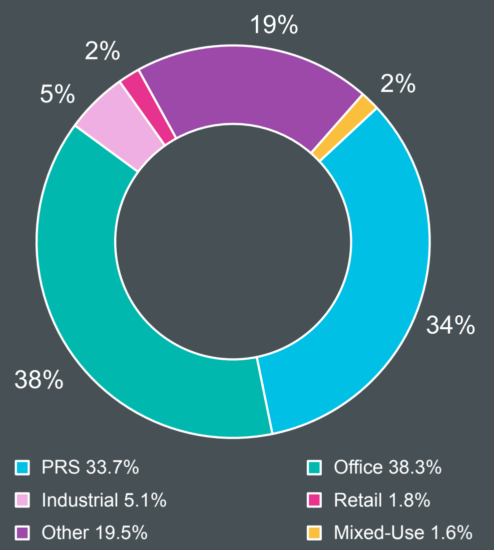
INVESTMENT

BY LOCATION
(Q3 2022)



Source: Lisney

BY SECTOR
(Q3 2022)



Source: Lisney

PRICING

Prevailing global economic conditions (Russian invasion of Ukraine, resultant energy crisis, rapid inflation and rising interest rates) began to have a greater impact on the CRE market throughout Q3. With price chipping and fewer transactions completing, yields softened, the degree to which depends on market sector.

In the office market, we estimate that prime CBD yields increased by 25 bps, moving from a cycle low of 3.9% to 4.15%. The last time prime office yields were at this level was in the latter half of 2017. Prime suburban office yields also softened by 25 bps to an estimated 5.75%. The increase in prime industrial yields was even greater, softening by 45 bps to stand at 4.25% at the end of September. This movement is less alarming than appears on the surface. Industrial yields were also at 4.25% just 12 months ago, however the extremely strong demand for industrial towards the end of 2021 and into 2022, along with some very good assets being sold, brought the prime rate down considerably, and it has now readjusted. Prime high street retail moved by between 25 and 50 bps, depending on location (Grafton Street and Henry Street respectively). We also estimate that prime shopping centres and retail parks moved out by 25 bps. In the PRS market, we estimate the yield on prime schemes increased by 25 bps, bringing it back to mid-2019 levels.

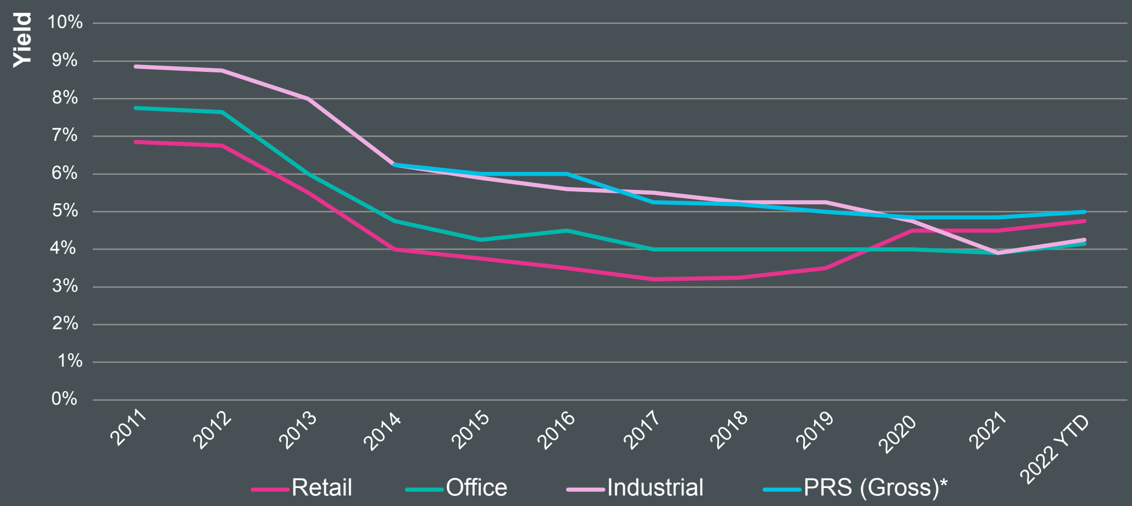
The most recent MSCI / SCSI Ireland Property Index figures are for Q2 2022 where 'total return' grew by 5% on an annualised basis (1.6% in the quarter) for 'all property', but this was largely driven by rental growth and yield compression in the industrial sector. Similarly, the 'capital value growth' index grew by 0.1% for 'all property' in the year (-0.2% in the quarter), but entirely driven by growth in industrial. Given the market dynamics in the last three months, we anticipate the 'all property' sector to register a decline, both in the 'capital value growth' index and the 'total return' index, mainly driven by softening yields but also reductions or stabilisation in market rents.

PRIME NET EQUIVALENT YIELDS

	RETAIL	OFFICE	INDUSTRIAL	PRS
Q3 2022	4.75%	4.15%	4.25%	5.00%
Quarterly Change	+25 bps	+25 bps	+45 bps	+25 bps

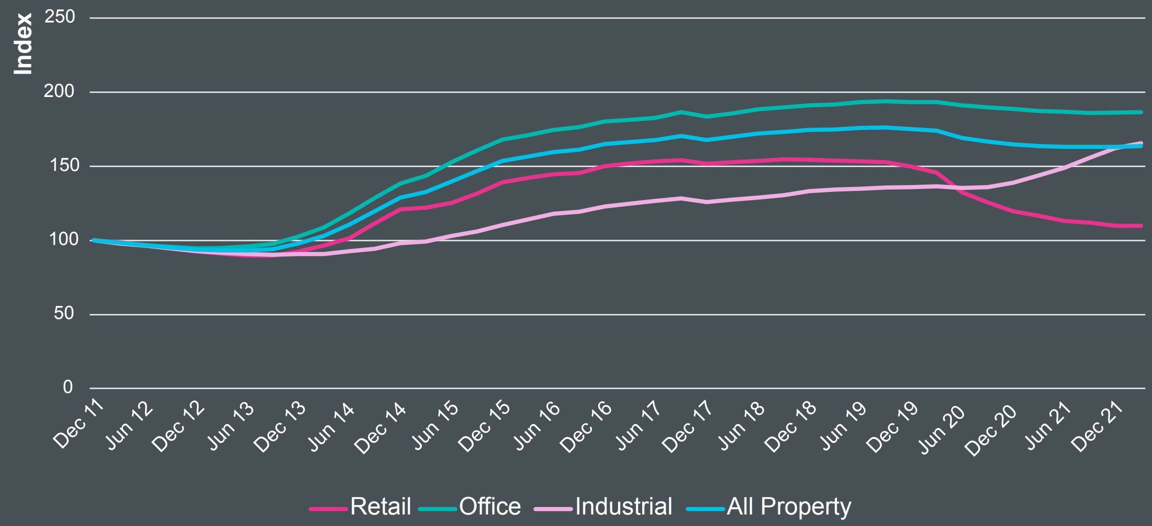
Source: Lisney

PRIME NET EQUIVALENT YIELDS (2011 – Q3 2022)



Source: Lisney

MSCI CAPITAL VALUE GROWTH INDEX (Q4 2021 – Q2 2022)



Source: MSCI

INVESTMENT

SUPPLY

At the end of Q3 2022, there was approximately €1.6bn worth of opportunities in on-market deals, some of which have deals agreed. However, given the exceptionally large amount of off-market activity taking place, this supply figure is in reality significantly higher. As highlighted above, the leasing delays in the occupational markets, particularly in offices, is resulting in a delay of assets being offered for sale. However, we do anticipate some of these high-profile buildings will come to the market in the months ahead. Some vendors might test the market with scaled-back marketing campaigns, only selling if required prices are achieved, while others may hold on until the new year and see what way interest rates and pricing settles.

IN-FOCUS – PAST EXPERIENCE

In an attempt to understand how pricing may change in the next 12 to 18 months, Lisney has carried out modelling on Irish economic and property market data going back to the 1970s. It shows that there is no consistent association between CRE yields, and interest rates and bond yields. In reality, and as to be expected, it is not the actual movement in property yields and interest / bond rates but rather the underlying causes of why rates are moving that affects yields.

The financial crisis of the late 2000s is not an accurate comparison given the underlying dynamics, particularly the levels of debt, however there are only interesting comparisons looking back further. In 1979/1980 the global economy was impacted by an oil crisis and the Iranian revolution. This resulted in huge changes in interest rates but only marginally impacted Irish property yields. Lisney's Annual Review publication from that time detailed how it was only really noticed in the secondary market and the prime yields actually hardened. In 1990s with the savings and loan crisis and the first Gulf war, Irish office and industrial yields softened by between 50 and 75 bps over a two-year period before recovering. When 9/11 occurred, yields again increase by 50 to 75 bps but recovered within a year.

While every crisis is different, the above examples do show how the Irish market reacts to external events. There are many differences now when compared to 20, 30 or 40 years ago, not least how international the Irish investment market has become in the last decade. The sources of funding now are very different, which may impact the market differently. Pricing may fall quicker but equally recover more quickly.

INVESTMENT

SALESFORCE HQ, SPENCER PLACE, DUBLIN 1

OUTLOOK

1 The market will continue in a period of price discovery in Q4. Further yield movements are likely, the degree of which will depend on how quickly vendor and purchaser expectations align. The quicker they adjust, the greater the levels of activity will occur. This will also be impacted by comments by the ECB, Federal Reserve and Bank of England as to when they expect to be at the end of interest rate increases.

2 The full year 2022 investment market turnover figure will depend on whether some large deals conclude and at what price. For example it has been reported Inditex founder, Amancio Orteg, is in negotiations to acquire Fibonacci Square for over €500m, while other very large lot sizes are also being discussed off-market. The completion of one or more of these sales will greatly impact 2022 turnover figures. In spite of this, we estimate that it will be at least €4.5bn (excluding the €1.09bn company sale of Hibernia REIT) but likely higher.

3 Despite the economic factors impacting the market, there is investor demand and there is still a lot of private equity money seeking a home having already been raised. It remains to be seen how much of this goes towards Irish CRE. Investor demand is at a level and judging by recent price chips on agreed assets, that is up to 15% less than values six months ago; but is very individual asset dependent.

4 Older offices in need of CapEx will continue to provide entrepreneurial investors opportunities. However, some investors in this market may find it more difficult due to the increased price of debt. Buildings offering longer WAULT periods (generally greater than two years) will be less in demand as they have a longer lead-in time. However, buildings with leases that are due to expire soon will be most in demand; but as with all transactions, pricing is critical to achieving completed deals.

5 With phase two (final four environmental criteria to be met) of the EU Taxonomy Regulations due to be implemented in January 2023, its impact on new builds, refurbishments and sales will be even greater across all CRE sectors. For investors, opinions and targets on ESG are likely to be extreme depending on their nature. However, sustainability credentials in general will lead to a wider gap in pricing between new and dated properties.

6 Domestic and international investors will continue to pursue PRS opportunities. However, Government intervention and often negative media attention on the sector is likely to have a growing impact. Some investors may consider different asset classes, but others (from overseas) may move on to other international markets.

7 Private domestic investors will continue to consider opportunities. These are currently generally broken into two brackets: those seeking a lot size of between €1m and €5m and those seeking opportunities between €5m and €10m. While negative interest rates on deposits have gone in recent months, private investors are seeking to invest in an asset class that has the ability to beat inflation, or at least go some way towards the meeting it. Research shows that CRE returns outpace inflation in the medium-term.

7 Investor interest in alternative opportunities such as healthcare and student accommodation remains and will progress further. Combined, these sectors accounted for 12% of market turnover in Q3. Perhaps as a result of the pandemic or just in search of better returns, there is interest in properties backed by tenants operating in the life sciences industry. We are also likely to also see greater levels of private equity / investor interest in the licensed and leisure trade, something which we only really began to see in the Irish market in 2021.

MEET OUR TEAM

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