Q4 IRISH INVESTMENT MARKET 2023

BNP PARIBAS REAL ESTATE

Q4 2023 KEY TRENDS

Q4 INVESTMENT SALES OF €434.6M
Flat Q/Q, but down 59% Y/Y

Largest deal accounted for **MORE THAN HALF OF QUARTER'S TURNOVER**

FY SALES OF €1.85BN
down 69% on 2022

LOGISTICS
accounted for biggest investment share for first time ever (28%)

RETAIL INVESTMENT REBOUNDED
to its highest share since 2017 (22%)

Residential and office shares **CONTINUED TO DECLINE** and have approximately halved since 2019/2020

NO PRIME, NEW-BUILD OFFICES
have now been bought since Q3 2022

SEA-CHANGE IN CAPITAL FLOWS:
US and UK stalwarts became net divestors in 2023, while EU countries led by Spain and France were net investors

MARKET ACTIVITY

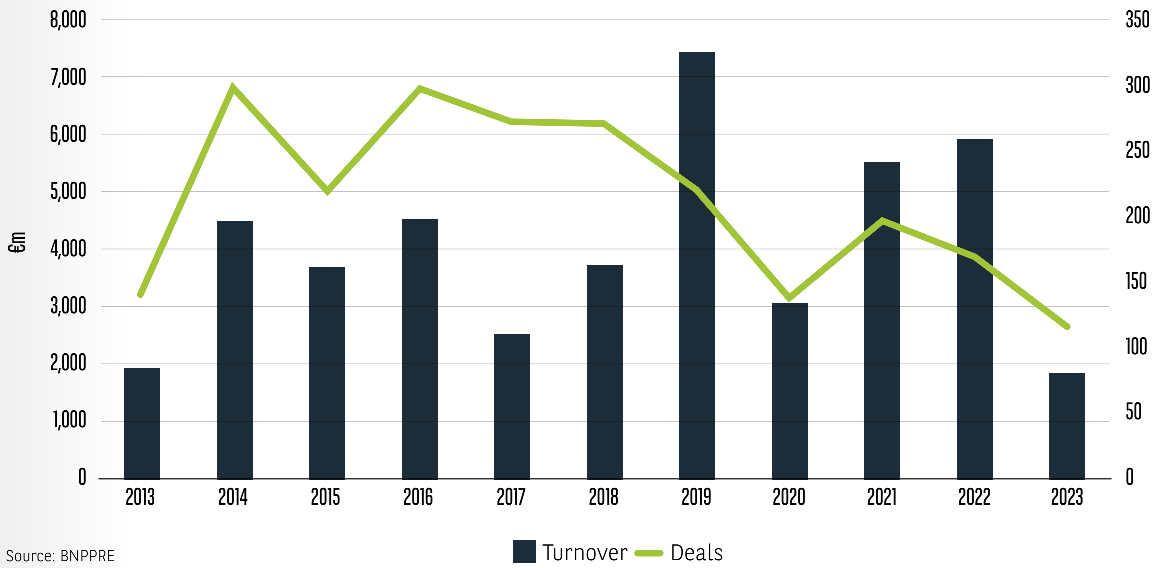
JOHN MCCARTNEY
Director & Head Of Research
BNP Paribas Real Estate

Q4 has historically accounted for 37% of the year's turnover in Irish investment property as bonus culture and, occasionally, forthcoming tax changes focus minds on getting deals signed. But seasonal dynamics could not rescue a dismal year for the market, and 2023 petered-out with a whimper. Just €434.6m of income-producing property changed hands between October and December. This transpired to be the weakest quarter of 2023, accounting for 24% of spending, and it was also the slowest Q4 for well over a decade. Compounding the gloom, one transaction accounted for more than half of total spending, and only 27 deals were signed.

Considering 2023 as a whole, turnover reached €1.85bn, a 69% contraction compared with 2022 and the lowest outturn since 2012. In terms of transactions, just 114 deals were done. For comparison, the 10-year average is 223 and nearly 300 transactions took place in both 2014 and 2016.

€434.6m
OF ASSETS TRADING IN **Q4**

FIGURE 1: INVESTMENT MARKET ACTIVITY



Source: BNPPRE

A transactional logjam caused by mispricing remains the issue. An age-old truism is that occupational markets set the rent and capital markets set the multiple. At present, challenges from both sides are conspiring to drag on values. Globally, the macro-economic backdrop has become less supportive of occupational property markets. In Ireland the scale of multinational activity makes it hard to get a definitive read, but two of the more insightful barometers - Modified Domestic Demand and unemployment – appear to be trending weaker.

Compounding this, sector-specific challenges are impacting on occupational demand. For offices, these include remote working, the tech-industry re-set, and the disproportionate impact of these global factors on Dublin because of its reliance on tech. For retail and residential, the challenges include online shopping and rent control respectively. In combination with a weaker economic backdrop, these sectoral factors have increasingly become priced into void risk and / or rental growth expectations.

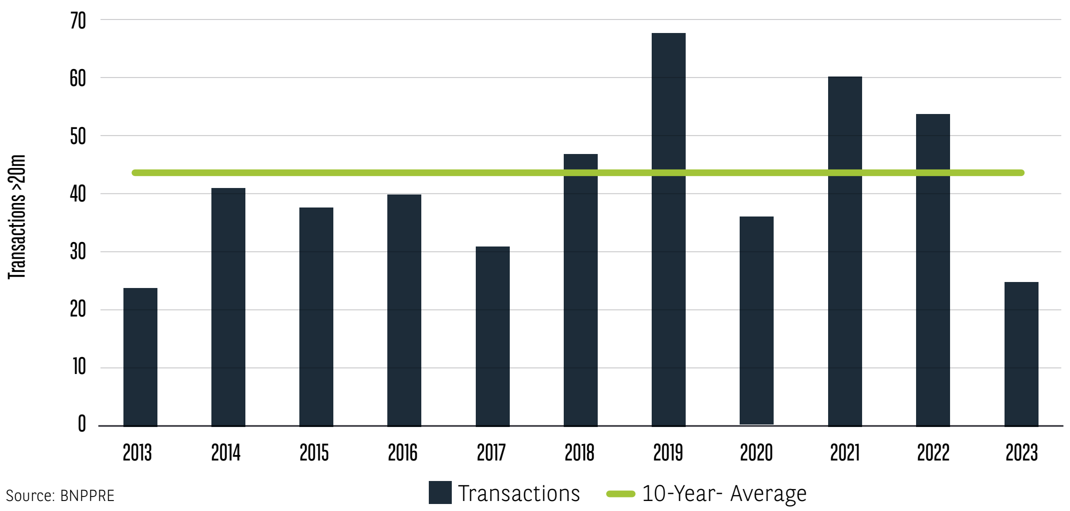
Simultaneously, in capital markets, higher interest rates have reduced the amount of debt that is available to finance larger property transactions, while rebased bond yields have put competitive pressure on real estate investment yields.

These dynamics are undoubtedly impacting values, but the extent of this is unclear due to a scarcity of comparable evidence. The information vacuum has triggered a cautious reflex in both vendors and purchasers, resulting in bid-offer spreads that are too wide to bridge. This only serves to further prolong the transactions drought, particularly for core assets that are traditionally purchased by institutional investors.

TURNOVER BY TRANSACTION SIZE AND BUYER TYPE

With higher costs of capital impacting on leverage, smaller deals have come to the fore. As illustrated in Figure 2, only 25 transactions of €20m or more occurred in 2023. This is the lowest number since 2013, and 43% below the 10-year average. Aligning with this, the average deal size in the market fell from €30.2m in the 2019-2022 period to €16.2m last year.

FIGURE 2: NUMBER OF TRANSACTIONS GREATER-THAN-OR-EQUAL-TO €20M



Source: BNPPRE

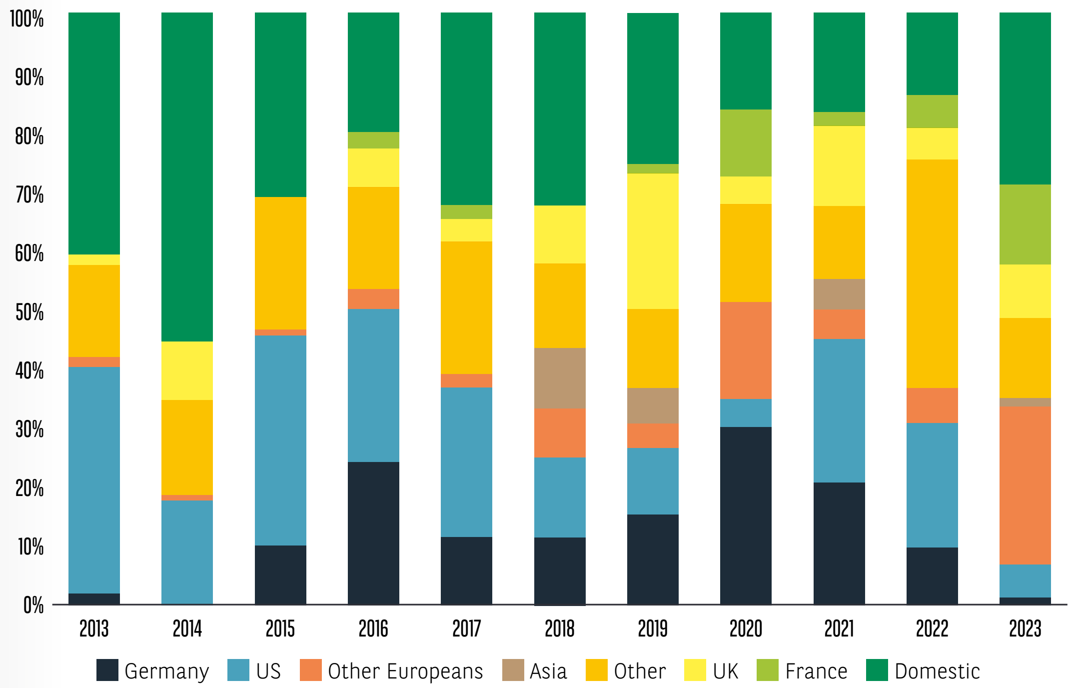
As ticket-sizes have fallen, the typical buyer profile has also changed. Private investors were behind 46% of last year's deals (31% in 2022). On average these buyers, who are typically equity funded, invested €4.7m – 16% below what they paid in 2022 and 70% below the overall market average. In contrast, the share of spending accounted for by institutions such as REITs and insurance companies fell from 37% in 2022 to 11% last year as buyers of core assets baulked at vendors' asking prices.

ORIGIN OF CAPITAL

A legacy of the 2008-2012 financial crisis was that Ireland's investment market became globalised beyond the traditional domestic and UK players. Initially risk-embracing private equity from the US was attracted by the availability of distressed assets at below replacement cost. However, as the economy steadied and recovered, investors' focus increasingly turned to Ireland's advantageous fundamentals which include political stability, a young, rapidly growing population, common use of English, and a unique blend of EU membership and close associations with the US. While North American capital continued to flow-in, it became more institutional in nature, and the investor base widened beyond the traditional US and UK players to also include German and French institutions.

However, there has been a sea-change since the second half of 2022 when interest rates took-off and a shock to the global tech sector impacted Dublin's office market. As outlined above, these conditions triggered a widening gap between vendors' expectations and buyers' willingness to pay, sharply stemming the tide of foreign institutional capital.

FIGURE 3: ORIGIN OF INVESTMENT SPENDING

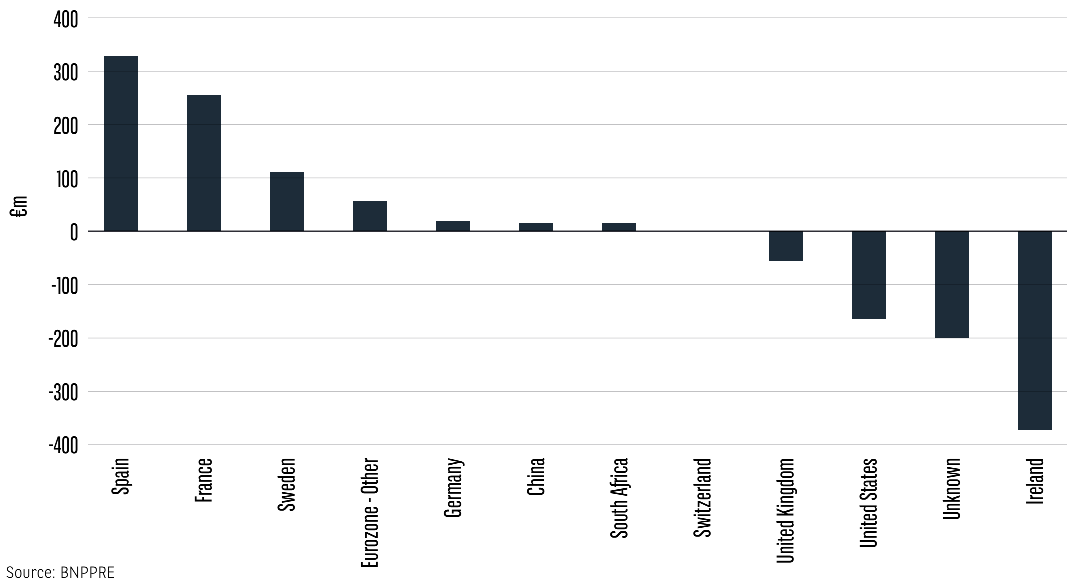


Source: BNPPRE

Germany was the biggest international investor in the Irish market between 2019-2021, with over €3.23bn of capital deployed across 38 deals, accounting for over one-fifth of the total spend. However, there was only one German buy in 2023, the €18.25m purchase of the Woodies and Tesco units in Newbridge, Co. Kildare, and there were no German purchases in H2.

US investors have been stalwarts of the Irish market in the post-GFC era, deploying €8.7bn between 2013 and 2022. However, they contributed a meagre €111.65m last year, accounting for 6% of the capital invested. However, unlike the Germans who came later to the party and bought fully-priced core assets, some American players have sought to lock-in their early mover gains and are exiting the market. Indeed, as illustrated in Figure 4, there was a net outflow of American capital in 2023 as US sellers divested €164.65m more than US investors purchased in the year.

FIGURE 4: NET CAPITAL FLOWS INTO IRISH INVESTMENT PROPERTY, 2023



Source: BNPPRE

While institutional capital has become less active French SCPIs - B2C property vehicles for assembling and investing capital from retail investors - have stepped into the vacuum over the last 18 months. This reflects an alignment of their investment objectives with the product that is currently available in the market. SCPIs are typically seeking smaller assets in the €5m-€15m price bracket, with stable rental income and attractive yield profiles. Once these criteria are met, however, they tend to be agnostic between sectors and locations and they have been willing to venture outside Dublin in search of assets that conform to this profile.

With core international players on the sidelines for now, domestic buyers accounted for 28.5% of spending during 2023 – their highest share since 2018. However, while private Irish investors with the local knowledge to seek-out value have remained active, indigenous investment fell in absolute terms from €803m in 2022 to €526m in 2023 as overall market activity contracted.

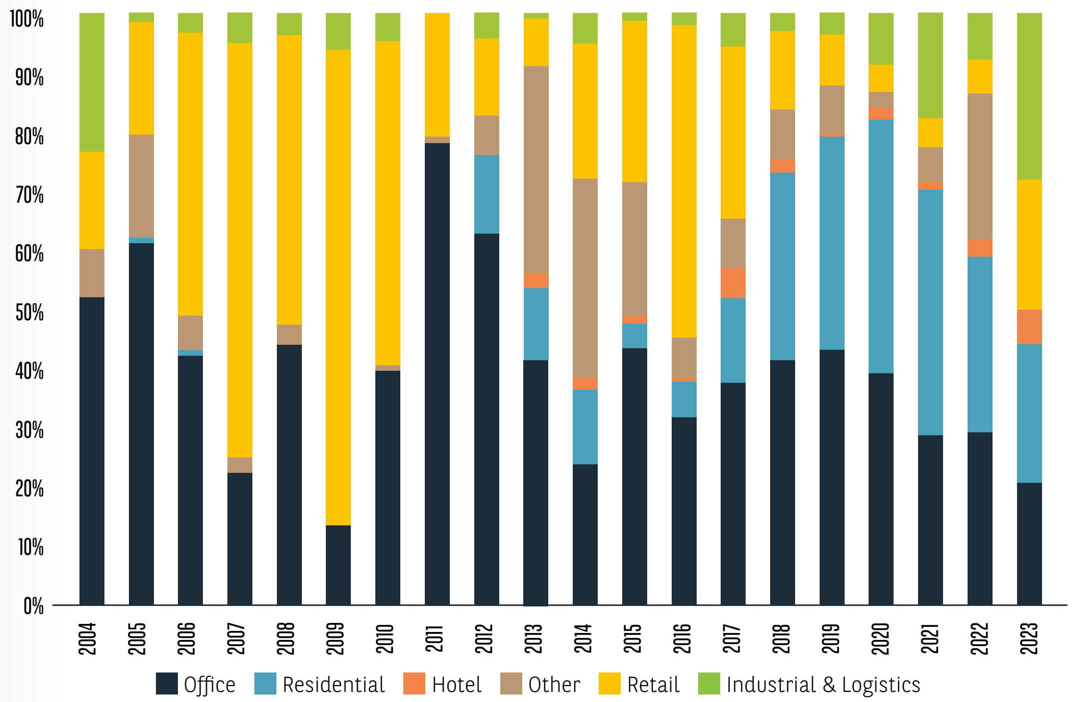
TURNOVER BY SECTOR

A shift in the sectoral distribution of investment spending has been underway for some time, and this continued in Q4. As recently as 2020 offices and residential accounted for 82% of the annual investment total. However, the share of both has been in decline since then. Only five offices traded in Q4. These include the Chancery Building in Dublin 8 which local buyer Eamon Waters purchased from Credit Suisse at a price believed to be around €14m, and Building 8 in the South Dublin suburb of Cherrywood, which is fully let to Laya Healthcare, and was bought by La Francaise for €13m at a net initial yield of 5.49%. Over the full year 20 office assets traded, adding to a combined spend of €386m. This represents the smallest flow of office investment since 2012, and no prime new-build offices have been purchased in Dublin since Blackstone bought the Salesforce Tower on Spencer Place back in Q3 2022. In proportionate terms, offices accounted for less than 21% of the investment capital employed in 2023 - the lowest share since 2009.

Such depressed trading reflects weakness in the occupational market; On the supply side, development lags (including Covid delays) mean that a group of buildings which were conceived before the pandemic are now coming through as completed properties. Meanwhile, on the demand side, a slowing global economy, remote working and the effects of the 2022 tech shock have dampened leasing activity. Inevitably these dynamics have combined to force vacancy rates up. One consequence is that many offices, including new-builds which might otherwise appeal to investors because of their low-carbon credentials, are now fully or partially vacant. This greatly limits the potential buyer pool for these assets. Of course, another consequence is that increased vacancy leads to downward pressure on rents and rental growth expectations.

Concurrent with all of this, as discussed above, higher interest rates have altered investors' yield demands, reducing their appetite to buy offices at current asking prices.

FIGURE 5: TURNOVER BY SECTOR



Source: BNPPRE

Vacancy in the private rental market is harder to gauge as online portals have incomplete coverage and single advertisements can be used to promote multiple similar units. However, unlike offices, residential rents are rising, suggesting a tighter market. Government supports like the Housing Assistance Payment (HAP) and the Rent Tax Credit are expected to underpin rent levels. However rent increases for already occupied properties are restricted by legislation to the lower of generalised inflation or 2% in most urban areas. These rent controls will remain in place until the end of 2024, but international experience shows that such measures can be difficult to remove once they are established, and investors are likely pricing this into their rental growth expectations. Together with the outward movement of interest rates, this has impacted institutional demand for PRS product. Simultaneously, with local authorities and Approved Housing Bodies hungry to buy-up new-builds, Government bodies have become an attractive exit option for developers, and fewer assets are available for investors to buy. In the round, these dynamics have led to a slowdown in residential investment from an average of nearly €2bn per annum between 2019-2022, to just €433m last year – the lowest outturn since 2017.

In contrast, investment into Irish logistics and retail property continued to rise. Logistics attracted over €520m of capital and, for the first time, topped the investment league table with 28% of the pie. The largest of last year's 24 logistics deals was Pontegadea's purchase of Phase II Baldonnell Business Park, incorporating approximately 98,000 sq m of new-build warehousing for €225m in Q4. Pontegadea is the property investment vehicle of fashion-group Inditex's founder Amancio Ortega and, coincidently, the investment vehicle of another retailer, IKEA, bought approximately 42,000 sq m of new-build logistics property at Greenogue Logistics Park in Q1 for €110m.

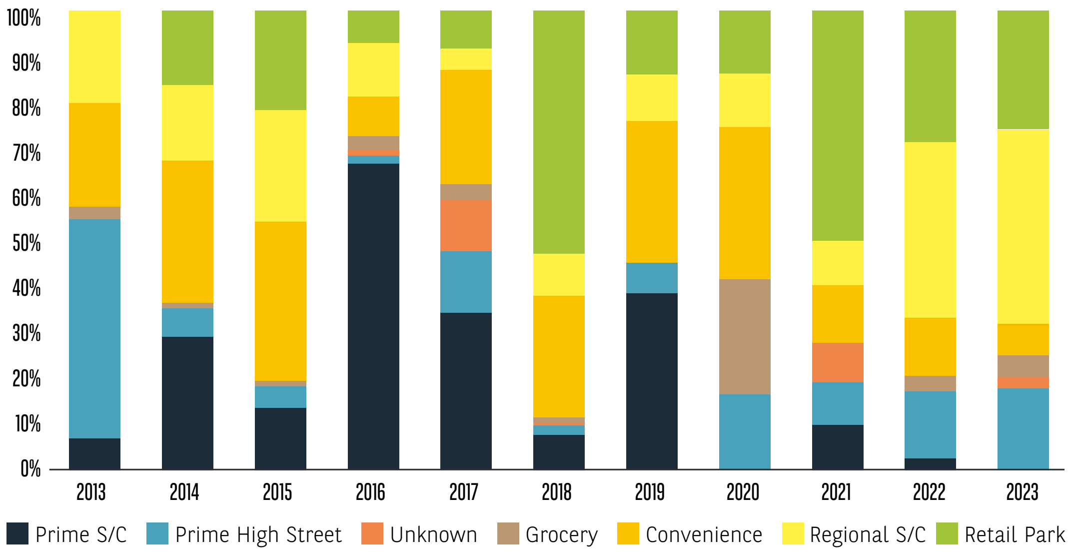
The retail share of investment spending crept-up from an all-time-low of 4.5% in 2020 to 5.3% in 2021 and 6.1% in 2022. However, against the run of play in a pedestrian market, there was a step-change in retail investment from €359m in 2022 to €407m last year, propelling retail's market share to 22% - its highest since 2017.

At a high level, the increased focus on logistics and retail investment is driven by Ireland's strong demographic growth.[1] It is a truism that people need 'stuff', and stuff needs to be warehoused. This has underpinned occupational demand, keeping a lid on vacancy even in the face of new development. Consequently prime rents in Dublin are rising more strongly than generalised inflation. While this promises upside for investors, any downside is limited because warehousing has inherently defensive characteristics. For sure, the quantity of goods consumed will decline in a weak economy, but by much less than the value of goods consumed because people substitute to cheaper products. This ensures an ongoing baseline level of demand for logistics space.

In previous reports, we have noted that the resurgence in retail investment has been driven by an increased focus on the sub-sectors that share these defensive traits – grocery-led, neighbourhood and convenience shopping. However, value has been another driver, and Ireland's retail property market is proof of the economists' adage that there is never too much of a commodity - it is just wrongly priced. Traditional retail has been grappling with the secular challenge of online competition for more than 15 years – far longer than the office sector has been facing the challenge of remote working. Moreover, it has been exposed to two major consumer crises during this period – the Global Financial Crash (GFC) and the Covid-19 pandemic. As a result retail values have repriced by over 70% compared with their pre-GFC peaks – a much heavier discount than has applied to offices (c. 40%) or logistics property (c. 35%). Consequently it has become possible to acquire well-performing regional assets, such as shopping centres in vibrant provincial towns, at yields of over 10%. Examples from 2023 include Fairgreen Shopping Centre in Carlow which sold for €20m at a yield of 10.73% in Q1, and the Marshes Shopping Centre in Dundalk which was picked-up for €29m at 10.7% yield in Q3.

While yield-chasing capital continues to follow this route, it appears that investors are now also seeing value in prime high street shops. In a remarkable turnaround, 11 properties in-and-around the prime retail streets of Dublin 1 and Dublin 2 changed hands in H2 2023 – mostly at yields of 5% - 6.5%. As a result of this, Dublin's share of retail investment spending, which had been on a downward trend, recovered from 21% in 2022 to 28% in 2023. However, similar high street assets in Cork city have also been bought, including the North Face store at 39 Patrick Street, and the McDonalds restaurant on Winthrop Street.

FIGURE 6: RETAIL INVESTMENT BY SUBSECTOR



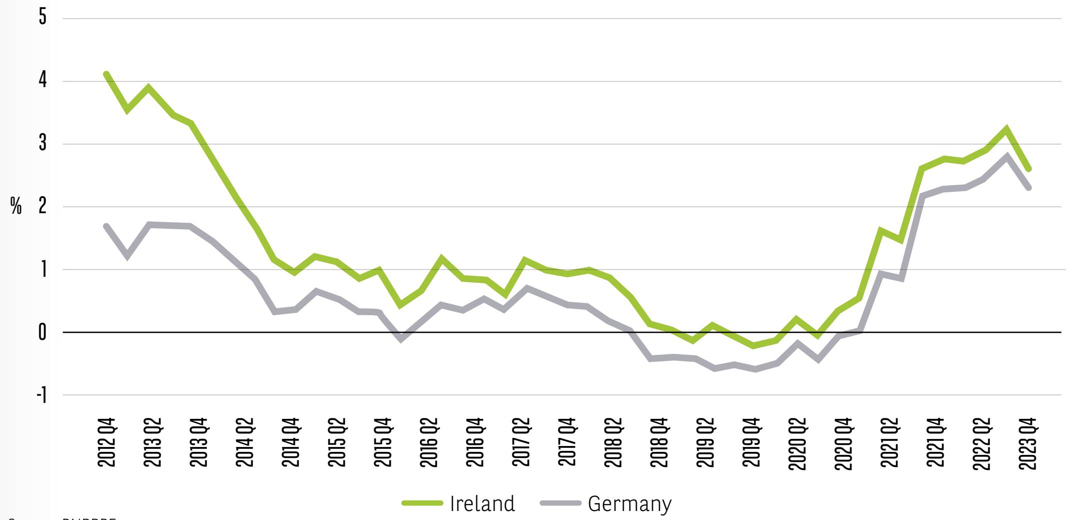
Source: BNPPRE

[1] According to Eurostat, Ireland's population rose by 2.65% in the year to Jan 2023, the third fastest rate of growth in the EU behind Malta and the Czech Republic. The EU average was 0.37% and 7 of the 27 member states experienced a contraction in their headcounts, while a further 3 countries had marginal population growth of less than 0.3% per annum.

OUTLOOK

Sluggish trading in 2023 will continue to cast a shadow on the market this year as vendors and investors remain starved of transactional evidence. Moreover occupier market conditions, especially in the office sector which is under most pressure, may get worse before they get better. Nonetheless, two factors should pave the way for an improvement later in the year. Firstly, it appears that a milestone has been reached in the monetary cycle. At the time of our last report the question was whether terminal interest rates had been reached. Three months later the tension is between those who expect the ECB to cut policy rates before mid-year and those who say it will come later in 2024. Reflecting this, sovereign bond rates have tightened sharply. With property yields expected to ultimately follow this lead, investors may be encouraged to advance with more confidence. Of course, vendors who do not have to sell might have the opposite incentive. But this brings us to the second factor; In any investment market downswing the limits of debt providers' forbearance are eventually tested, particularly if there is a willing pool of buyers to sell assets to. Therefore, although we do not expect a slew of distressed sales, the flow of forced sales is likely to strengthen as the year progresses. Clearly this is painful for the parties involved but, as it provides pricing transparency, it should create more liquid trading conditions in the market.

FIGURE 7: IRISH AND GERMAN 10-YEAR SOVEREIGN BOND YIELDS



Source: BNPPRE

TABLE 1: NET INITIAL YIELDS (%), PRIME ASSETS

	Q4 2022	Q4 2023	OUTLOOK
Dublin Office	4.25	5.00	→
Dublin Logistics	4.50	5.00	→
Retail (High Street)	4.75	5.25	→
Dublin Residential (PRS)	4.25	4.50	→

> Seasonal dynamics could not rescue a dismal year for the market, and 2023 petered-out with a whimper. While no immediate recovery is expected there are signs that market conditions will improve later in 2024

JOHN MCCARTNEY
Director,
Head of Research,
BNP Paribas Real Estate Ireland

> Sellers are having to accept significant discounts to the guide price in order to get deals over the line. Although unpalletable for the vendor these deals provide a new bellwether in the market and should lead to better pricing certainty in 2024

PETER FLANAGAN
Head of Capital Markets,
BNP Paribas Real Estate Ireland

PHASE II BALDONNELL BUSINESS PARK
bought by Pontegadea for €225m in Q4.

TOP 10 INVESTMENT DEALS Q4 2023

	BUILDING	LOCATION	SECTOR	PRICE (€)
1	Baldonnell Business Park, Phase II	Dublin 22	Industrial & Logistics	225,000,000
2	Trinity Point, 10/11 Leinster Street South*	Dublin 2	Office	40,000,000
3	Douglas Court Shopping Centre	Cork	Retail	21,500,000
4	Confidential - Citywest	Dublin 24	Industrial & Logistics	20,600,000
5	Private & Confidential		Mixed-Use	18,000,000
6	The Chancery, 3/10 Chancery Lane	Dublin 8	Office	14,000,000
7	The Grafton Port Collection	Dublin 2	Retail	13,500,000
8	Building 8 Cherrywood	Dublin 18	Office	13,000,000
9	Northwood House, Santry	Dublin 9	Office	9,000,000
10	Griffeen Centre Lucan	Co. Dublin	Mixed-Use	7,000,000

THE CHANCERY BUILDING, 3/10 CHANCERY LANE, DUBLIN 8,
sold in Q4

CONTACTS

BNP PARIBAS REAL ESTATE

57 Adelaide Road
Dublin 2, Ireland
+353 1 661 1233
realestate.bnpparibas.ie

PSRA No: 002702

DR. JOHN MCCARTNEY
DIRECTOR & HEAD OF RESEARCH
BNP PARIBAS REAL ESTATE

T +353 1 661 1233
M +353 87 974 8485
john.mccartney@bnpparibas.com

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PETER FLANAGAN
DIRECTOR
HEAD OF CAPITAL MARKETS

T +353 1 661 1233
M +353 86 848 9054
peter.flanagan@bnpparibas.com

DAMIEN MCCAFFREY
DIRECTOR, INVESTMENT
CAPITAL MARKETS

T +353 1 661 1233
M +353 87 985 2272
damien.mccaffrey@bnpparibas.com

SAHIL KALE
INVESTMENT ASSOCIATE

T +353 1 661 1233
M +353 87 395 6854
sahil.kale@bnpparibas.com

FEARGHAL LYNAM
INVESTMENT SURVEYOR

T +353 1 661 1233
M +353 87 429 6532
fearghal.lynam@bnpparibas.com

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