Q1 IRISH INVESTMENT MARKET 2024

BNP PARIBAS
REAL ESTATE

Q1 2024 KEY TRENDS

WEAKEST TRADING IN OVER A DECADE
with just €160.5m of investment property sold

TURNOVER DOWN
75% Y/Y

RETAIL ACCOUNTED FOR 43% OF TURNOVER
its highest share since Q4 2016

Two sizeable retail parks comprised
77% OF RETAIL TOTAL

OFFICES ACCOUNTED FOR LESS THAN 8% OF SPENDING
third lowest share ever recorded

NO DUBLIN CITY CENTRE OFFICES PURCHASED
between January – March

US AND UK STALWARTS REMAIN INACTIVE
France was biggest investor accounting for 42% of spend

MARKET ACTIVITY

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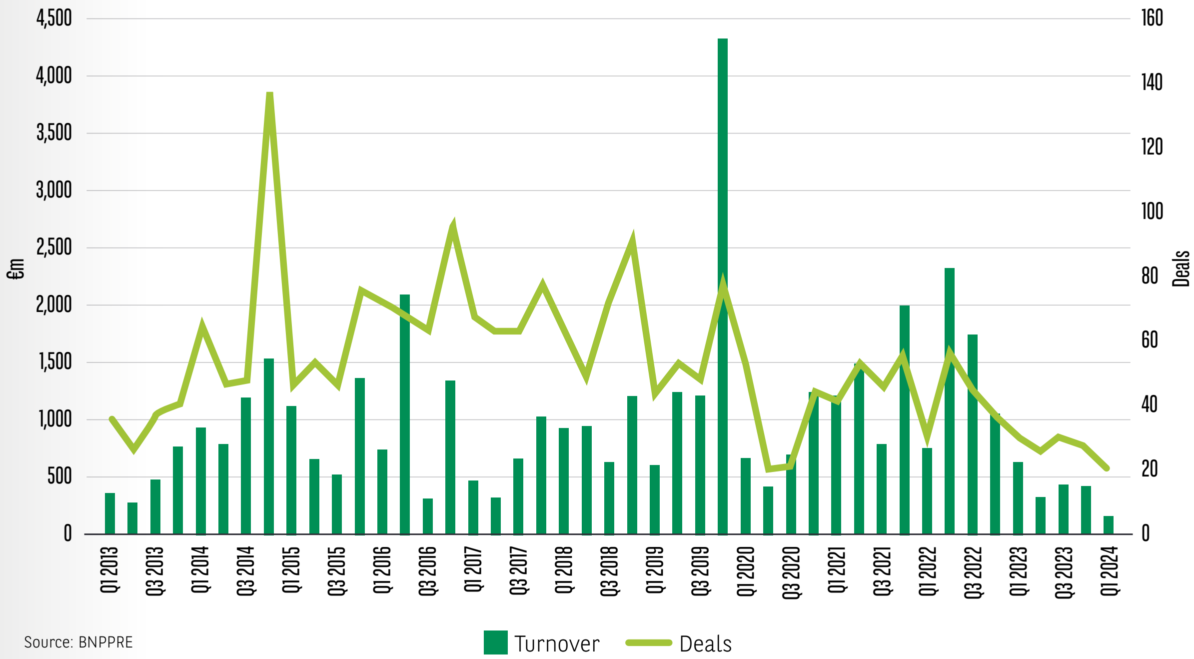
Ireland's investment property market limped out of the blocks with just €160.5m of income-producing assets changing hands in the first quarter of 2024. This is the lowest total since Q3 2012 and, to put it in perspective, the amount of capital invested in Irish property was only 37% of that invested during the quietest quarter of the Covid pandemic (Q2 2020).

Spending was caught in a pincer between fewer transactions and smaller deal sizes. Only 20 contracts were signed, the joint-lowest number in over a decade. Concurrently, the average deal-size halved to just over €8m in Q1. This compares with a 10-year average of €20.4m.

€160.5m
OF ASSETS TRADING IN **Q1**

FIGURE 1: INVESTMENT MARKET ACTIVITY



Source: BNPPRE

The sluggish velocity of trading reflects the fact that the price discovery process remains a work-in-progress; In the face of higher interest rates and unresolved structural challenges in occupier markets, many vendors have simply not softened their price expectations enough to make bid-ask spreads bridgeable.

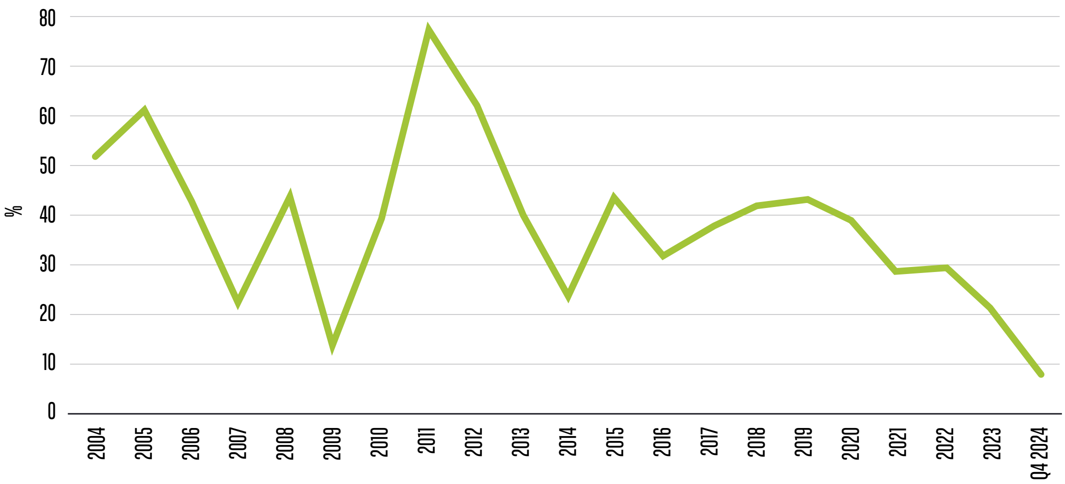
The squeeze on deal sizes reflects multiple factors. Weak occupational markets and structural changes to lease terms have deducted from the average value of investment properties in Ireland, and this is ultimately becoming reflected in the value of assets that trade. Compounding this, rate hikes have impacted the cost and availability of debt capital for leveraged transactions, leading to tighter budget constraints.

At the same time there has been a compositional shift towards cheaper regional markets, segments where the price adjustment process is further advanced, and buyers who have an appetite for 'wet' investments that require more asset management.

TURNOVER BY SECTOR

The office sector has traditionally been the mainstay of the Irish market, attracting almost €14bn of capital between 2004 and 2019, and accounting for nearly two-fifths of total investment spending during this period. However, as illustrated in Figure 2, the office share of investment has trended progressively lower since then, retreating to just 7.8% in Q1 2024.

FIGURE 2: OFFICE SHARE OF INVESTMENT TURNOVER



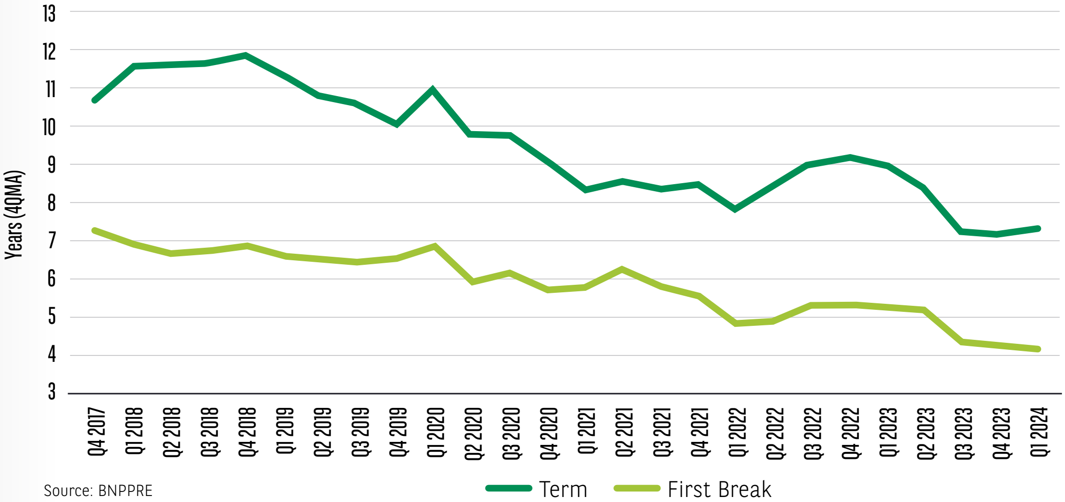
Source: BNPPRE

The slowdown reflects both cyclical and structural factors. In the occupier market, tenant demand is challenged by the inactivity of tech firms which has left a large vacuum in take-up. ICT accounted for more than half of office leasing in Dublin between 2017-2021. However, the 2022 tech shock triggered a round of global headcount reduction that is still underway, including in Ireland. As a result, tech has only taken 20,000 sq m of office space in Dublin over the last year, and its share of overall take-up has receded to 17.2%. Unfortunately, this has coincided with a spike in new office supply, causing vacancy to rise.

The tech hiring slowdown will pass in due course and, as Dublin is an established global tech hub, office take-up will benefit. But other factors impacting the office market are longer-term and more structural in nature. Compounding the challenge of sluggish tech leasing, remote working has weakened the link between jobs growth and office demand. There is emerging evidence that, while the number of people working remotely in Ireland has stabilised, they are spending fewer days at home on average. Nonetheless, it is uncertain whether the sharp reduction in the office-space-per-employee ratio that resulted from the hybrid work revolution will be fully reversed.

In addition to this, structural changes to leases have made future rental income streams more uncertain. Lease contracts signed after February 2010 no longer contain upwards-only rent review mechanisms. Furthermore, over a 20-year period, lease terms have gradually shortened. The standard institutional office lease in Dublin was once a 25-year commitment, with 30-year leases not unusual. However, the benchmark term for prime office buildings has gradually been pared back to 15 years and, across a mixed-quality basket of assets, the average term is significantly shorter – see Figure 3.

FIGURE 3: AVERAGE LEASE TERM AND FIRST BREAK ON NEW LETTINGS – DUBLIN CITY CENTRE OFFICES

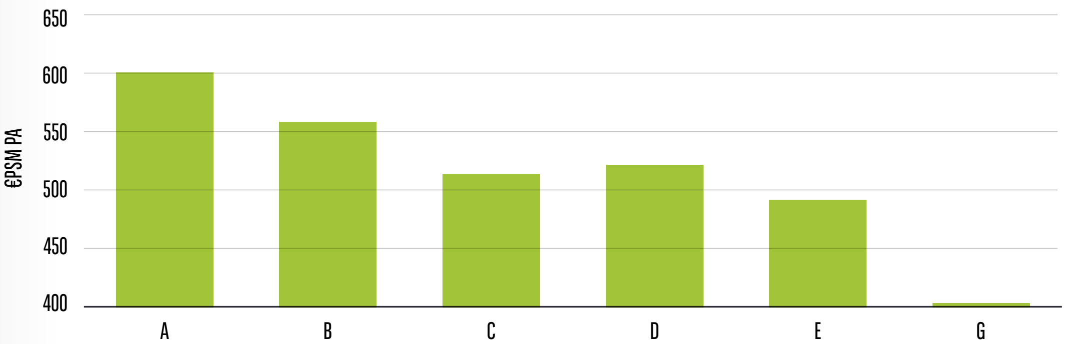


Source: BNPPRE

In line with this shortening of leases, the average time to first lease break has also reduced. The fact that these changes have now continued over more than two decades, and through multiple leasing and development cycles, suggests that they are structural and, on average, they make the future income stream that is being sold with office investments less certain.

A shift in preferences at the top end of the market towards energy efficient green buildings also represents a structural challenge for the office sector. Figure 4 illustrates an almost linear relationship between BER ratings and headline office rents in Dublin city, meaning that capital values are now highly sensitive to buildings' energy performance. However, most Dublin offices are not A-rated and therefore many require significant capex to future-proof against environmental stranding and to achieve top rents.

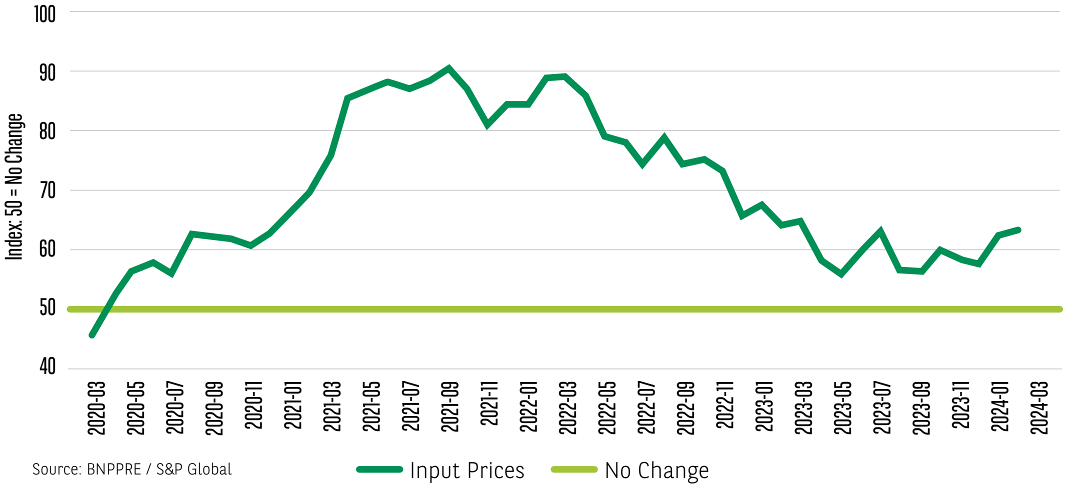
FIGURE 4: AVERAGE HEADLINE RENTS BY BER – DUBLIN CITY CENTRE OFFICE LETTINGS Q1 2022 – Q1 2024



Source: BNPPRE

Unfortunately, construction costs inflation has made many investors wary of taking-on this risk. As illustrated in Figure 5, the BNP Paribas Real Estate Ireland Construction PMI shows that input costs have risen for 47 successive months since April 2020 (readings over 50). Moreover, the slowdown in inflation between October 2021 and May 2023 now appears to have reversed. Reflecting this, where investors are prepared to bid on brown offices, their offers are calibrated to reflect the potential costs involved.

FIGURE 5: CONSTRUCTION COSTS INFLATION

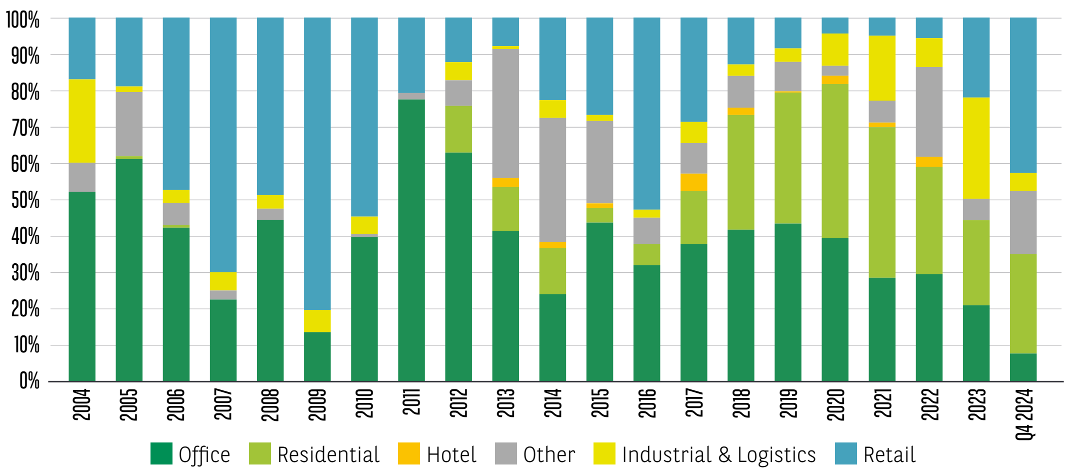


Source: BNPPRE / S&P Global

All of these factors are weighing on the prices that are being achieved in transacted office deals. In many cases, however, bid-ask spreads have been too wide for deals to happen because of vendors' reluctance to accept lower prices in the absence of comparable evidence. This is particularly the case in the prime Dublin city centre market where no new-build offices have been sold since Q3 2022. Indeed, of the four offices that traded for a combined €12.55m in Q1, three were outside the capital and one was in a city-fringe location. In this context, it is very positive for the market that negotiations for the purchase of 40 Molesworth Street, a redeveloped block in one of Dublin's most prime pitches, were reportedly at an advanced stage as Q1 closed.

While office investment is struggling, retail has been enjoying its strongest share of the action since 2016 (although, given the low overall turnover, the absolute value of trading in retail assets remained approximately two-thirds below the 10-year quarterly average).

FIGURE 6: SECTORAL DISTRIBUTION OF INVESTMENT

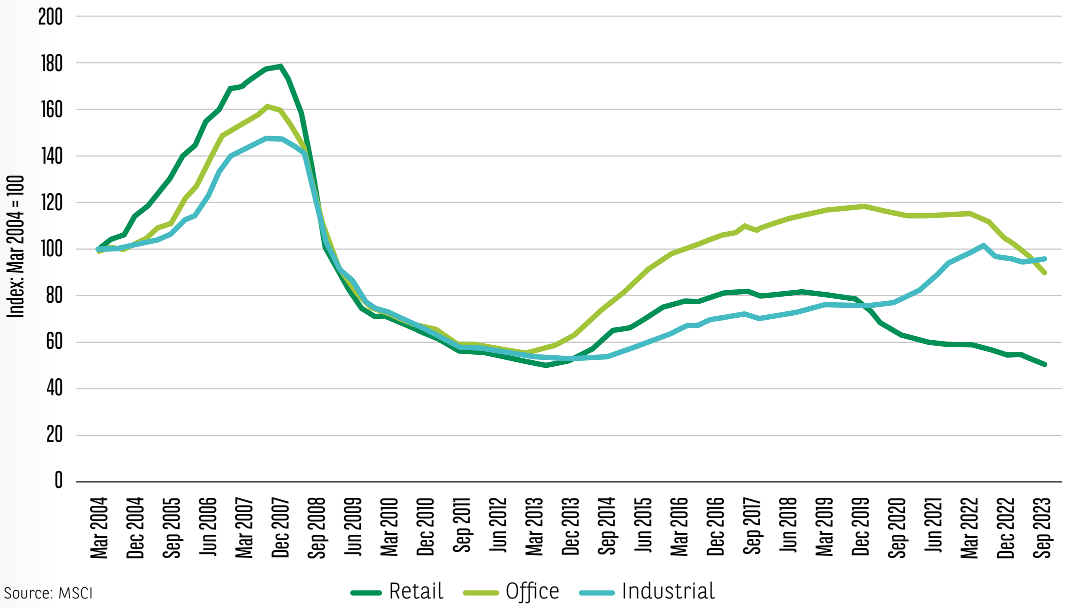


Source: BNPPRE

€69.06m of retail assets traded in the quarter, accounting for 43% of the total. This trend has been driven by several factors; On one hand, the defensive properties of some retail segments – including grocery, convenience and retail warehousing – have attracted capital in a more uncertain macro-environment. This continued in Q1 with two sizeable retail parks – Gulliver's Retail Park in Santry and Kilkenny Retail Park – trading for €28.3m and just under €25m respectively in the second and third biggest deals of the quarter.

While secure income is undoubtedly a motivator, value has been another key driver of capital into retail property. There are two dimensions to this. Firstly, the market has now had a considerable time to price-in the structural challenge of online shopping and, as a result, retail property has been subjected to more repricing than logistics or offices (where the structural challenge of remote working is more recent) – see Figure 7.

FIGURE 7: MSCI CAPITAL VALUE INDEX BY SECTOR



Source: MSCI

Secondly, by its nature, retail property is more geographically dispersed. In contrast to offices and logistics buildings, which tend to cluster in well-defined, dedicated locations, the various forms of retail property are distributed across towns, villages and neighbourhoods throughout the country. This has provided opportunities for yield-driven investors to seek-out mispriced assets in vibrant provincial towns where the occupational risks do not justify the regional discount. Reflecting this, 73% of all retail investment in Ireland since the start of 2022 has been outside of Dublin.

In addition to these factors, the supply of retail investment opportunities has become more liquid with a number of international private equity investors seeking an exit and with the Irish funds seeking to rebalance their portfolios. As noted in previous commentaries, high street units in Dublin's prime retail streets rarely came up for sale in the past as many were locked-into institutional ownership. However, more of these assets have become available in recent years. Since the beginning of 2022 twenty-three shops in Dublin 2 have changed hands, including six on Grafton Street. A further three have traded on the nearby Wicklow Street, along with two properties on College Green. The latter includes 1-2 College Green which BNPPRE bought for French debutant Altixia REIM for €2.5m in Q1.

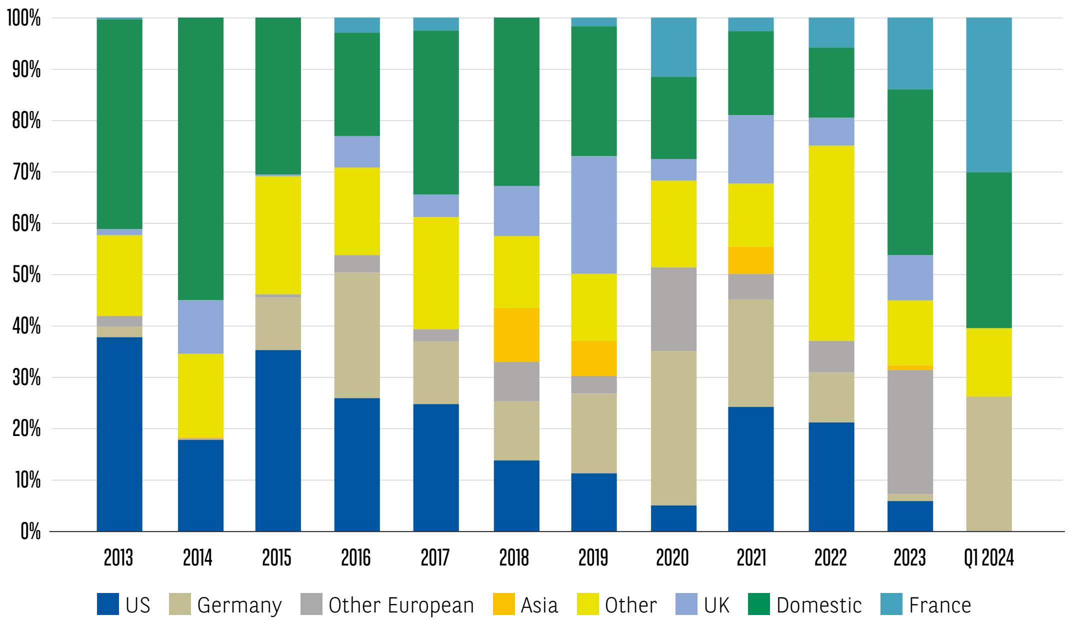
As previously reported, the outward movement of interest rates, and the strictures of Ireland's rent control system, have curtailed institutional investment in the private rented sector. However, somewhat against the run of play, the biggest deal of Q1 was German fund KGAL's purchase of 104 apartments at Shackleton Park in west Dublin for €42m. There is a strong pipeline of apartment development in Dublin. However, at current yields, the main sales outlet for developers is likely to remain Government-funded bodies.

Given tight vacancy and robust rental growth in the occupational market for warehousing and distribution facilities, almost €2.25bn of capital was attracted to Irish logistics property over the last four years. 2023 was a record year for new logistics space delivery in Dublin. However most of the new builds have been held by their developers, and the development pipeline is now slowing. As such buy opportunities are limited and just €7.5m of assets traded in Q1.

BUYER TYPE AND ORIGIN OF CAPITAL

With interest rate increases impacting on the cost and availability of debt capital, cash-buyers have come to the fore. Private Irish investors tend to be cash funded, and they only accounted for 5.5% of turnover in the 2013 – 2022 period. However, in a higher interest rate environment, their market share has doubled to 10.6% since the start of 2023. Their average purchase price in Q1 was just under €2.2m. French SCPIs, which are also typically cash funded, have become even more active. These purchasers are yield driven and typically operate within a €5m - €25m price range but, assuming their yield objectives are met, they tend to be quite agnostic between commercial sectors and locations. As illustrated in Figure 8 French money has accounted for 15% of total investment since the start of 2023 and French buyers were the biggest investors in Q1 with 30% of the spend. Iroko Zen, which was introduced to the Irish market by BNPPRE, has been the busiest of the SCPIs. It bought three retail properties in Q1, including Kilkenny Retail Park (€24.97m), 24 Suffolk Street (€3.635m) and the Dealz store in Bray Co. Wicklow (€1.56m). BNPPRE advised another French fund, Inter Gestion REIM, on its purchase of a mixed-use office and retail building at 21-24 Capel Street in Dublin 1.

FIGURE 8: TURNOVER BY ORIGIN OF CAPITAL



Source: BNPPRE

In contrast, after retreating sharply in 2023, US money effectively disappeared in Q1 as core buyers that had been active such as Blackstone and Greystar remained on the sidelines as pricing continues to adjust.

OUTLOOK

Looking ahead, the quantity of investment product that is openly for sale on the Irish market continues to contract, and so we do not expect a dramatic rebound in activity. Nonetheless, there are some positive signs. The value of sale agreed stock has risen three-fold over the last 12 months and the value of assets under offer has also picked-up – albeit both are coming from a very low base.

However, these statistics provide limited forward visibility because, as in any downswing, off-market trading has come to the fore. Regarding assets that are known to be available off-market, our view is that total turnover for the year could reach approximately €1.5bn with a fair wind.

Looking further ahead, these trades, in themselves, should be the catalyst for a more fluid market as they will provide much needed comparable evidence for vendors and investors alike. In this respect the impending sale of 40 Molesworth Street will be a particularly important bellweather for the prime office market which has been starved of such evidence for the last 18 months. The monetary and macro-economic outlook also augurs well for a better 2025. Following the ECB's 11th April meeting, markets are now pricing-in a high probability of interest rate cuts in June, although this is conditional on Q2 data-flow. Assuming this relaxation of monetary policy and the more positive macro-economic forecasts for next year come to fruition, a more vibrant investment market can be expected beyond 2024.

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

	Q4 2023	Q1 2024	OUTLOOK
Dublin Office	5.0	5.25	→
Dublin Logistics	5.0	5.25	→
Retail (High Street)	5.25	5.50	→
Dublin Residential (PRS)	4.5	4.75	→

> Investment activity remained very subdued in Q1. However, the tectonic plates of the macro-economy are shifting and, assuming interest rates cuts and stronger economic growth come through as predicted, increased investment activity will follow.

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> Overall, investor activity and market confidence in Q1 was low as investors continue to grapple with the fresh set of challenges and risks the current market presents. There are already clear signs however that investment spend is set to pick up markedly in Q2 as we enter a new market cycle with a number of sizeable transactions currently agreed and in legals.

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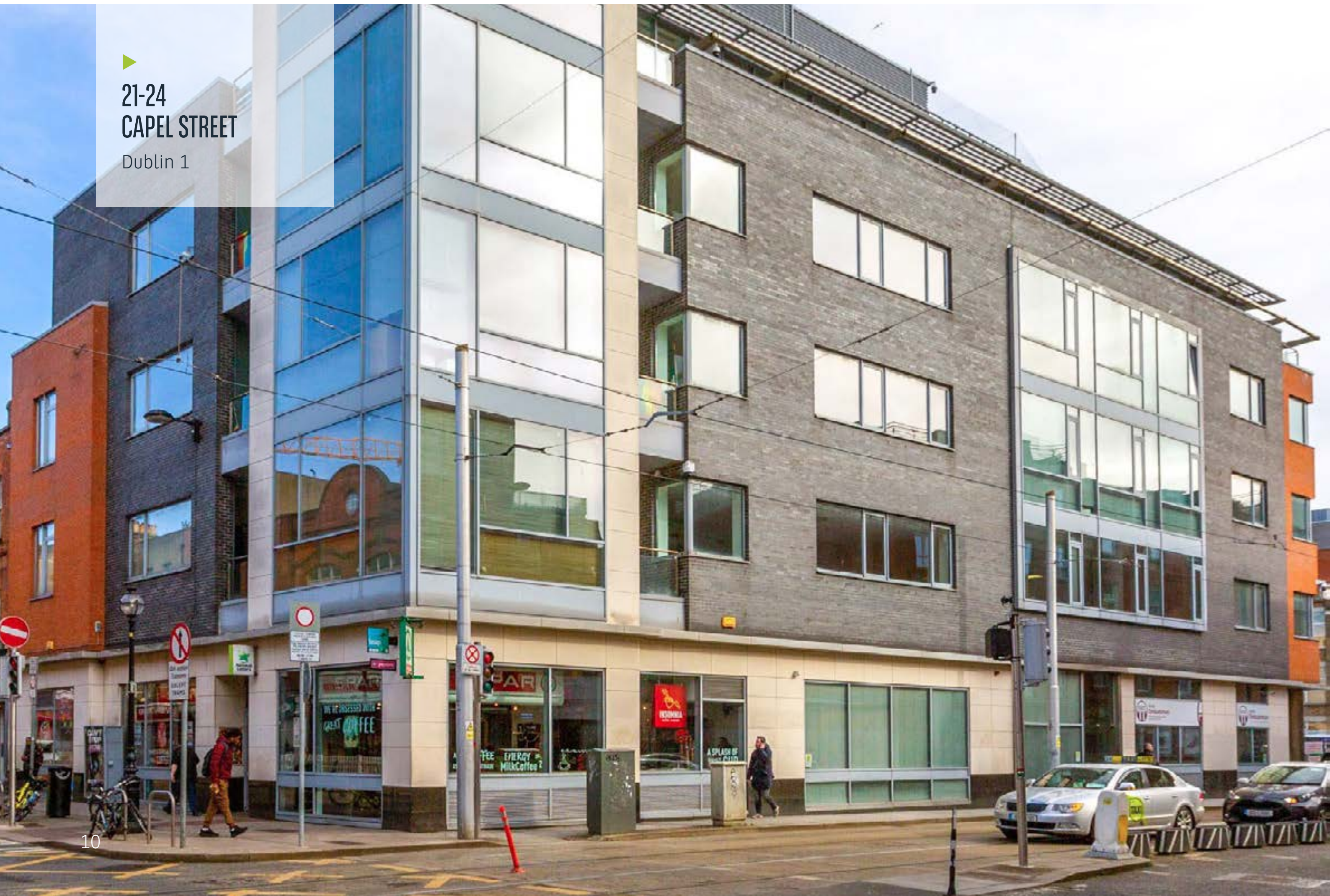

21-24
CAPEL STREET
Dublin 1

TOP 10 INVESTMENT DEALS Q1 2024

	BUILDING	LOCATION	SECTOR	PRICE (€M)
1	Shackleton Park, Lucan, Co. Dublin	Co. Dublin	Residential	42.0
2	Gulliver's Retail Park, Santry	Dublin 9	Retail	28.3
3	Kilkenny Retail Park	Kilkenny	Retail	24.97
4	21-24 Capel Street	Dublin 1	Mixed-Use	16.0
5	Units 7 & 8 Airways Industrial Estate, Santry	Dublin 9	Industrial & Logistics	7.5
6	6/7 Dawson Street	Dublin 2	Mixed-Use	7.1
7	Athlumney House, Navan	Meath	Office	4.4
8	Park Pointe, Honeypark, Glenageary Road Upper, Dun Laoghaire	Co. Dublin	Retail	4.3
9	24 Suffolk Street	Dublin 2	Mixed-Use	3.64
10	Block 2, Galway Financial Services Centre	Galway	Office	3.0

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