

Ireland Investment Market



Outlook for 2023

1

Quiet first half of the year expected



We expect lower investment turnover in the first-half of the year before a recovery in the second half. Rather than acquire new investments, real estate owners will be focusing their energies on shoring up current holdings. Fundraising will be a particular focus in this regard, with fresh equity required to plug gaps where LTV covenants are at risk of being breached. The sale of assets may also need to be undertaken though many

will be reluctant to sell at a time of market weakness. At an institutional portfolio level, the decline in bonds and equity valuations means that real estate target allocations may have increased beyond allowable thresholds, necessitating the sale of real estate assets or at least a moratorium on purchases until appraised property values decline or public capital markets recover sufficiently.

2

Preference for off-market deals to increase further

The last number of years has seen an increase in the prevalence of off-market deals taking place. Rather than engage with full open market marketing campaigns, agents have been typically presenting opportunities on a confidential basis to a select number of identified parties that have the ability to execute. Due to the decline in transactional values and the rise in price uncertainty, sellers are expected to further increase their preference for off-market deals as they offer greater transactional certainty and deliverability. Furthermore, even if an off-market sale does fall through, it greatly reduces the stigma that can be generated by an unsuccessful open-market sales process.



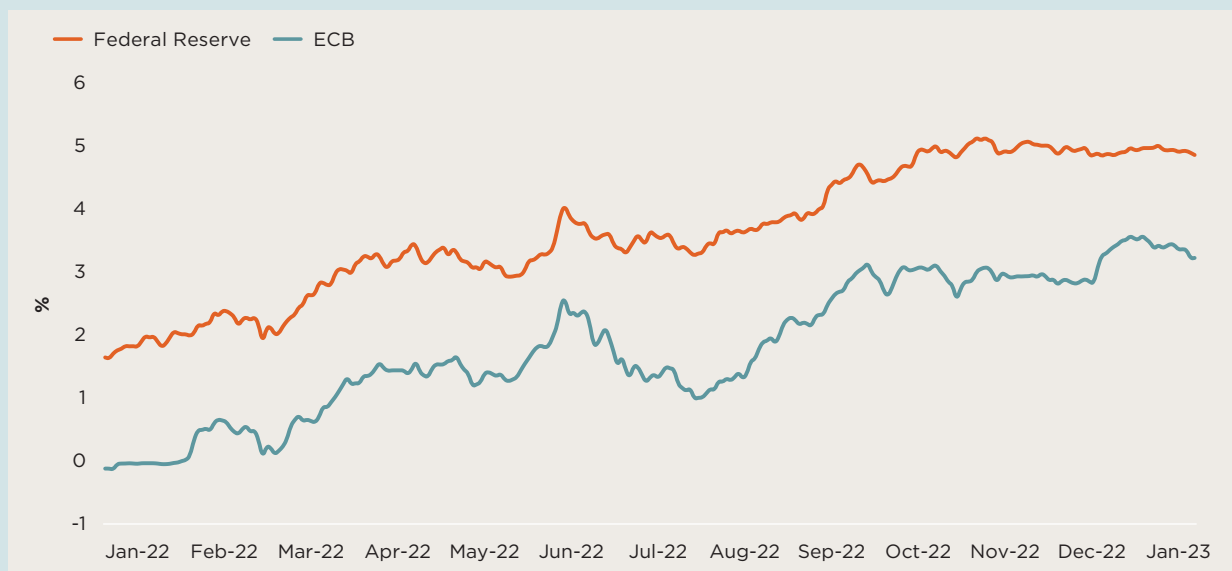
3

Flattening terminal rate expectations to set the basis for recovery

The unprecedented increase in interest rates witnessed in 2022 caused significant market dislocation. It was not only that central banks increased rates after a sustained period of ultra-low rates, but it was the pace of rate hiking that caused the greatest unease. While equity and bond markets both repriced quickly to the downside, the real estate sector inevitably entered a period of inactivity as a gap in pricing expectations opened up between buyers and sellers. It is noteworthy that while we expect to see further rate rises this year from their current levels of 4.58% and 2.5% for the Federal Reserve and the

European Central Bank respectively, we have seen a stabilisation in market expectations regarding the level at which interest rates will peak, otherwise known as the 'terminal rate'. Over the last four months, the terminal rate has been relatively steady at approximately 5% for the Fed and approximately 3.25% for the ECB. This stabilisation of the terminal rate – close to where rates have already reached – will help bring greater certainty to the underwriting process and set the basis for a recovery in transactional volumes in 2023.

Figure 1: Market-implied expectations for terminal rates



Source: Savills Research, Macrobond

4

We will see greater dispersion in returns



The era of quantitative easing dominated the investment landscape for the best part of the last decade. One of its main consequences was to compress bond yields, thereby tightening investment spreads across all asset types, including real estate. Central banks have now made it clear that they want to see inflation brought under control no matter what pain it causes capital markets in the interim. While this current market adjustment makes for an undoubtedly difficult transition, we are seeing real estate yields return to levels more in-line with historical norms. This will lead to a greater dispersion of returns for diverging investment strategies across asset quality, location and income where IRRs more accurately reflect risks taken rather than being backstopped by monetary policy. With risk no longer artificially compressed, the playing field will be opened up to a wider range of possible outcomes, making for an attractive and interesting environment to deploy capital.

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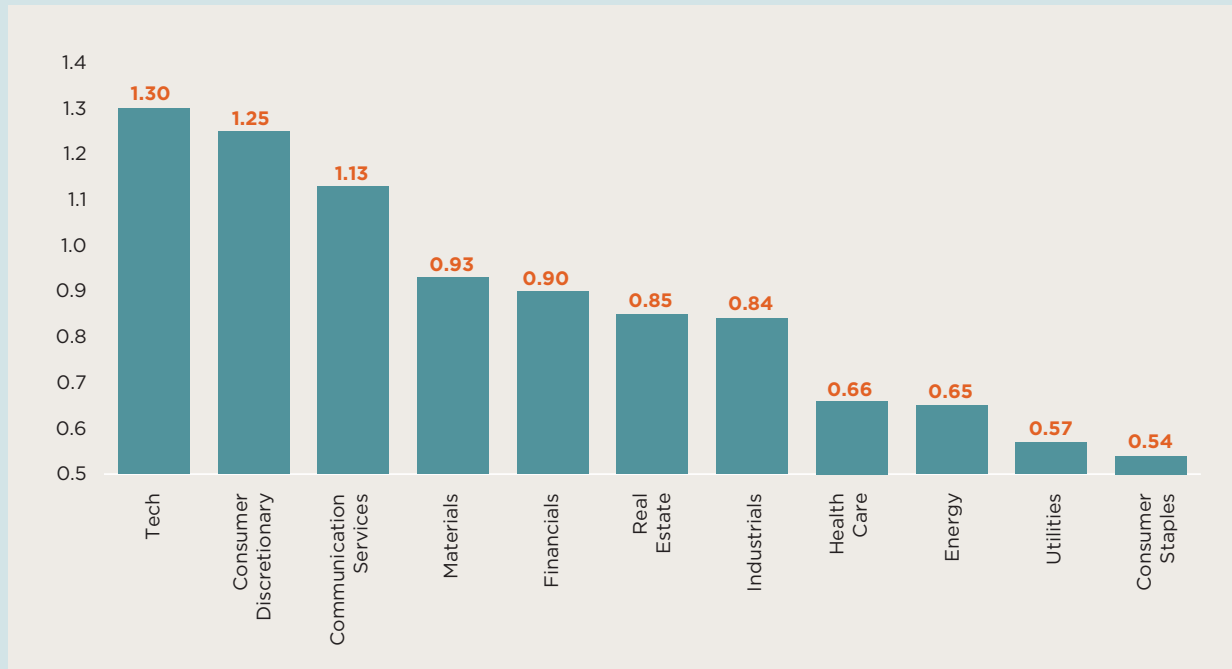
Dublin's high Beta exposure

The current period is undoubtedly a challenging time for Dublin's office market due to its exposure to the tech sector, which accounted for 50% of take-up in the six years before the pandemic. During these times of equity market stress, it is instructive to look at the cyclicity of the tech sector as measured by Beta. Looking at Beta sector exposures of the S&P 500, we can see that the tech sector's Beta of 1.3 places it at the top end of the sectoral components of the S&P 500. This means that the tech sector moves by 30% more on an up or downswing compared to the overall S&P 500 market movement. Therefore, in a challenging capital

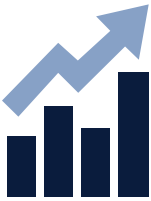
markets environment which has seen significant losses for equities in the last 12 months, the underperformance of the tech sector should hardly be surprising. Given the weighting of the Dublin office market towards the tech sector vis-a-vis other sectors, it is inevitable that the office market will also see periods of pronounced weakness as is currently being experienced. The flip side to this is that the tech sector will be poised for a significant upswing when equity markets recover. When it does, this will benefit the Dublin office market as this demand feeds through to the occupational market once again.

🗨️ Looking at Beta sector exposures of the S&P 500, we can see that the tech sector's Beta of 1.3 places it at the top end of the sectoral components of the S&P 500. 🗨️

Figure 2: Beta exposures by sector, S&P 500



Source: Savills Research, S&P 500



8.2%

rate of HICP inflation recorded in 2022



€5.8bn

transacted in 2022, the second highest year on record



38%

largest market share accounted for by offices



€1.1bn

purchase of Hibernia REIT by Brookfield was the largest deal of the year

Macro view

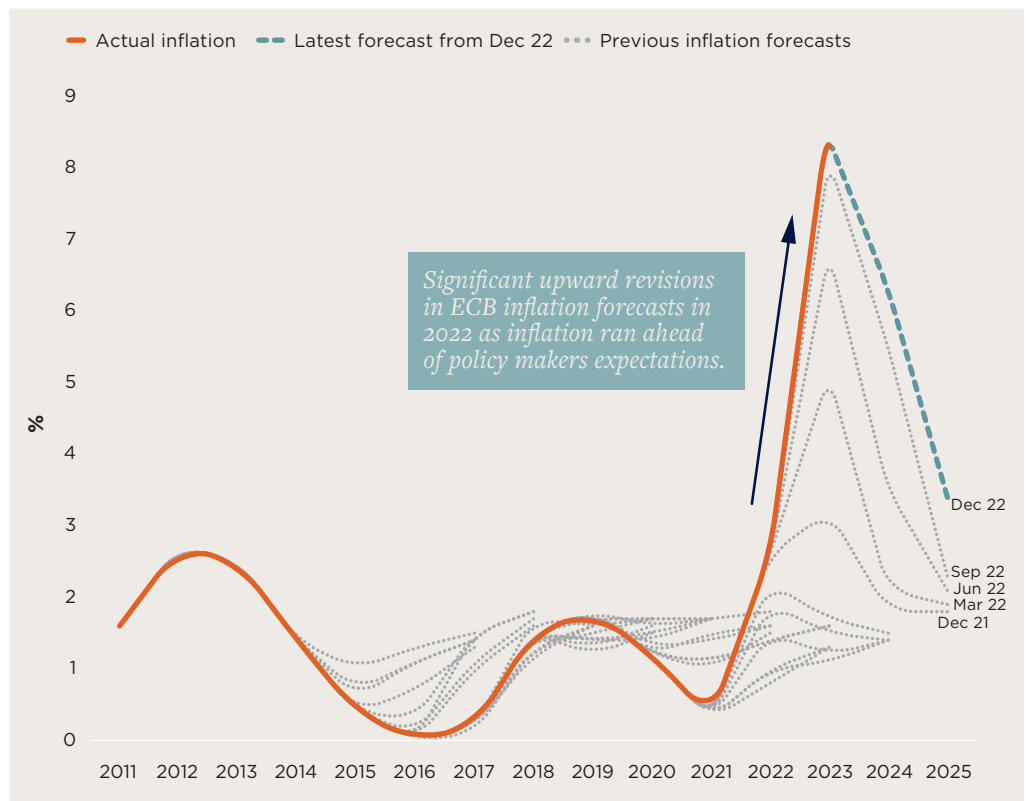
Interest rates, and by extension inflation, continue to be the fulcrum around which investor sentiment revolves.

With inflation taking such a central role in the current market, it is interesting to look back at the accuracy of inflation forecasts made by the ECB/Eurosystem staff over time. In Figure 3, we have plotted these forecasts – of which there are four per annum – back to 2011. We can see that, while forecasters consistently overestimated actual inflation from the period 2014 to 2020, this trend has reversed significantly since then. The substantial upward revisions of inflation during 2022 reflected the rapidly deteriorating inflation dynamic and motivated the ECB’s aggressive rate hiking cycle in the second half of the year as

it sought to maintain its credibility. The latest inflation forecast from the ECB/Eurosystem staff, from December, suggests that the policy is working. While the inflation forecast for 2023 was once again upwardly revised to 6.3% from 5.3% in September, and from 2.3% to 3.4% for 2024, it was the smallest upwardly revision since the March 2022 forecast. It does, also, represent a fall from the 8.2% recorded at the end of 2022 while monthly data shows a declining inflation rate for the last three months (November to January). This is evidence, at last, that inflation is being brought under control and the spike of the past 12 months is subsiding.

👉 **6.3% rate of inflation expected in 2023, down from 8.2% recorded in 2022.** 👈

Figure 3: ECB/Eurosystem forecasts over time

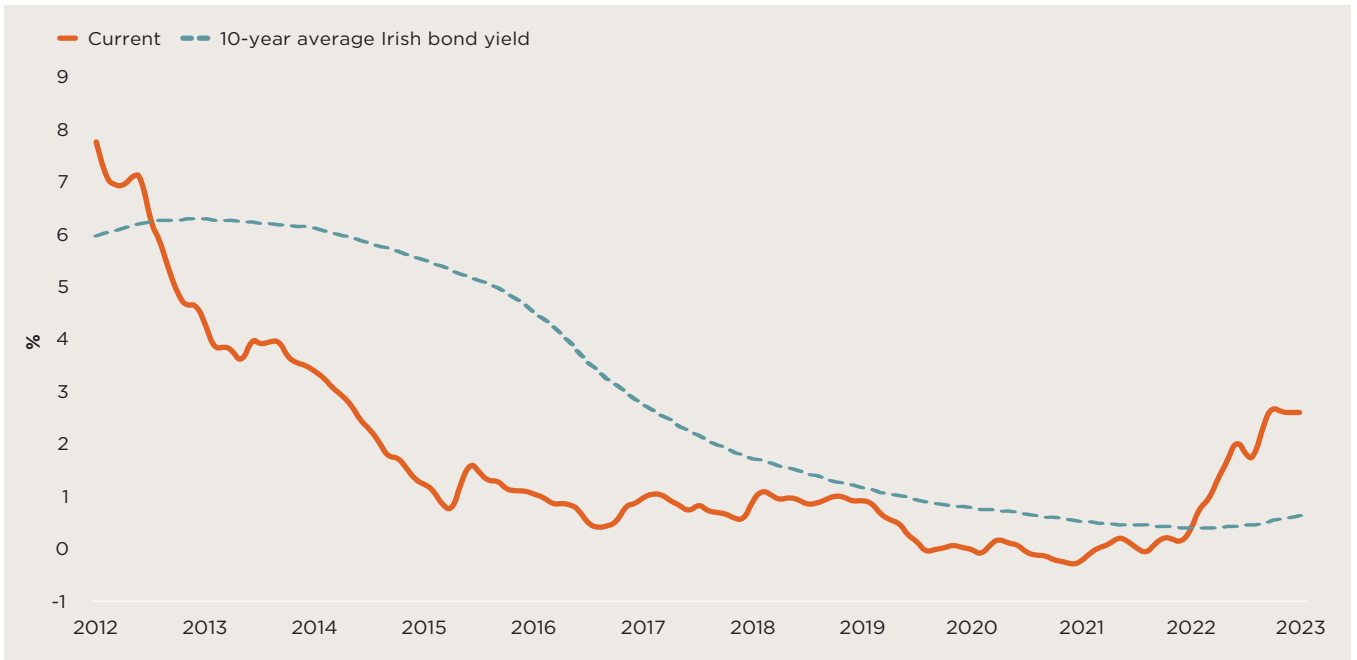


Source: Savills Research, ECB

Nevertheless, inflation is remaining higher for longer than in the recent past due to the stickiness of core inflation (excludes food and energy), which stood at 3.9% last year but has shown no signs – unlike general inflation – of slowing in recent months. This means that interest rates are likely to remain significantly higher than they have been over the last ten years. As illustrated in Figure 4, Irish 10-year bond yields broke through the 10-year average for the first time since 2012 to now stand at 2.9%, well above the 10-year average of just 0.7%.

As a proxy for the risk-free rate, the rise in 10-year bond yields has obvious consequences for the pricing of commercial real estate in Ireland, notwithstanding the relatively strong position of Irish Government yields in comparison to its European peers. For example, Ireland’s 10-year debt now trades at levels in-line with France, while the yield on prime offices in Dublin now stands at 4.25%, which compares favourably with Paris which has a prime office yield of 3.50%.

Figure 4: Irish Government bond yields, current versus 10-year average



Source: Savills Research, Eurostat



Tesco, Baggot Street, Dublin

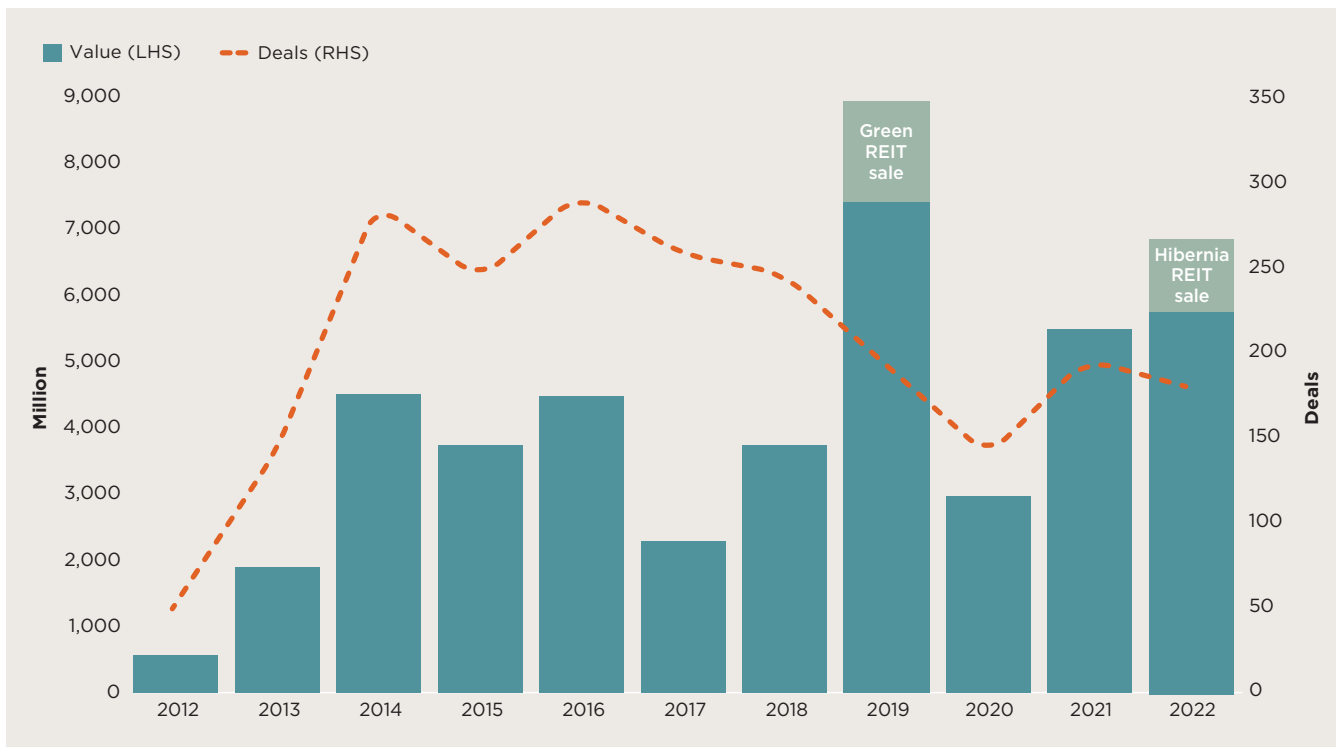
Investment flows

The investment market slowed in Q4 as €761.5 million worth of property deals traded, the slowest final quarter to a year since 2012. The slowdown was expected, with the rapid increase in the cost of capital in the second half of the year putting upward pressure on yields at a pace not previously witnessed. As a result, differences in pricing expectations between buyers and sellers quickly emerged, with many choosing to sit on the sidelines while pricing in the new environment becomes clearer. Nevertheless, reasonable levels of activity did take place in Q4 all things considered, reflecting the sophisticated and diversified investor base active in the country, and ensuring a baseline level of liquidity is maintained even during periods of difficulty such as the present. Confidential off-market deals undertaken by State and semi-State bodies certainly boosted activity in Q4, providing

a countercyclical buffer during a weakened market. The Land Development Agency provided the basis for some of these deals and is something that is likely to be a feature of the market in 2023 as Project Tosaigh continues to be rolled out. Under the initiative, the LDA has €3.5bn worth of capital to deploy for the delivery of new residential supply on private lands.

€761.5 million
transacted in Q4, the slowest final quarter since 2012.

Figure 5: Investment volumes and number of deals



Source: Savills Research

Outside of the residential sector, the largest transaction in Q4 was the expansion of the National College of Ireland's campus to include the West Wing of Block R, Spencer Dock. The €48.5 million transaction is in addition to the current campus on Mayor Street, bolstering the college's footprint in the IFSC. The next largest was an office sale, namely St. Stephen's Green House by joint partners SSGA and Irish Life to French fund Novaxia. The price paid of €45 million represented a net initial yield of 6.9% to the purchaser with an unexpired lease term of approximately 3.5 years remaining. One of the more noteworthy trends to emerge in Q4 was an increase in the number of retail properties that changed hands with €160 million across 13 deals taking place. In total, €363 million worth of

retail transactions took place in 2022, higher than 2021 and 2020 (€307m and €141m respectively), indicating that the reopening of the economy last year significantly boosted this segment of the market. Nevertheless, volumes still have a significant way to go before they reach the pre-pandemic five-year average of €1 billion. Significantly, two US private equity funds exited regional retail parks in 2022. Namely, Varde exited its holding of Dundalk Retail Park for €25 million in a deal with Canada-based Camgill, while Davidson Kempner sold Tullamore Retail Park for €18.5 million to French fund Corum. Elsewhere, German investor Deka continues to deploy into the Irish market, spending €36 million on a soon to be completed Premier Inn Hotel in Newmarket Yards, Dublin 8.



Turning to the full-year 2022 market activity, a total of €5.8 billion transacted across 179 deals, making it the second strongest year on record. The largest transaction of the year was the acquisition of Hibernia REIT by Brookfield for the sum of €1.1 billion. This was the second privatisation of an office-focused REIT in Dublin, following Henderson Park’s purchase of Green REIT in 2019. The second largest deal of the year was also office focused, with the approximate €500 million sale by Fortress/RGRE to Blackstone of the newly completed Spencer Place on Dublin’s north docklands, consisting of the Salesforce HQ as well as a 204 key hotel operated by Dalata. Blackstone and Brookfield are the two largest owners of commercial real estate in the world, with a preference for large transaction sizes that allow them to capture an illiquidity premium while also enabling the deployment of capital at scale. Blackstone was also involved in the fourth largest office deal of the year - this time on the sell side – as it disposed of the Watermarque Building in Dublin to French investor Corum for €92.3 million. Blackstone’s involvement on both the buy and sell side of the office market last year demonstrates that, while investors may seek to exit positions in the current environment, they remain as active capital on the buy- side as well.

These large mega deals helped boost the average deal size in 2022 to €32.2 million, the largest since 2019 when it stood at €38.2 million. Excluding these two deals, the average deal size stood at €23.7 million in 2022, still significantly up on the long-term average of €18.3 million. This was primarily driven by a relatively high number of deals over €50 million, of which there were 30 in 2022 and accounted for 71% of investment volumes.

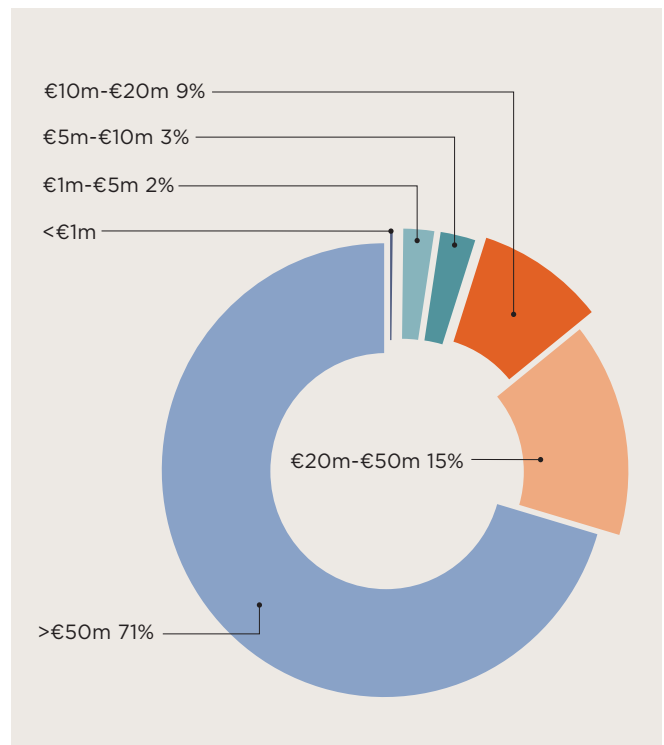
“ While investors may seek to exit positions in the current environment, they remain as active capital on the buy-side as well. ”

The third and fourth largest deals of 2022 were portfolio sales in the alternative residential sector. Care home specialist Aedifica REIT purchased a Dublin nursing home portfolio from Bartra for €161 million, at a net initial yield of approximately 5% with leases marked to CPI. Bringing its total Irish portfolio to €460 million, this investment consisted of two care homes and a transitional care unit, along with the forward purchase of a care home due in Q3 this year. The nursing homes will continue to be run by Bartra’s operating platform Bartra Healthcare. On the purpose-built student accommodation side, Ares and its JV partner Generation Partners purchased a portfolio of three assets – two in Dublin with one in Galway – from Bain Capital for €145 million. The three assets are stabilised and returning a net initial yield of 5%, and will sit under the ‘Here! Student Living’ platform. The fifth largest sale of the year was the forward fund purchase by Union from Barola of the new Primark distribution centre in Newbridge for approximately €129 million, representing a yield of 3.6%. Slated for completion in 2024, the distribution centre will extend to almost 700,000 sq ft. The purchase represents the first acquisition by Union in Ireland’s logistics market and will be added to its European logistics portfolio worth €1.6 billion. The lack of available occupational space in the logistics market – where vacancy currently sits at 1.6% – combined with the lack of investable assets for sale, is causing investors to look to create their own product through developmental activity.

€1.1bn

The largest transaction of the year was the acquisition of Hibernia REIT by Brookfield.

Figure 6: Investment by deal size, 2022



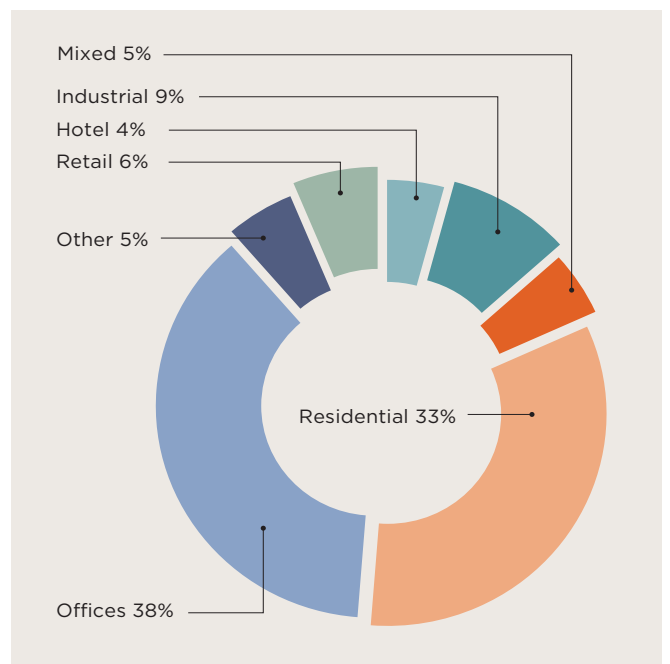
Source: Savills Research



In total, there were 30 deals in excess of €50 million in 2022, second only to 2019 in terms of the number of deals above this threshold. Interestingly, however, activity was not just limited to large deals, with strong deal flow across the lot size spectrum. For example, €537 million was spent across 37 deals in the €10 - €20 million lot size range, the highest level witnessed in this category. Furthermore, there were no PRS deals in the top five transactions in 2022, although they accounted for all of the deals from sixth to 10th place. In total, the residential market accounted for 33% of deals, slightly below the average of 37% witnessed between 2018 and 2021. Offices accounted for the largest share of deals at 38%, proving the resilience of the sector despite choppy sentiment in the occupational market.

👉 In total, the residential market accounted for 33% of deals, slightly below the average of 37% witnessed between 2018 and 2021. 👉

Figure 7: Breakdown by sector, 2022

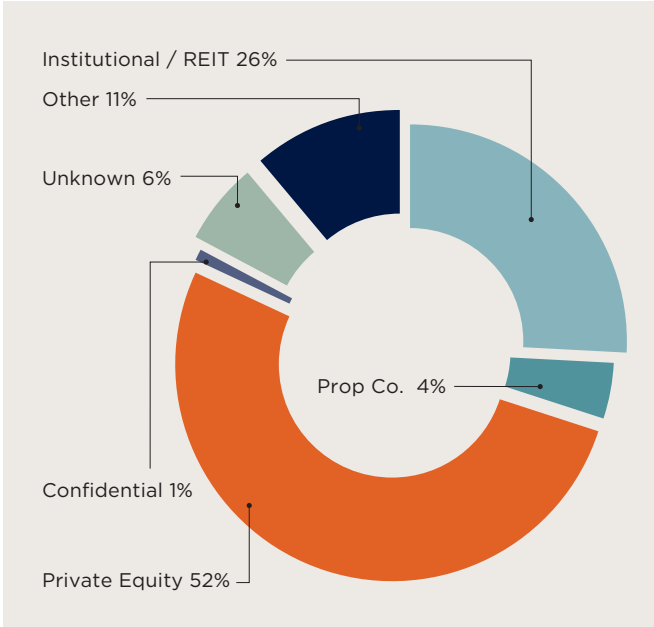


Source: Savills Research

Private equity was the largest buyer type, accounting for over half of the market (52%), followed by institutional/REIT investors at

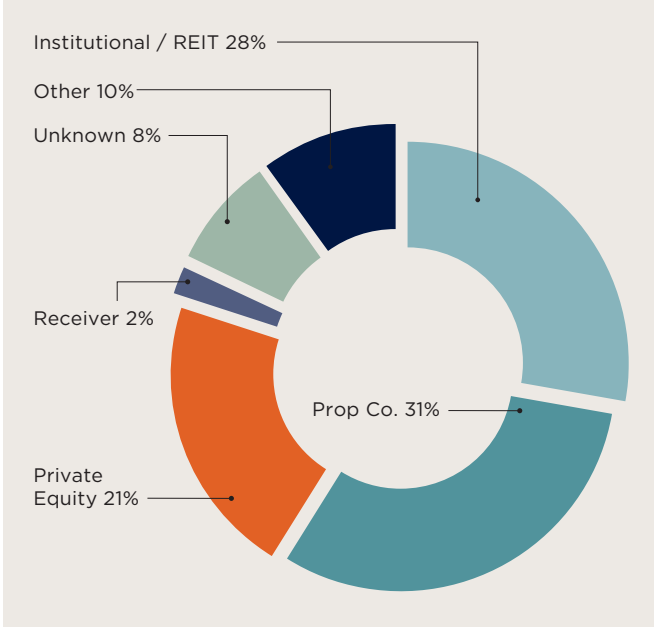
26%. Property companies were the largest sellers at 31%, followed by institutional/REIT with 28% and then private equity at 21%.

Figure 8: Breakdown by buyer type, 2022



Source: Savills Research

Figure 9: Breakdown by seller type, 2022



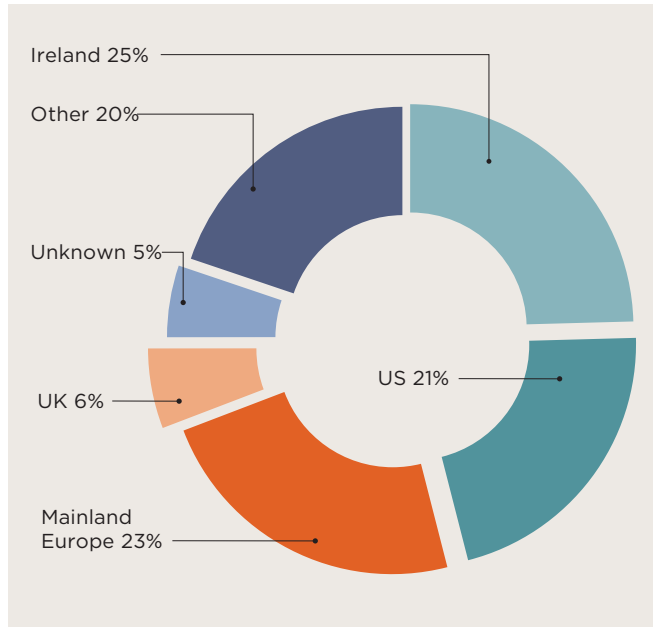
Source: Savills Research



Interestingly, Irish buyers were the most active in 2022, accounting for 25% of acquisitions, and the first time since 2018 that they had the highest share of the market. However, mainland European buyers were just marginally behind at 23%, as were United States at 21%, while Canadian asset manager Brookfield’s taking private of Hibernia REIT drove the ‘Other’ category to 20%. In short, it serves to demonstrate the geographic diversity of active capital in Ireland’s

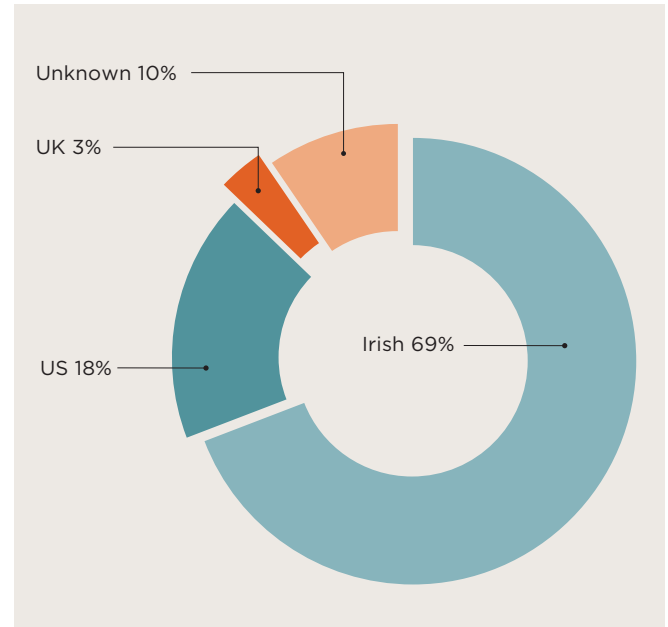
commercial property market even during a year of heightened market volatility. In terms of sellers, Ireland accounted for the largest share of sellers at 69%, followed by the United States at 18%. The former’s high share is in-line with historical norms and driven mainly by the disposal of newly built stock by Irish property companies, while the US share is driven by private equity firms exiting their positions within their targeted investment time frames.

Figure 10: Breakdown by buyer nationality, 2022



Source: Savills Research

Figure 11: Breakdown by seller nationality, 2022



Source: Savills Research

Table 1: Top 10 deals, 2022

Quarter	Property	Price	Sector	Vendor	Buyer
Q2 2022	Hibernia REIT Portfolio, Dublin	€1,089.0m	Offices	Hibernia REIT	Brookfield
Q3 2022	Spencer Place, Dublin 1	€500.0m	Office and Hotel	Fortress/RGRE	Blackstone
Q3 2022	Project Saffire Portfolio, Dublin	€161.0m	Nursing Homes	Bartra	Aedifica
Q1 2022	Project Ruby Portfolio, Dublin and Galway	€145.0m	Student Accommodation	Bain Capital	Ares
Q1 2022	Primark Distribution Centre, Newbridge, Co. Kildare	€128.7m	Industrial	Barola	Union
Q3 2022	Brickfield Square, Dublin 12	€123.5m	PRS	Durkan	Greystar
Q2 2022	Magna Drive, Citywest, Dublin 24	€122.0m	PRS	Glenveagh	Ardstone
Q3 2022	Churchview Road, Killiney, Co. Dublin	€110.0m	PRS	Park Developments	DWS
Q2 2022	Phase 3, St Edmunds, Palmerstown, Dublin 20	€105.0m	PRS	Montane Developments	Ardstone
Q2 2022	14-17 Malahide Road, Dublin 17	€98.0m	PRS	GEM Group	Round Hill Capital

Source: Savills Research

Investment yields

After years of sustained compression, the shift in the monetary environment saw yields move out in the second half of the year as the risk-free rate increased. Rising debt costs have been the most tangible effect of this shift, while there is debate ongoing as to what the fundamental spread for real estate above the risk-free rate should be in the new environment. With regards the latter, the spread for real estate globally has been at historical highs during the quantitative easing era, implying that a return to more normal spreads doesn't necessarily mean that real estate yields will shift outwards in tandem with the rate hiking cycle. Furthermore, where Dublin sits relative to the rest of Europe in the risk-return trade-off is a further point of consideration, especially in the context where our 10-year government bond now trades at a rate aligned with core European countries such as France but our real estate trades at a much larger spread.

A slowdown in deal volumes in the second half of the year - especially for prime benchmark sales - adds further nuance to the current debate on yields. We have shifted out yields for prime real estate by 25bps, except for PRS and retail warehousing, which we have adjusted by 40bps and 50bps respectively. There is additional subtlety within this. For example, we believe that a prime office being offered for sale in Q4 2021 would have achieved in the region of 3.50% to 3.75%, but we did not change yields to reflect this due to a lack of transactional evidence. Secondary yields have shifted out more in absolute basis points terms, with both offices and industrial moving out by 100bps. This reflects the increased focus on prime stock in 2022, driven by both occupier preferences and ESG considerations. Looking ahead, it is clear that pricing under the higher interest rate environment still has a way to go before a market consensus will be arrived at, and is something that will continue to unfold as we move through 2023.

Table 2: Investment yields

Sector	Q4 2022	Y/Y Change
Offices - prime CBD yield	4.25%	0.25% ▲
Offices - secondary CBD yield	6.00%	1.00% ▲
Industrial - prime yield	4.25%	0.25% ▲
Industrial - secondary yield	5.75%	1.00% ▲
Shopping centres - prime yield	6.00%	0.25% ▲
Shopping centres - secondary yield	10.00%	0.75% ▲
Warehouse retail - prime yield	5.50%	0.50% ▲
Warehouse retail - secondary yield	9.75%	0.25% ▲
High street - prime yield	4.75%	0.25% ▲
High street - secondary yield	7.50%	0.25% ▲
PRS - prime yield	4.00%	0.40% ▲
PRS - secondary yield	5.50%	0.50% ▲

Source: Savills Research





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