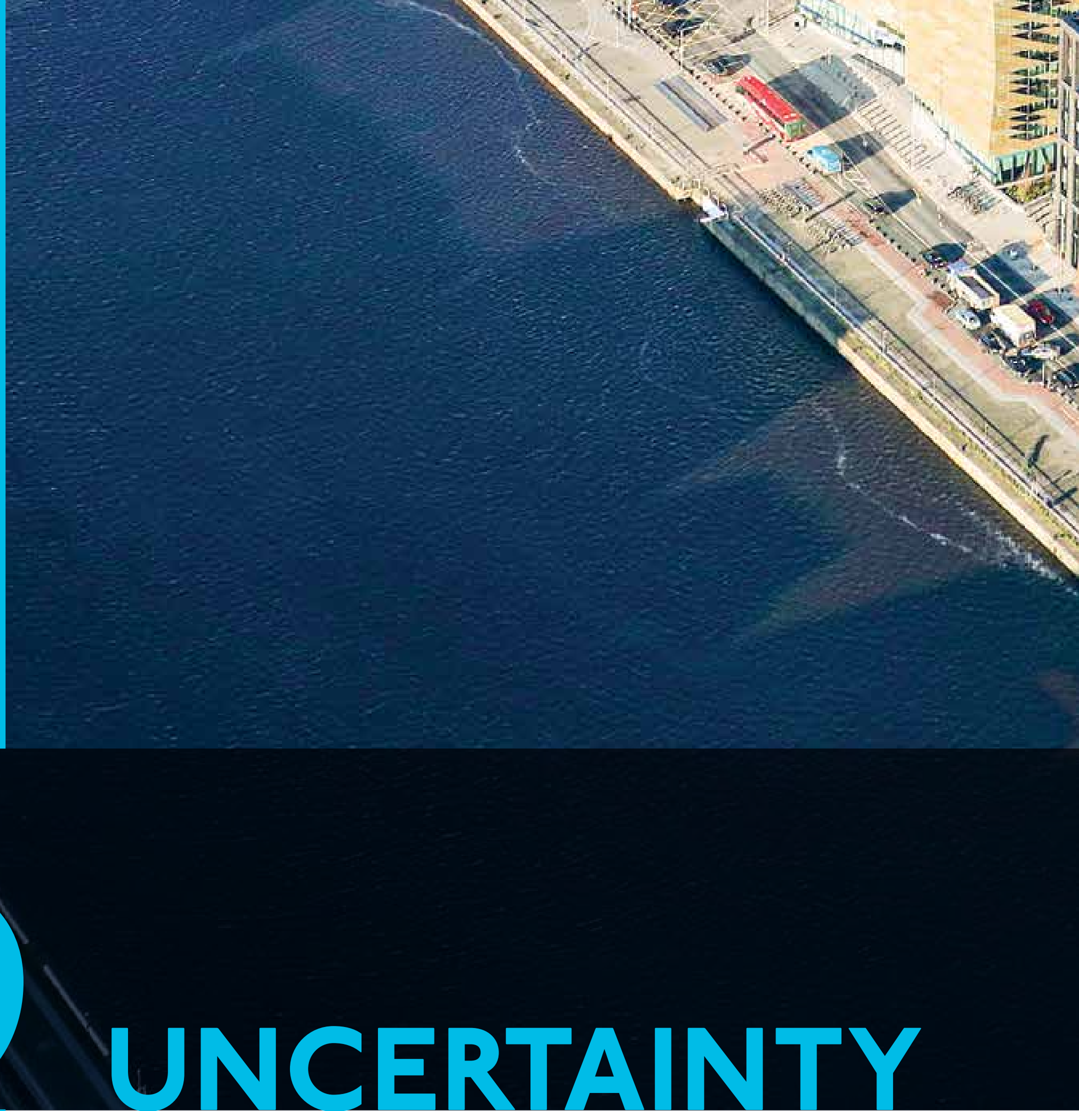
MARKET TURNOVER IS EXPECTED TO BE **STRONG IN 2020,** WITH MANY **LARGE LOT SIZES**



03 UNCERTAINTY

INVESTMENT

Similar to the last two years, uncertainty will be a key aspect of the Irish property investment market in 2020. This stems from both global events and those closer to home.

An Irish general election is due this year and depending on the composition of the new Dáil, further market interventions may be made, which could undermine investor confidence. It appears this is likely to be particularly relevant for PRS (residential) as it is the hottest sector and the most politically charged. If the significant capital (about €7bn) chasing this sector of the market was to disappear, then residential construction would decline and unmet occupier demand would spiral even further.

In spite of this, we expect market turnover to be strong in 2020. There are several high-profile assets due to be put up for sale that will contribute to overall turnover levels. Additionally, the market anticipates that Henderson Park Capital may sell some Green REIT properties. Many of the sales in 2020 will be large lot sizes, notably in the office and PRS sectors. Some could be forward funding or forward purchase opportunities. Off-market transactions will continue to represent a significant proportion of the market. International investors will remain dominant, much of which will comprise funds that have an ability to use internationally sourced debt.

2020 follows on from a particularly strong 2019 where turnover is estimated at €4.7bn, the largest amount of investment ever recorded in a year, and 18% more than what was achieved in 2018. This €4.7bn does not include the company sale of Green REIT, which was an additional €1.34bn. What is interesting from 2019 figures is the fact that the average lot size increased further due to the sale of some large assets; averaging about €23m, up from €13.8m the year previous and just €8.6m in 2017. Demand for the biggest assets mainly came from overseas.

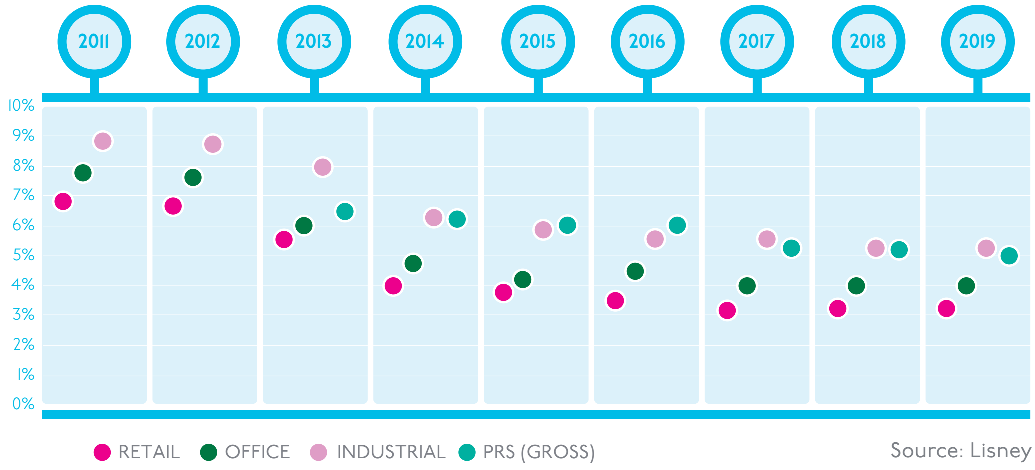
The increase in the stamp duty rate to 7.5% in Budget 2020 was an unhelpful intervention in the market. It means that the rate has now increased by 275% since October 2017. Some investors are concerned that an additional hike in stamp duty to 9% may be on the cards in 2020. Such uncertainty heightens risks in investors eyes and makes the market less attractive. We expect turnover levels to be less in 2020, albeit still at good levels.

PRICING

Capital values of prime assets were relatively stable in 2019 with the MSCI index showing an 'All Property' growth of 1.6% in the 12-months to the end of September. Of note however is the fact that the 'Retail' sub-index declined in Q2 and Q3. Generally, yields have been stable since 2017 and the pace of rental growth has slowed significantly. Entering 2020, values and yields remain stable but there is likely to be some softening in the retail sector as the year progresses. This has been masked in the last 12 months by the lack of activity in the sector.

At the end of 2019, yields were significantly below the highs prevailing in 2012 as the property market began to improve. The average improvement across office, retail and industrial is 365 basis points, while gross PRS yields have improved by about 150 basis points. In 2020, properties offering better returns to investors will be those that carry more risk, either off-prime or requiring capital expenditure. It can be seen in the investment geographical breakdown in the last few years that high-profile investors chasing returns are looking to well-performing regional cities like Cork where stronger yields are on offer. With historically low interest rates forecast for the medium-term, it is expected that the occupational markets will be the key driver of yield shifts in the next few years.

INVESTMENT YIELDS



Source: Lisney

MARKET CYCLE ANALYSIS

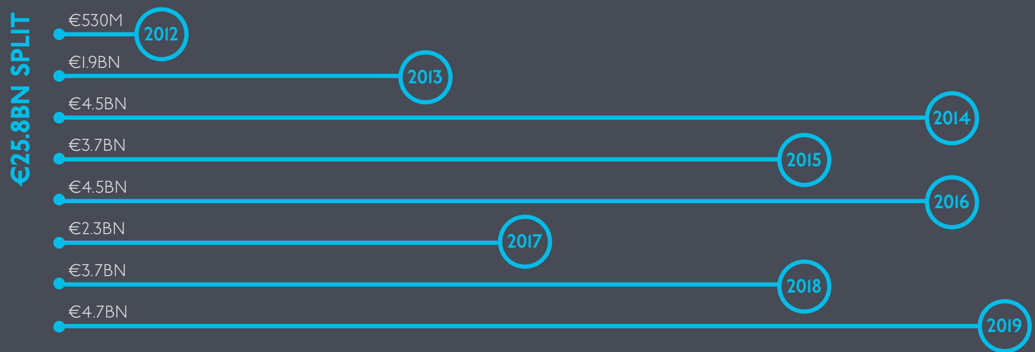
Budget 2012 kick-started this property market cycle; one we are now eight years into. Over that time, more than €25.8bn worth of Irish investment property has transacted as asset sales with a further almost €120bn (nominal value) spent on property-backed loan sales and €1.34bn on Green REIT. Many of the properties have been sold more than once over this time. In 2019 alone, close to three-quarters of the €4.7bn was already sold in this cycle either as asset or loan sales. An assessment of the asset sales since 2012 shows that Dublin has clearly dominated demand, making up 82% of turnover. This is followed by Cork at 5%.

SINCE
2012

ALMOST
€26BN

HAS BEEN SPENT ON
IRISH INVESTMENT PROPERTY.

This excludes the almost €120bn spent on property-backed loan sales over the period and the €1.34bn spent on the company sale of Green REIT in 2019.



82% DUBLIN

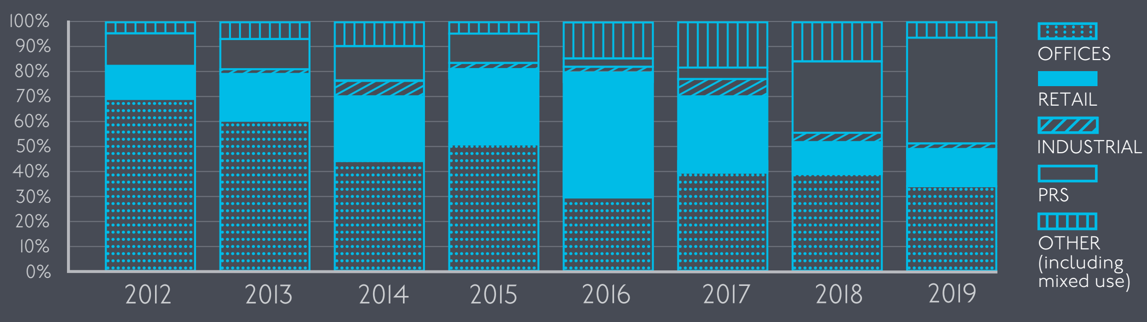
5% CORK

13% OTHER AREAS

As has traditionally been the case in the Irish market, the office sector has dominated the cycle as the investors' sector of choice. But interestingly, its dominance has lessened in the last few years as PRS has risen. On average between 2012 and 2015, offices accounted for 56% of all Irish investment property spend. Since then, the average has been about 35%. Over the same timeframe, the PRS averages have moved from just 13% to 20%, but at a dominant 43% of the market in 2019. Over the years, both the retail and industrial sectors have adjusted too. Retail was very strong mid-cycle with the sale of numerous large shopping centres and retail parks around the country, but this representation has fallen back. Industrial has generally seen little activity since 2012, averaging just 3%, which is less than half the rate that prevailed in the previous cycle when it averaged about 7%. This change is not due to lack of investor demand, there is significant demand, but is as a result of very little investment grade properties coming to the market in recent years.

We believe that the 2020 market composition will be similar to that seen in 2019. It will be driven by the office and PRS sectors, which combined will likely account for at least 70% of market activity. Some better-quality industrial assets may come to the market, while in the retail sector some assets that were bought several years ago may re-trade. If the retail occupational markets do not improve, some buyers that have not seen positive performance may 'cut and run' from the market, particularly with secondary assets.

MARKET COMPOSITION (2012-2019)



Source: Lisney

RENT REVIEWS: IN FOCUS

5 YEAR PATTERN

Rent reviews have been largely absent from the market in recent years. This is due to the five-year pattern on which they fall and the fact that prevailing market rates have often, up to now, been below the historic rents being paid by tenants.

HOWEVER, THERE WAS A SIGNIFICANT **REFOCUS ON RENT REVIEW CLAUSES** IN 2019, A TREND THAT WILL CONTINUE IN 2020.

Market rents are generally quoted in the media and by agents as headline rates. However, when it comes to rent reviews, the new rent is determined by:

NET EFFECTIVE RATES

TAKES ACCOUNT OF ANY **INCENTIVES GRANTED TO INCOMING TENANTS** WHEN TAKING A NEW LEASE, SUCH AS RENT-FREE PERIODS, CONTRIBUTIONS TO FIT-OUT AND BREAK OPTIONS.

FOR LANDLORDS:

A RE-FOCUS ON RENT REVIEWS IS IMPORTANT FOR ACTIVE ASSET AND PORTFOLIO MANAGEMENT.

DRIVING RENTAL INCOME IN BUILDINGS WHERE LEASES HAVE REVERSIONARY POTENTIAL MEANS A **HIGHER CAPITAL VALUE AND IMPROVED TOTAL RETURNS.**

FOR TENANTS:

IT WILL MEAN AN INCREASE IN OUTGOINGS, BUT IT IS IMPORTANT THAT THEY OBTAIN STRONG ADVICE AND REPRESENTATION SO **THAT THEY DO NOT PAY MORE THAN THEY SHOULD.**

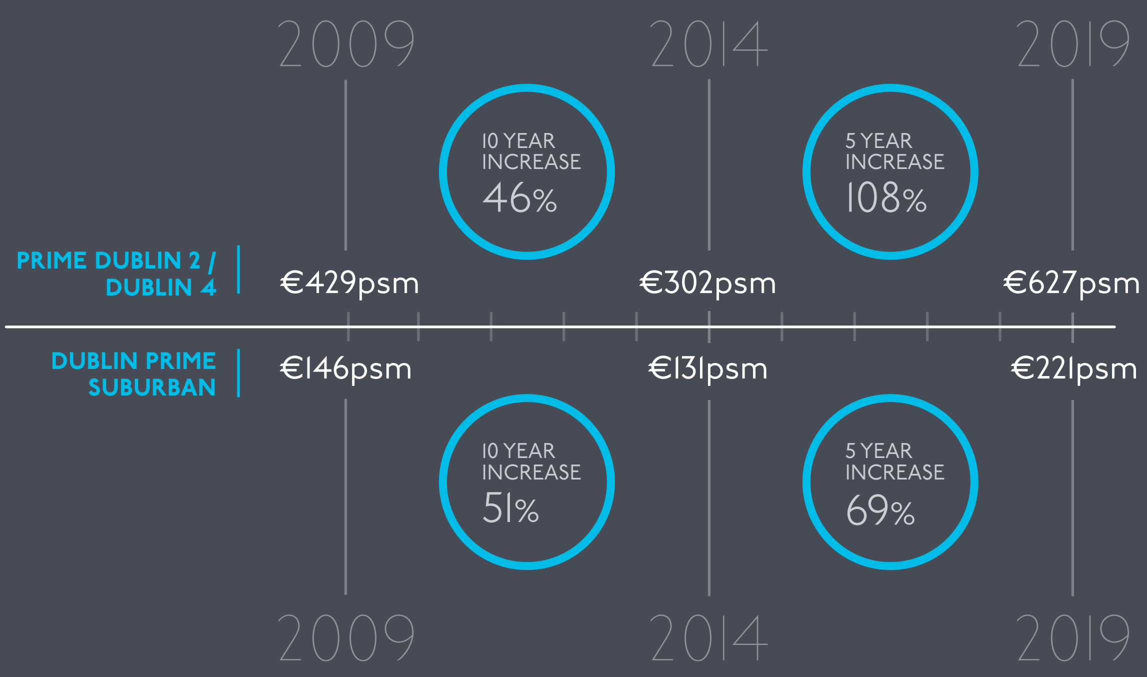
ADDITIONALLY, RENT REVIEWS PROVIDE TENANTS WITH THE OPPORTUNITY TO REVIEW THEIR OVERALL PROPERTY REQUIREMENTS, WHICH MAY LEAD TO AN EXPANSION OR A CONTRACTION, OR EVEN A RELOCATION OR LEASE RE-GEAR.

CASE STUDY:
OFFICE MARKET

The infographic below shows the movement in the net effective rent of prime office accommodation in Dublin city centre and in the suburbs. Assuming rent reviews were due in early 2009, 2014 and 2019 and that the lease contained an upwards only rent review clause (agreed before such clauses were abolished in February 2010).

IT CAN BE SEEN THAT THERE WOULD HAVE BEEN NO CHANGE IN RENT AT 2014 REVIEW BUT NOW THERE IS THE PROSPECT OF SIGNIFICANT INCREASE, PERHAPS

UP TO 50% GROWTH



Taking the office market as an example, the resurgence in rent review negotiations has been driven by the

SIGNIFICANT GROWTH IN RENTS SINCE 2014

LINKED TO THIS IS THE FACT THAT THE MARKET HAS BECOME MORE OF A LANDLORD'S MARKET AND INDUCEMENTS HAVE REDUCED

CASE STUDY

E ENVIRONMENTAL
S SOCIAL
G GOVERNANCE

ENVIRONMENTAL CONSIDERATIONS

ARE INCREASINGLY MORE IMPORTANT WHEN MAKING PROPERTY INVESTMENT DECISIONS

Nova Atria,
Sandyford, Dublin 18

SUSTAINABILITY

There is now a global people-movement focussed on the moral obligations of organisations and their environmental responsibilities. The built environment is not immune from this. Up to now, sustainable changes in the industry have generally been forced on occupiers and developers through building regulations. However, the pace of this people-movement is rapid and for the first time, people-power may force changes in advance of legislative changes. What is now an exception in terms of sustainability, will become the norm. Properties not reaching the desired standards will not only perform poorly but may suffer from both functional and economic obsolescence.

For the investor, a United Nations initiative in 2004 called 'Who Cares Wins' brought sustainable investment principles into focus, by integrating environmental, social and governance (ESG) considerations. Environmental considerations, in particular, are increasingly more important when making property investment decisions given the impact of buildings on greenhouse gas emissions and the fact the risks of climate change are intensifying. Across Europe, NZEB requirements will be mandatory from the end of the year and will ensure that buildings are energy efficient and using an element of renewables. This is a significant step forward from the BER ratings that we have in Ireland, which have been in place for over a decade now and while it states energy performance, it allows inefficient buildings to operate without sanction.

The ESG criteria are a set of standards for a company's operations that socially conscious investors use to screen potential investments.

ENVIRONMENT	Making investment decisions that are committed to preserving and maintaining the physical world, focusing on energy use, waste pollution and natural resource conservation.
SOCIAL	Socially aware investing examines the social and societal implications of each investment opportunity.
GOVERNANCE	Maintaining strong corporate governance and behaviour structures within the property investment company.

SUSTAINABILITY

Investors with medium to long-term investment strategies are generally more focused on ESG as it builds long-term value sustainability. The IMF has stated that to date, funds adopting ESG investment criteria do not benefit from any greater returns in terms of performance, however other studies, such as that carried out by MSCI differ, showing better growth. As ESG is in its infancy, it is likely that further data and greater levels of investment over a longer time period is necessary. This will be possible given the pace of growth. The Global Sustainable Investment Alliance reported that ESG investment grew by 34% between 2016 and 2018, and given this adoption rate and the growing awareness, the speed of growth could improve.

For companies, there are other considerations and issues in adopting ESG. For example, there is no universally accepted reporting standard, the time taken to assess opportunities can be longer and this can mean higher fees for individual investors. In terms of reporting standards, both MCSI and GRESB are high-profile providers. MSCI uses ratings to measure a company's resilience to long-term financially relevant ESG risks. It rates companies on an AAA to CCC scale (AAA being the best) according to exposure to ESG risks and how well these risks are managed relative to peers. GRESB (Global Real Estate Sustainability Benchmark) focuses on a climate risk and a resilience score card. It shows how well the fund is managing location specific ESG and climate risks in a property portfolio and scores accordingly to provide a GRESB score out of 100 (he higher the score, the better).

Building on ESG, there are various other ratings and certifications now being applied to buildings, generally but not exclusively in the office sector. 'LEED' or Leadership in Energy and Environmental Design is a green building certification system. It is in ever increasing demand by occupiers given the energy cost savings for them and greater levels of wellbeing for their staff due to improved indoor environmental quality. Linked to this is 'WELL', another rating system that is used for advancing health and wellbeing in buildings.

As the people-movement intensifies and policies follow, there will be greater adoption of these measures in the property market, particularly in the office sector. It is evident already with Irish property funds and REITs. Their ESG scorecard will only improve as investors increasingly move to align their personal values with their investment choices.