Lisney

Lisney

Sotheby's

INTERNATIONAL REALTY

OUTLOOK

2023

4 INVESTMENT

Prime yields have softened by between 35 bps and 75 bps and are likely to drift further in Q1.

ACTIVITY

OPTIMISTIC FOR RECOVERY

The dynamics in the investment market quickly changed last summer as global interest rate rises took hold. Deals that were agreed earlier in the year had their prices chipped and the market went into a process of price discovery. As a result, prime yields have softened by between 35 bps and 75 bps (depending on sector, location and specification) in the last six months and are likely to drift further in Q1. Pricing in the next six months will be dictated by cash purchasers, and for some larger deals based on sentiment.

Entering 2023, the market is still in that process of discovery and limited activity is occurring or likely to occur in the coming months. In most instances there is a disconnect between vendors price expectations and what purchasers (and their credit committees) are willing to pay. Some investors, mainly smaller scale cash buyers, are willing to buy assets now with less competition, but the opportunity must be a good fit meeting all their requirements, and available at a discounted price. In most instances however, investors have adopted a wait-and-see approach and want to witness greater levels of certainty in global interest rate stability before they re-engage fully with the market.

While there is no crystal ball to predict when this will occur or if other unforeseen circumstances will arise, it is likely to be into the second half of the year. We are optimistic for a recovery in demand and activity from around September and once this comes, we believe it will happen quickly. This is evidenced from previous market cycle experience but is also compounded by the fact that all types of investors have funds to spend. All are simply being prudent at present, unwilling to make substantial purchases knowing assets and perhaps funding will be cheaper in a few months' time.

WE ARE OPTIMISTIC FOR A RECOVERY IN DEMAND AND ACTIVITY FROM AROUND **SEPTEMBER** AND ONCE THIS COMES, WE BELIEVE IT WILL HAPPEN **QUICKLY**

SECTORS

DIFFERING PERFORMANCE

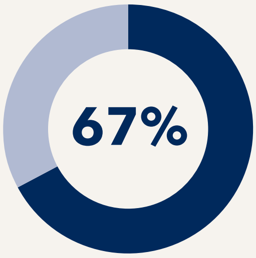
The various sectors of the commercial property market will continue to perform differently this year, heavily influenced by macro events and occupier trends. Even within sectors, assets will perform differently. High street retail along with shopping centres will attract very limited interest unless priced to sell; greatly impacted by the cost of living and the performance of fashion retailers. Conversely, supermarkets and services-led schemes will attract greater interest, but pricing will be key.

In industrial, demand remains from various categories of investors who are willing to bid counter-cyclically. Some deals are likely to be done off-market in the coming months but at yields more than 50 bps higher than 12 months ago. In offices, concerns over the tech industry and WFH will be in investors minds and given the generally large lot size, many investors in this category will be holding off until the latter part of the year. However, if priced appropriately, there will be buyers for opportunities. Investors are becoming more focused on super prime locations where properties can be easily re-let if tenants vacate.

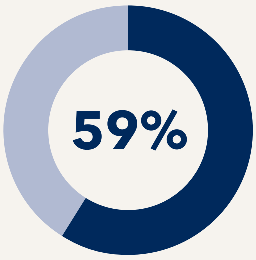
The PRS sectors has been extremely active in recent years and despite the housing and rental crisis, many investors may hold off investing further into the sector in the early part of 2023, particularly if they are involved in forward deals. Land is repricing quickly and while still unsustainably high, construction costs are beginning to move in a downward direction. Better value will be on offer later in the year, however investors will continue to watch government intervention in the sector, along with planning reform.

Salesforce HQ, Spencer Place, Dublin 1

A 2020 DEEP DIVE SURVEY BY THE CENTRAL BANK FOUND THAT:



OF PROPERTY FUNDS WERE **SINGLE INVESTOR FUNDS**



OF MULTI-INVESTOR FUNDS HAD **LEVERAGE BELOW 50%**

TRENDS

ESG TO THE FORE

The impact of the European Green Deal and the resultant EU Taxonomy Regulations on purchasing or funding properties will come into even greater focus this year. Investors will be interested in BERs and will be seeking reports on how ratings could be improved for buildings of B3 or below. However, there are concerns on costs in the short to medium term, which will push yields higher in older buildings, particularly older office buildings. Some opportunities that were acquired on a value-add basis in the last four to five years may experience forced sales given the increased costs of works and funding.

MACROPRUDENTIAL POLICY FOR IRISH PROPERTY FUNDS

Last November the Central Bank of Ireland published its Macroprudential Policy Framework for Irish Property Funds, which introduces a 60% debt-to-total assets leverage limit. This will have a five-year implementation period (until November 2027) with funds expected to make a gradual move towards lower leverage levels over that period. Any new funds must now have below 60% leverage to be authorised by the Central Bank. There is an exception for funds that have at least 80% of their assets in social housing (long-term leases).

This policy is softer than what was initially envisaged. In 2021 it was suggested that the leverage limit would be 50% with a three-year lead in time. The reduction is welcome and will give property funds more time to comply with the restrictions, particularly now that the market is weaker and falling valuations are already having an impact on loan agreements and debt thresholds.

The Sorting Office, Dublin 2

It will also reduce the reliance of the CRE market on Irish bank funding and there is likely to be more funding interest from overseas investors. In the longer-term it will provide a more balanced investor base for the CRE market and make it less susceptible to shocks; higher levels of leverage increase the risk that in a downturn funds may breach loan-to-value covenants.

In terms of who this will affect, a 2020 deep dive survey by the Central Bank found that 67% of property funds were single investor funds and within multi-investor funds, 59% of them had leverage below 50%. Consequently, it will not impact all Irish property funds.

Lisney

Lisney Sotheby's INTERNATIONAL REALTY

OUTLOOK 2023