OUTLOOK 2024

4 INVESTMENT

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MARKET CONTEXT

GLOBAL INTEREST RATES IMPACTING

Entering 2024, interest rates in the EU and US remain at 22-year highs and while the likelihood of further increases is now more limited, the prevailing elevated rates are unlikely to begin to fall until at least mid-2024. This, along with the demands of meeting ESG credentials (much of which is not factored into valuations) and a changing occupational demand (especially in offices), will mean a continued subdued investment property market for much of this year. The Irish, and indeed global, market suffered from falling values, limited activity and negative sentiment last year. This led to buyer inertia, which was compounded by the mismatched pricing expectations of vendors and purchasers. As a result, investment market turnover nationwide (≈ €2bn) was at about one-third of the annual average of the past five years. It is 10 years since the combined volume of transactions was this low.

Encouragingly, there is some (albeit limited) evidence of appropriate pricing emerging, which should result in deals, but H1 2024 is likely to be flat in terms of activity levels. How interest rates evolve will be an important factor – a steady decline to more sustainable levels is preferable as faster adjustments could mean greater issues in the underlying economy. Pricing and valuations, particularly in offices, will also be important. The significant cost of improving the sustainability credential of buildings will need to be factored-in to bridge the gap in expectations. Overall demand should improve over H2.

PRICING

PRICES WILL FALL FURTHER

Data from MSCI to the end of September 2023 show that capital values in the CRE market (all property types) was down by 22% in the last three years and we estimate a further 3% decline in the final months of the year. This brings the total value adjustment to nearly 25%. However, there are differences across sectors. Retail assets have been in decline since early 2019 and based on MSCI data have fallen by 37% since then. For offices, there were some falls in value over the pandemic period, but the pace of decline intensified in mid-2022, and has now fallen by 22%. Notably however, industrial values held firm over COVID and only began to fall as interest rates rapidly rose. Since the end of 2022, the MSCI index for industrial has only declined by 3%.

3B Aungier Street, Dublin 2

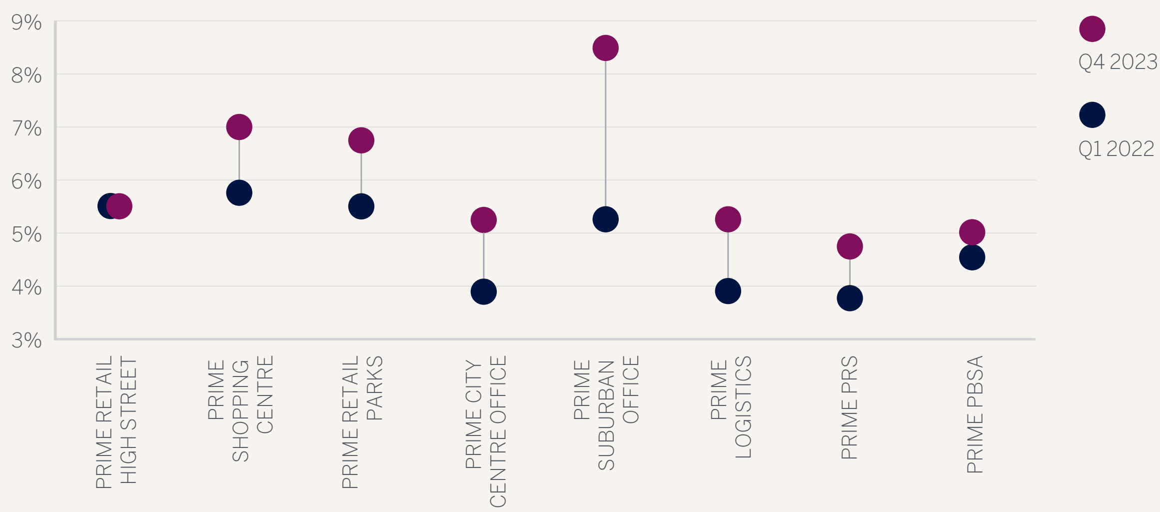
Capital value falls were predominately driven by yield softening. Over the course of 2023, prime yields generally drifted out by 50 to 125 bps with offices and PRS impacted the most and retail and industrial to a slightly lesser extent. For most investors to re-engage in the market, further price adjustments are required with particular focus on the cost of ESG upgrade works. Consequently, yields will move out further and prices will continue to fall in 2024, particularly in the first half of the year.

ACTIVITY

OFF-MARKET DEALS WILL CONTINUE

The various sectors of CRE will continue to perform differently this year, heavily influenced by the local and global economy, geopolitics, sustainability and occupier trends. Even within sectors, assets will perform differently. However, across the sectors, many transactions will continue to be done off-market. Positively, some larger investors are earmarking a return to the market in the second half of the year, albeit for institutions this will depend on their structure – open ended funds may be constrained by redemptions, while specific mandated funds will be more flexible. They will be assessing what is on offer and at what price. It will likely be the end of the year and into 2025 before they conclude deals. Some smaller scale buyers with cash will be in the market throughout the year, taking advantage of fewer competitors, but opportunities will have to be a good fit, meeting all their requirements, and available at a realistic price.

PRIME YIELD MOVEMENTS



Source: Lisney.

SECTORS

INDUSTRIAL SECTOR THE MOST ACTIVE

For the first time ever, the industrial sector was the busiest part of the investment market last year with several large portfolios sold. There are high-profile investors with active requirements, which means demand will remain robust 2024. Attraction will continue to stem from the strong underlying occupational market as well as the yield profile offered. Sustainability concerns will heighten in this sector over the course of the year with some investors pricing-in the cost of upgrade works.

36 Grafton Street, Dublin 2

CERTAIN FUNDERS UNWILLING TO FINANCE OFFICES

Also for the first time on record, the office sector was the least active of the four key market sectors. Changing occupier requirements since the pandemic as well as concerns about some buildings (BER of B3 or lower) becoming stranded assets are the key challenges. In the months ahead, certain funders will remain unwilling to finance office purchases, which will impact demand levels. For those with money to spend, office opportunities will need to be priced appropriately for deals to conclude. Investors will be focused on super prime locations where properties can be easily re-let if tenants vacate. Dublin will continue to compete with other European cities, including larger UK cities, where better returns are on offer. Some standing investments with growing LTV ratios and in need of re-financing could become distressed and come to the market for sale. Additionally, institutional investors will be assessing the costs of upgrading older buildings, particularly around M&E to achieve BER ratings of A or high B. This could result in a re-set of values to account for the works.

PRICES HAVE BEEN ADJUSTING FOR LONGER IN RETAIL

The retail market had a good year in 2023 with notable levels of activity around retail parks, regional shopping centres offering double-digit returns, and smaller lot size prime high street buildings. Prices have been adjusting in this sector for longer and there are very few vacant stores on prime pitches and in centres and parks that trade well. Demand will continue this year both from larger investors and from privates but prices will need to be attractive.

INTEREST RATES HAVE GREATLY IMPACTED PRS

The PRS sector was extremely active in recent years, with demand strong for both standing stock and forward commitment deals. However, interest rates have greatly impacted this market in the last 12 months. Notably, there were no deals completed in the sector in the second half of 2023 with only a limited number concluded earlier in the year. Despite the ongoing rental crisis across the country and demand for accommodation, many investors will continue to stand back from this sector in 2024 – fearful of a changing

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Government and legislation, as well as concerns about construction viability. However, government-supported bodies, such as the LDA, AHBs and local authorities, will be active in seeking schemes for affordable cost-rental and social lets.

SUSTAINABILITY

INTENSIFICATION OF REGULATIONS

EU directives will continue to tighten to achieve a climate-neutral building stock by 2050. These directives impact a property's life cycle – from conception and planning to construction, use, financing, and sale. Compliance with the Sustainable Finance Disclosures Regulation (SFDR) and EU Taxonomy is now essential for financing property assets and is influencing market demand. Value-add investors generally step into this type of market on the basis of 'buy it, fix it, sell it', however the cost of finance makes it difficult for them to be active at present. Failure to meet sustainability criteria will result in a significant devaluation of assets. This is already beginning to materialise but will intensify in 2024. Therefore, the real estate industry must continue to adapt to evolving conditions and take a holistic approach to address ESG aspects.

FAILURE TO MEET SUSTAINABILITY CRITERIA WILL RESULT IN A **SIGNIFICANT DEVALUATION OF ASSETS**

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