ILIM

Life \ Pensions \ **Investments**

Quarterly Report Q2 2023
Pension Irish Property Fund

more **INVESTED**

FUND CHARACTERISTICS

AT A GLANCE ▼

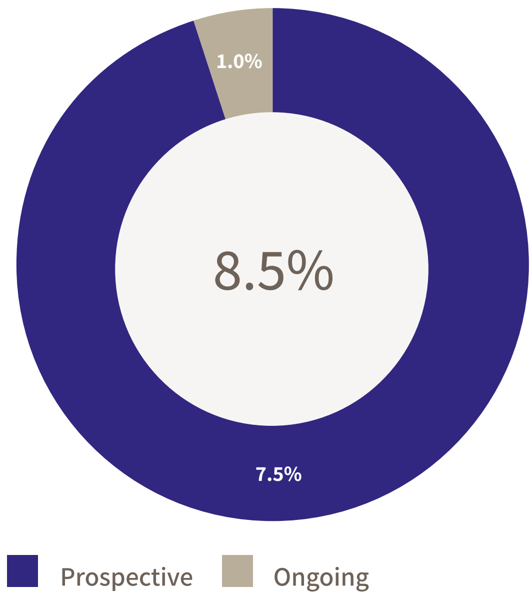
NAV	GAV	NO. OF ASSETS	GRESB
€1.40bn	€1.66bn	70	

FLOOR AREA (SQ FT)	PASSING RENT PA	MARKET RENT PA	WAULT
3.45m	€78.39m	€96.08m	5.92 yrs

YIELD PROFILE ▼

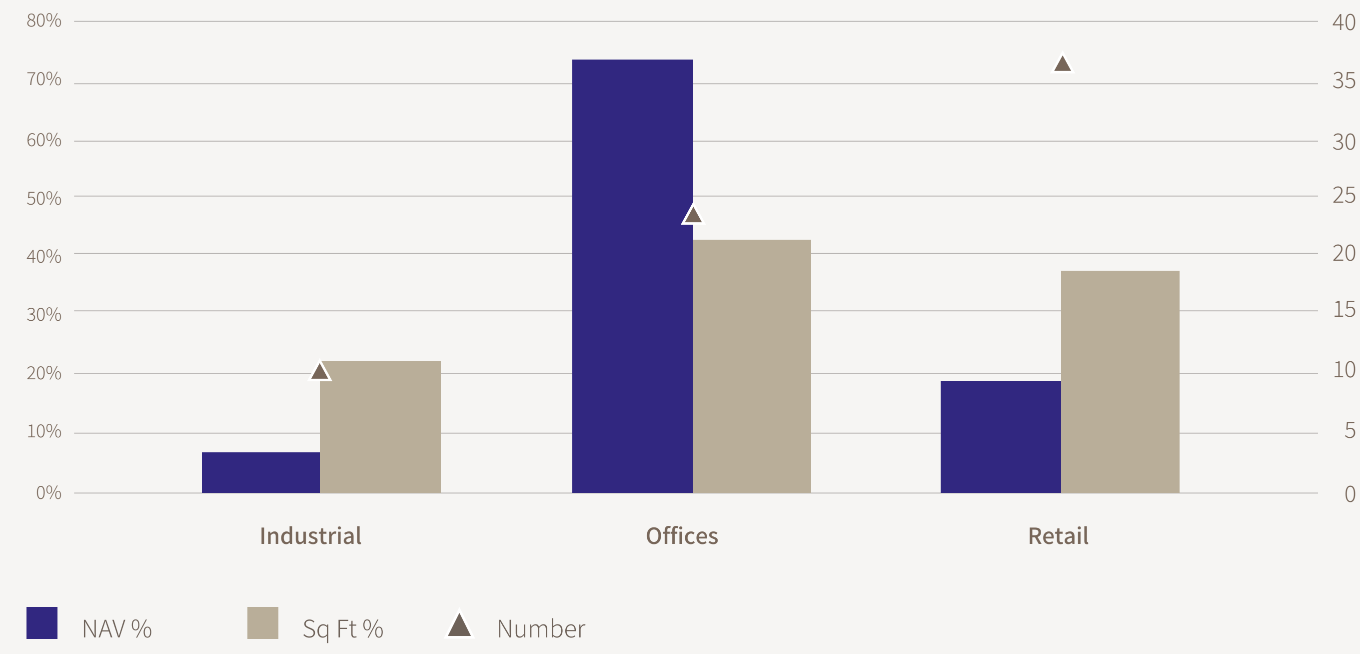
DEVELOPMENT ASSETS

as % of NAV

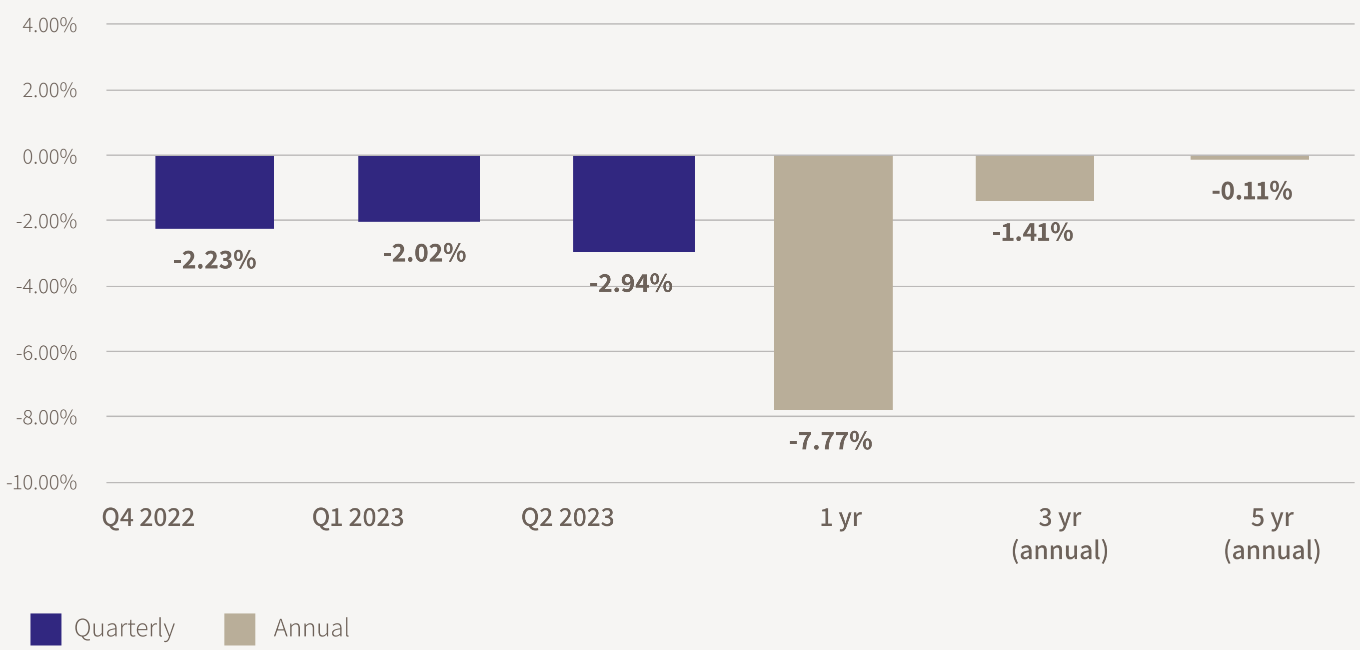


PERFORMANCE

SECTOR



FUND PRICE PERFORMANCE



MARKET COMMENTARY

A total investment turnover of €333m across 26 transactions occurred in Ireland in Q2, with over two thirds of this into the retail and residential sectors (39% and 28% respectively). This is a low level of activity compared to an average quarterly total of €1.1bn since 2017. Institutional investors remain cautious in terms of increasing their exposure to real estate in light of continued interest rate hikes, uncertainty in the occupational market for office property, and future capital expenditure to bring buildings up to EU Taxonomy Regulation standards.

26% of the investment into the Irish property market in Q2 was from French investment funds, a cohort that has been most active in recent times. French funds known as Societé Civile de Placement Immobilier (SCPIs), effectively 'Real Estate Investment Companies', have been experiencing significant inflows from retail investors and pension schemes in France for several years. A combination of these inflows, the relative performance of equities and bonds, and the repricing of real estate, has led a number of these funds to source investments outside of their domestic market. SCPI's have been active in Ireland for over five years; however, their share of the buy-side market has increased notably in the wake of lower demand from traditional institutional buyers. Target opportunities typically range between €5m and €40m in size. Similar market characteristics have seen an increase in activity among private high-net-worth investors, who are typically local. Increased interest rates have reduced overall competition in the market and advantaged cash buyers.

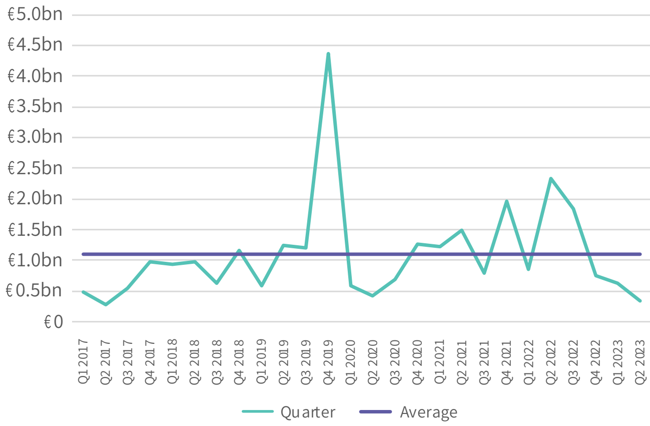
Of the five largest transactions of the period, residential accounted for two with lot sizes of €55.0m and €24.5m. S&P 500 company Realty Income acquired its first assets in Ireland in Q2. High yielding assets at Blackwater and City East retail parks in Meath and Limerick respectively were bought by the group for €45.9m, while another large retail deal completed when Inter Gestion REIM (a French SCPI fund) acquired the B&Q unit in Liffey Valley Retail Park for €26.6m, equating to an income return of 7%. Another SCPI fund, Remake AM, bought 87-88 Harcourt Street, an office property leased to Byrne Wallace Solicitors for €34.0m, giving them an income return of approximately 6.7%.

Otherwise, in the office sector, activity remained subdued, with little investor appetite for secondary or older offices due to concerns about occupational demand and the cost of refurbishment works required to enhance the buildings' energy efficiency.

The proportionate increase in activity in the retail sector is reflecting the attractive yields now available, as well as vendor-side motivation following the scheduled completion of business plans for schemes acquired over the past decade. It emerged during Q2 that Oaktree, which currently holds a retail portfolio across Ireland valued at approximately €400m, is considering disposals, including that of a majority interest in The Square Shopping Centre, Tallaght.

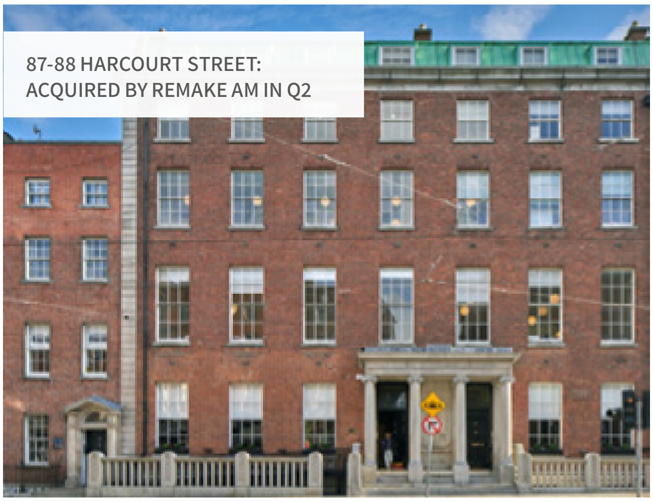
The relatively low-level of activity in Q2 meant that no significant market evidence was created to guide valuations. However, a continued expansion in yields in the residential, office and industrial sectors has reflected negative sentiment and the lower number of investors active in the market at present. This continued upwards movement in yields is in line with European trends and reflects an increasing cost of capital and reduced investor demand.

Quarterly Investment Volumes



Source: ILIM

B&Q UNIT, LIFFEY VALLEY RETAIL PARK: ACQUIRED BY FRENCH FUND INTER GESTION REIM IN Q2



87-88 HARCOURT STREET: ACQUIRED BY REMAKE AM IN Q2

MARKET COMMENTARY (CONTINUED)

Offices

A total of 389,000 sq ft of office space was taken up in Q2 across 49 deals, which compares to a 10-year quarterly average of 558,000 sq ft. This brings the total take-up to 674,000 sq ft for H1 2023, which is a significant reduction on the average H1 take-up of 1.2m sq ft since 2013. The largest letting of the quarter was of 79,600 sq ft in the newly built Haymarket House, Smithfield to the National Transport Authority.

Evidence is emerging that reduced aggregate demand for office space, resulting from the growth of hybrid working arrangements, has diverted traditional demand to smaller floorplates, many of which are provided for in older buildings. Savills reports that 32 lettings of <5,000 sq ft occurred in Q2, which is the largest quarterly number in this category since the start of 2017.

The broader uncertainty, or transitionary period in respect of hybrid working, has augmented the amount of grey space available on the market – space tenants are seeking to sub-let, which currently stands at 1.9m sq ft. This currently accounts for almost 33% of available space on the market.

In addition, shorter lease terms are more prevalent, with tenant break options a standard feature in non-prime properties.

Total office vacancy in Dublin now stands in excess of 14% and, notably, 80% of the increase in recent years is attributable to grey space. Despite this, modern, prime office space remains in demand and rents of >€60 per sq ft are being achieved for best-in-class buildings. JLL notes that there are currently 16 active requirements for space in excess of 50,000 sq ft, including EY's recently announced requirement for approximately 200,000 sq ft.

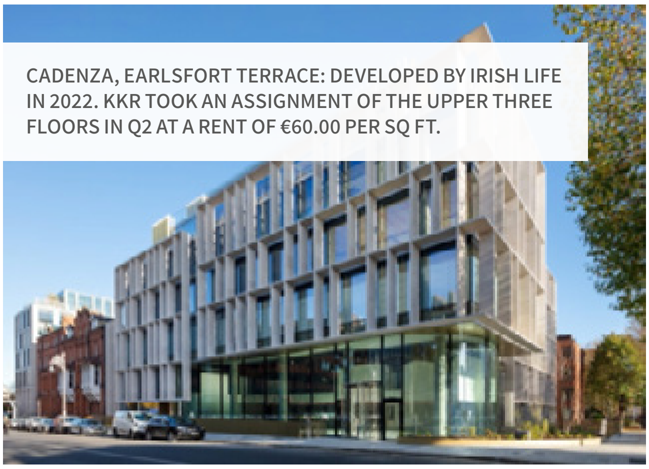
Industrial

Over 650,000 sq ft of industrial space was leased or bought for occupation during Q2 in 26 transactions, which brings the year-to-date total to 1.57m sq ft. Take-up in 2022 amounted to over 4.2m sq ft. These figures include pre-let space that is currently under construction and typically built to suit the occupier's operational requirements. CBRE is reporting a vacancy rate of 1.4% in Dublin and continued rental growth to Q2, with the prime rental rate now at €12.50 per sq ft. That agency also tracks current demand, which now stands at 5m sq ft, 1.25m of which was added in Q2.

Retail

€128m of retail property transacted in Q2, equating to 39% of the, albeit subdued, market in the period. Following a significant re-pricing during the pandemic, which disproportionately impacted the sector, combined with positive occupational take-up since then, relatively high income returns have attracted a number of investors of late.

Vacancy across the main retail districts and schemes nationwide has reduced significantly since the pandemic. There are currently 12 units available in Grafton Street and five units available in Henry Street. HMV entered a new lease for 18 Henry Street, a property managed by ILIM, in Q2. In addition, clothing retailer Castore signed for 34 Grafton Street, and Carroll's Irish Gifts entered a new lease for 6-8 College Green. Rental levels have shown signs of growth in 2023, although they still reflect a discount on pre-pandemic levels, and lease terms average five years to a first break option or expiry.



CADENZA, EARLSFORT TERRACE: DEVELOPED BY IRISH LIFE IN 2022. KKR TOOK AN ASSIGNMENT OF THE UPPER THREE FLOORS IN Q2 AT A RENT OF €60.00 PER SQ FT.

UNIT G, MOUNTPARK, BALDONNELL: 97,000 SQ FT PRE-LET TO REXEL GROUP IN Q2

18 HENRY STREET (MANAGED BY ILIM): LEASED TO HMV IN Q2 2023

OUTLOOK

Limited stock is being prepared for the traditionally busy post-summer marketing period, and we do not expect institutional demand to re-emerge in scale in 2023. Investment into the property sector in the short term is expected to continue to be limited to yield-seeking international funds (mainly French) or private, domestic investors.

Low levels of transactional activity and international pricing trends will continue to influence valuers' yield selection. While a significant adjustment has already been factored into values to Q2, further valuation adjustment is expected as transactional price discovery evolves.

Occupational markets, particularly in the retail and industrial sectors, continue to benefit from a strong local economy and low unemployment. We see opportunities for further rental growth in certain submarkets during H2 2023. Demand for office space is evolving to reflect hybrid working models and sustainability attributes. Aggregate demand will, therefore, continue to lag that of previous years, with occupiers for larger footprints focused on modern, strategically located, and high specification space, while those seeking greater flexibility or transitionary offices will focus on smaller floor areas at low cost. We believe this will maintain prime rents for best-in-class offices but continue to put pressure on rents for secondary buildings.

FUND UPDATE

The Fund produced a total return of -2.94% in Q2. This was largely driven by yield expansion in the office sector – negatively impacted by the continued rise in interest rates, lower occupational demand and increased allowances for future capital works to enhance building specification, in particular expenditure to enhance sustainability credentials. In addition, the Fund's income return reduced marginally in 2022, owing to the progression of properties moving into the development stage of their life cycles.

The Fund now has three large office redevelopments on its short-term horizon. In addition to these, it acquired a current development site at 74-75 Lower Baggot Street in April. The Frame, a high-profile, net-zero office building extending to 50,000 sq ft, is currently being constructed, which is due for completion in early 2025.

These developments will deliver long-term performance for the Fund and assist in its goal of achieving net-zero emissions.

The Fund's income return will be boosted by the expiration of rent-free periods, amounting to a value of approximately €8m / 0.5% by the end of 2023, the majority of which is emanating from Cadenza. KKR, the private equity investment firm, took an assignment of the leases of the top three floors of that property in Q2, at a rent of €60 per sq ft.

The positive occupational demand seen following the pandemic in the retail sector is being reflected in the Fund's holdings, and a number of new leases were agreed in Q2 and are expected to contract in the coming months. Terms are also agreed to lease the Fund's newly developed logistics unit at Vantage Business Park, close to Dublin Airport. Completion of the building and commencement of the lease are expected in August.

74-75 LOWER BAGGOT STREET: DEVELOPMENT ON-GOING OF THE FRAME OFFICE BUILDING

ENVIRONMENT, SOCIAL AND CORPORATE GOVERNANCE

ILIM Property is defining a Net Zero Pathway that will provide a framework for the reduction of greenhouse gas emissions, energy use, energy intensity targets, renewable energy use and the use of circular economy principles in new developments. The Net Zero Pathway is ongoing.

Across the real estate funds, ILIM reviews key environmental impacts on a quarterly basis, including:

- **Energy Consumption:** reducing like-for-like energy use where ILIM is directly responsible by 15% by December 2024 (based on a 2019 baseline);
- **Renewable Energy:** procuring 100% of electricity from renewable sources, where economically or operationally feasible;
- **Greenhouse Gas Emissions:** reducing like-for-like Scope 1 and 2 emissions by 25% by December 2024 (based on a 2019 baseline), and defining and measuring Scope 3 emissions in line with best practice by December 2024;
- **Water Use:** reducing like-for-like water usage by 10% by December 2023 (based on a 2019 baseline); and
- **Production of Waste:** diverting 100% of waste from landfill.

As a responsible investor, ILIM adopts an active ownership approach across its real estate assets, which aims to maximise the medium to long-term value for its clients. ILIM uses its ownership to constructively engage with property managers, encouraging better standards and management processes covering financially material ESG risks.

At asset level, ILIM has developed an Environmental Management System (EMS) to manage sustainability impacts, risk and opportunities across its real estate portfolios. The EMS also aims to improve resilience and performance in ILIM's portfolios and assets. The EMS was established to deliver commitments set out in the ILIM ESG policy and covers all aspects of the direct real estate investment management life cycle for all real estate operations.

The Pension Fund has continued to improve and deliver on ESG and has been awarded four stars in the 2022 GRESB Real Estate Assessment for both its standing stock and developments, with a score of 85 for standing stock. In defining a net zero pathway for the reduction of greenhouse emissions, a particular focus has been placed on data collection over the past 12 months. Analysing this data provides the Fund with a transparent, science-based decarbonisation pathway to identify and measure greenhouse gas (GHG) reduction targets aligned with the Paris Agreement. This has involved working closely with occupiers to share operational GHG emissions and develop practical solutions to achieve reductions. ILIM is also working to understand the footprint of embodied carbon in its developments and targeting net zero for these projects.

GRESB ★★★★☆ 2022

During 2022, ILIM Property undertook a materiality assessment covering key areas including environmental, social and economic issues. A broad range of internal and external stakeholders, including investors, were contacted to gain a better understanding of the key issues to their business and what steps ILIM Property should be making to enhance ESG performance. The materiality assessment recognised that ESG targets are becoming critical to investment value as potential EU legislation will mean more stringent measures being imposed on the built environment.

The Fund is classified as an 'Article 8 Fund' under the Sustainable Finance Disclosure Regulation (SFDR).

1 George's Quay, Dublin 2 – redeveloped in 2017. BER A3 rated, Leed Platinum

ILIM

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