ILIM

Life | Pensions | **Investments**

Quarterly Report
Q4 2023
Pension Irish Property Fund

more **INVESTED**

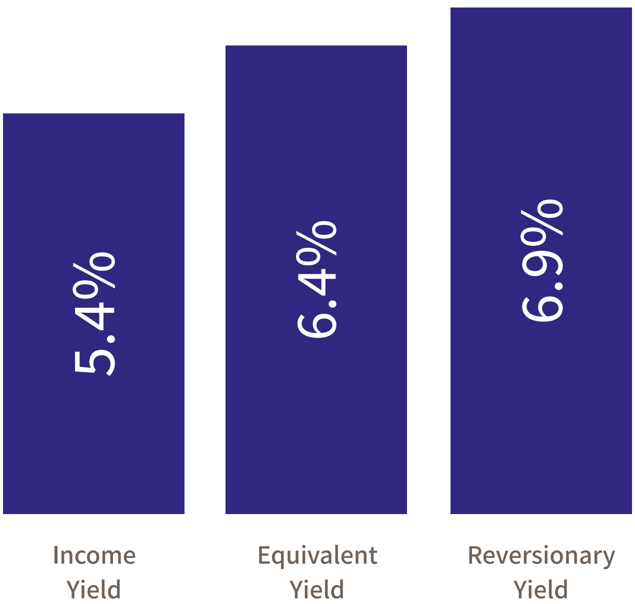
FUND CHARACTERISTICS

AT A GLANCE ▼

NAV	GAV	NO. OF ASSETS	GRESB ★★★★★ 2023
€1.20bn	€1.43bn	65	

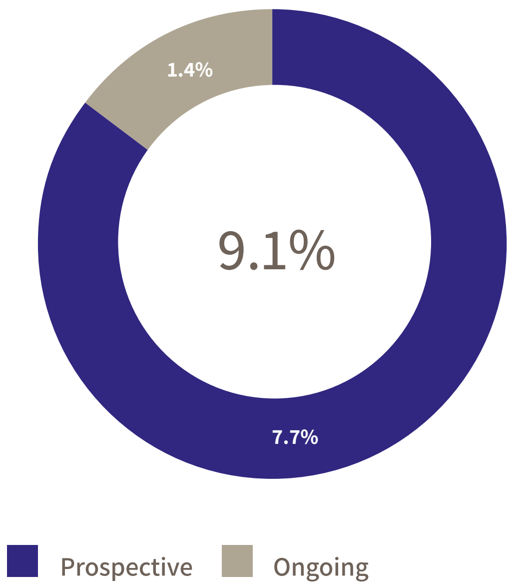
FLOOR AREA (SQ FT)	PASSING RENT PA	MARKET RENT PA	WAULT
3.30m	€71.98m	€91.01m	5.25 yrs

YIELD PROFILE ▼



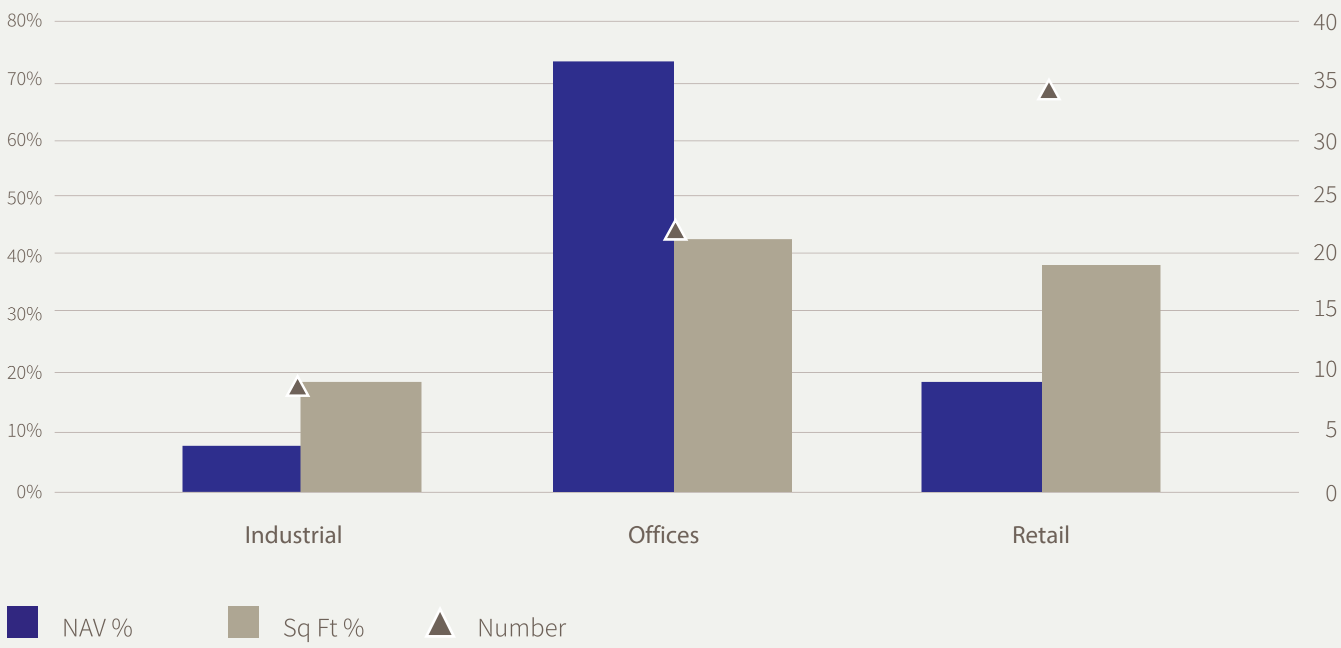
DEVELOPMENT ASSETS

as % of NAV

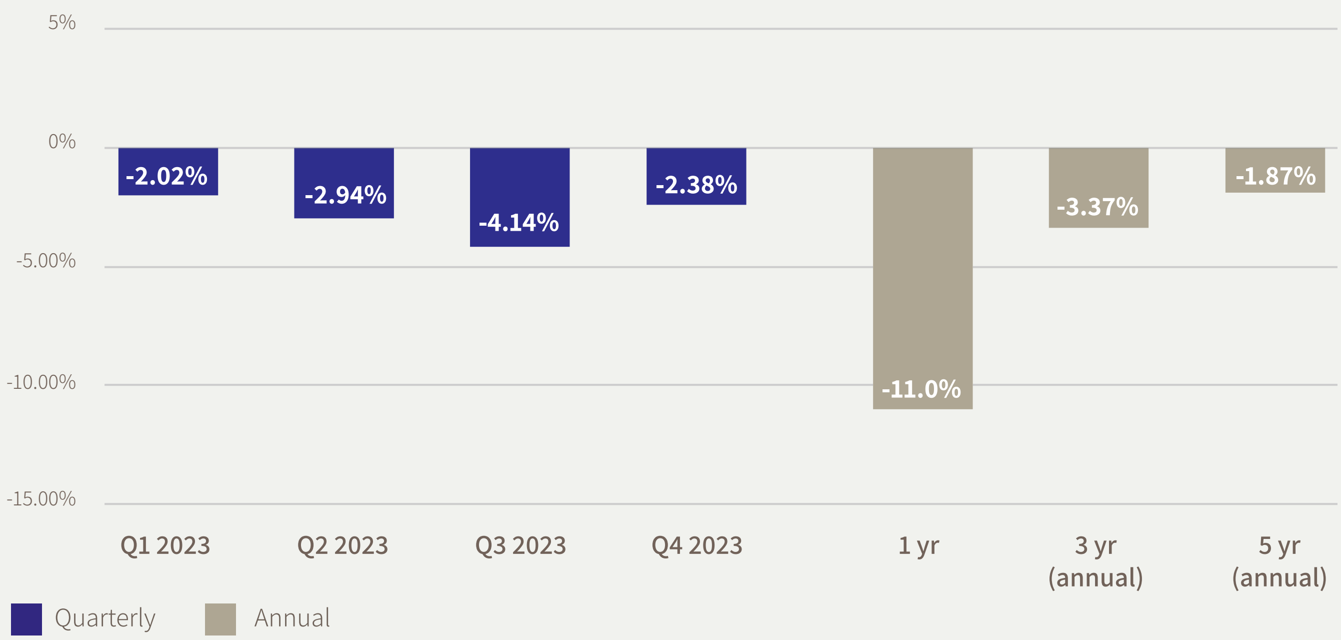


PERFORMANCE

SECTOR



FUND PRICE PERFORMANCE



MARKET COMMENTARY

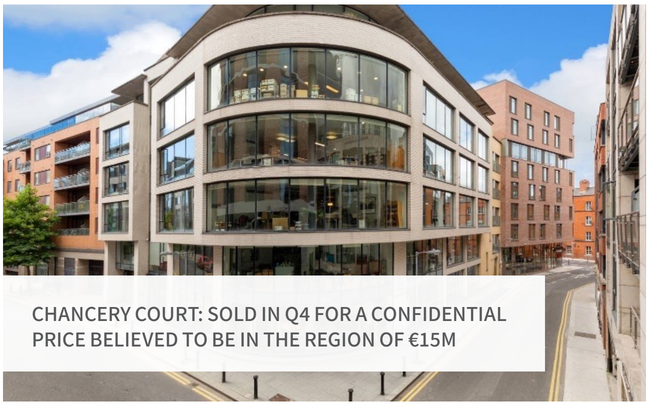
The steady rise in European Central Bank (ECB) interest rates from July 2022 (0.0%) to September 2023 (4.50%) led to a contraction in investment activity into property, which is heavily reliant on debt financing and investor sentiment. This perpetuated a rise in valuation yields across all property sectors, having a negative impact on values. The MSCI All Property Ireland Index equivalent yield moved out 1.0% in the 18 months to December 2023, from 5.5% to 6.6%. The spread of property yields to government bonds therefore improved by 0.73% to 4.3%, thereby increasing the relative attractiveness of property yields.

Investment turnover in Ireland reached approximately €440m in Q4, boosted by the off-market sale of an Amazon logistics centre in Baldonnell Business Park for €225m. This brings the annual tally to close to €2bn, roughly half the annual level of trade over the previous decade. Only 28 deals completed in Q4. Private investors continued to be the most active, focused on small lot sizes. The largest office transaction of the period was the OPW's acquisition of Trinity Point in Leinster Street for a reported €40m, which breaks back to excess €900 per square foot (sq. ft.). The OPW had leased four of the six floors in the property at a total rent of €2.59m p.a. The two remaining floors are currently vacant and account for 41% of the building. Chancery Court, a mixed-use property comprising over 34,000 sq. ft. of office accommodation and four two-bedroom apartments, is also believed to have sold in Q4 for a price in the region of €15m, which would represent a net income yield of 9%. The property last traded to Credit Suisse in 2017 for €23.8m.

A large proportion of the 28 investment transactions in Q4 were of retail properties. These included a collection of buildings in Grafton Street for €13.5m, Opera Lane scheme off St. Patrick's Street, Cork for €20.6m, and Tralee Town Centre for €6m. Private Irish buyers acquired the majority of these.

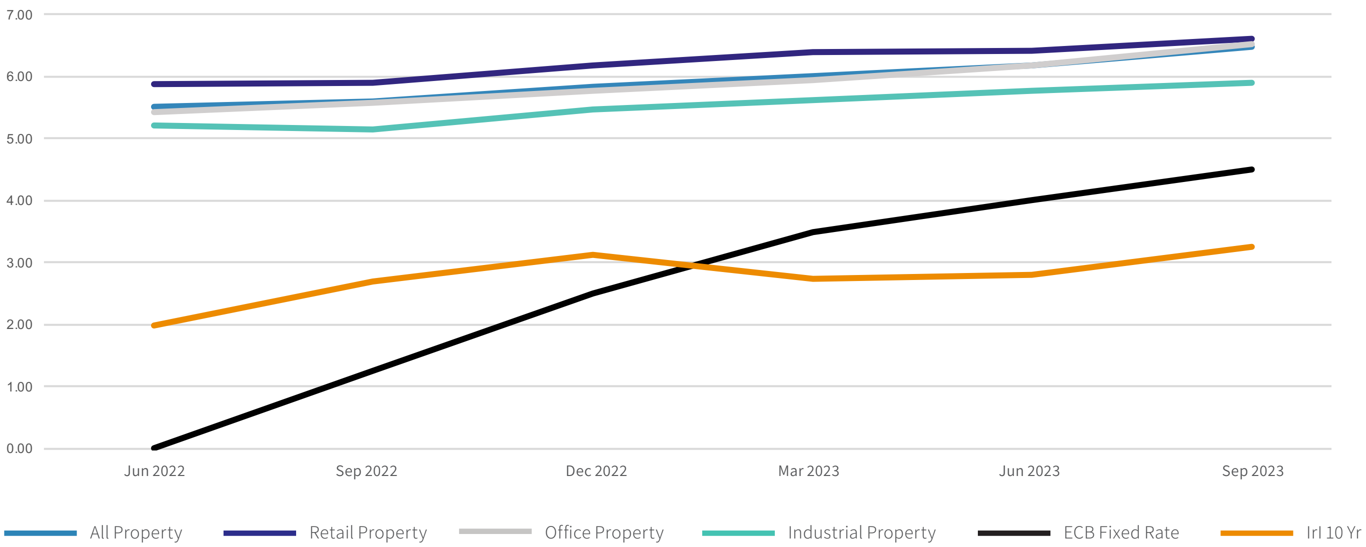
Increased income yield, which now stands at close to 5.75% across the Irish commercial market according to the MSCI Index, has not been sufficient to offset the capital decline caused by yield expansion, which dictated property performance in 2023. In addition, net income declined due to rising vacancy and associated costs, particularly in the office sector.

TRINITY POINT: SOLD IN Q4 FOR A REPORTED €40M



CHANCERY COURT: SOLD IN Q4 FOR A CONFIDENTIAL PRICE BELIEVED TO BE IN THE REGION OF €15M

Property Equivalent Yields vs. ECB Fixed Rate



Source: MSCI, ILIM

MARKET COMMENTARY (CONTINUED)

Office

Office take-up in Q4 amounted to approximately 367,000 sq. ft., according to CBRE. This brings the 2023 total to just shy of 1.4m sq. ft., representing a significant retraction from the average over the past 15 years (2.2m sq. ft.) and the lowest annual take up of office space since 2010. That timeframe did include a five-year period between 2014 and 2019 of extraordinary growth in office sector, led by the expansion of the tech sector.

The main factors at play continue to be the corporate world's adaptation to hybrid working arrangements, staff amenity and welfare, a heightened focus on ESG, and a reaction to upcoming lease events (break options and lease expiries) in the context of greater availability and flexibility in the market. Vacancy across Dublin offices now lies above 16% and a significant amount of grey space is available for sub-lease – with fully fitted accommodation making up a sizable proportion of this segment.

Despite the aggregate decline in activity, demand for prime offices, i.e. well-located, modern, high-specification and environmentally sympathetic buildings, continue to command rent in excess of €60 per sq. ft. As well as traditional BER ratings, the assessment of these buildings from a sustainability perspective is improving, using different accreditations such as LEED, BREEAM, WELL Score, NZeb, etc. During due diligence, active investors are also concerned with the carbon output of a property, its pathway to decarbonisation, and alignment with the EU's taxonomy framework.

This has created a two-tier market at investment and occupational level for office property, with older, lower specification property suffering greater valuation decline and appeal.

Retail

2023 was a positive year for the occupational retail market. Retail sales growth, in terms of both volume (+0.8% YoY to November '23) and value (+3.9% YoY to November '23), remained positive for the duration of 2023, despite the impact of rising inflation and the cost of living on consumers. This is supported by close to full employment and population growth, which is augmented by net inward migration. Footfall in retail schemes has now surpassed its pre-pandemic level, and high street footfall continues to recover, but notably is lower on weekdays due to remote working. A more insightful metric is the ratio of retail sales versus footfall, which is at an all-time high, according to Bannon, a property consultancy. Occupancy across retail property increased in 2023, most notably in retail schemes outside of Dublin, where greater availability offered retail property more opportunities to grow during the year.

Industrial and logistics

The industrial sector accounted for its largest proportion of investment activity in 2023. Its attractiveness is anchored by the dramatic growth in occupational demand (particularly from logistics operators), the long-term profile of income streams, and low baseline allocations to the sector. These factors all act as a counterweight to investors' retraction from both the retail and office sectors, which have been going through structural changes in recent years.

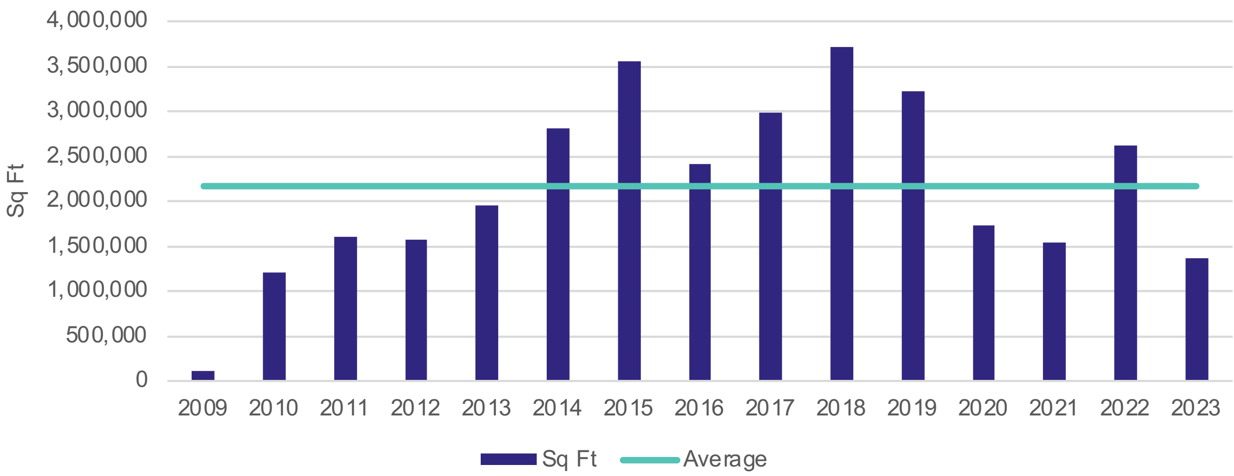
Vacancy across industrial and logistics stock in Dublin is currently <2%, making new space difficult to source and putting continued upward pressure on rents. Prime rents are now comfortably in excess of €11 per sq. ft. for modern or well-located buildings. Take-up of space is somewhat hampered by a dearth of supply, and amounted to 1.04m sq. ft in Q4 and 3.26m sq. ft. for 2023 in total.

Residential

2023 was a challenging year for the residential investment market. Higher yields compressed capital values across the sector, which were compounded in leased schemes where rents are held back by rent control measures. Rental growth, which is factored into vacant (under development) schemes, was recorded by Daft.ie at 8% YoY to Q3 2024, although, anecdotally, this appears to have slowed in modern developments that attract premiums to market rents. The rental caps in rent pressure zones are constraining rents receivable in existing leased schemes. In addition, inflation has added to operational costs, reducing net operational income in residential schemes.

The structural undersupply in the residential market is perpetuating the trajectory of rents and, despite the significant rise in borrowing costs, owner occupier house prices rose 3.4% in 2023, albeit incorporating a decline of -1.5% in Q4.

Long-term Office Occupational Annual Take-up



Source: ILIM

OUTLOOK

Long-term SWAP rates reduced significantly in Q4 in anticipation of ECB rate cuts in 2024. While the scale and timing are uncertain at this point, it is expected to ease pressure on the market. This is an important metric for property activity; however, the availability of appropriately priced stock and debt financing will need to improve in the short term for this to take effect.

Significant valuation adjustment has already been priced in, with valuations on average down over 13% across the commercial sectors in Ireland over the last 18 months. We expect to see some further outward yield adjustment, before stabilising for most segments of the market through the latter part of the year.

Loan refinancing pressure resulting from the step change in debt costs should lead to some more stock coming to the market for sale this year. Opportunistic fund investors, who have raised significant equity and debt over the last year, will start to deploy capital, attracted to adjusted pricing levels. We do not expect long-term, institutional investors to generate significant demand for commercial property in 2024 due to lower fund raising and on-going liquidity management issues.

In the office sector, sustainability-led polarisation, based on asset quality, will see a divergence in valuation and pricing. Further depreciation in the value of older office stock will attract opportunistic capital to invest in brown to green refurbishments and potentially conversions, while selective pre-letting of super-prime high-sustainability offices will emerge as large corporate occupiers see little new pipeline stock being delivered speculatively.

In the industrial/logistics sector, we anticipate record rents being achieved as tenants compete for limited new stock, with demand fuelled by high economic activity and evolving supply chains.

FUND UPDATE

The Fund's performance in 2023 was heavily influenced by the market-driven moves in values in the office sector, to which it had a weighting of 73% at year end. These moves included discounts to the value of older office stock, reflecting lower aggregate demand for space and heightened capital expenditure requirements, as well as the rise in yields for all stock, on the back of interest rate moves. ILIM is adapting the Fund's holdings through a defined strategy to reflect the evolution in the market by assessing each asset's current specification in the context of net-zero commitments (by 2050) and the needs of the occupational market.

To that end, progress continued in Q4 on the development of a new, net-zero office property at 74/75 Lower Baggot Street, as well as pre-construction activity on other office properties to be developed over the short to medium term. On-going and prospective development assets currently equate to 9% of the Fund's NAV.

Despite this development pipeline, the income return across the entire portfolio now exceeds 5.5% on an annualised basis, which was enhanced in Q4, with Cadenza coming off an initial rent-free period and delivering an additional €6.8m p.a. from tenants Intercom and KKR. The portfolio currently has significant reversionary potential in terms of income, which will be realised in line with the strategy of asset improvement.

In the same vein, a reduction in exposure to smaller and older assets with relatively lower development potential contributes positively to this strategy. Six assets were disposed of in Q4 for €77m and a further two assets were sold post quarter end.

THE FRAME, 74-75 LOWER BAGGOT STREET: CGI IMAGE OF THE COMPLETED DEVELOPMENT, WHICH IS CURRENTLY UNDER CONSTRUCTION.

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