IRISH 2022 OUTLOOK FOR

REAL ESTATE

- Gaining ground -

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The overall outlook for the real estate market in 2022 is favourable, on the back of a particularly active fourth quarter in 2021. Several factors are driving this optimistic outlook, despite the turbulence wrought by COVID-19:

1. **The economy is performing strongly**, with the latest Central Bank bulletin forecasting 8.7% growth for this year.

2. **The level of foreign direct investment in Ireland continued to rise in 2021**, with the highest number of jobs created in a single year. This strong level of FDI is expected to continue into 2022.

3. **The infrastructure deficit in residential housing remains a key social, political and economic issue.** Under the widely publicised Housing for All plan, Ireland needs an average of 33,000 homes constructed per annum until 2030 to meet targets set out for additional households, as outlined in the National Planning Framework. Supply must therefore continue to increase off current rates of completion, with just over 20,000 units delivered in 2021.

4. **There is an unprecedented level of capital to be deployed** as a direct result of the Central Bank's COVID-19 response stimulus packages. **Ireland is seen as an attractive economy in which to invest**, and it is important that policy makers ensure that this remains the case.

This report was drafted before the invasion of Ukraine. However, the trends outlined in the following pages still hold true. To understand the potential impact of the invasion on Financial Services specifically, please refer to the foreword at the beginning of our magazine.

However, there are challenges:

1 **Cost inflation in the construction sector increased by 7% nationally during the first half of last year.** Viability of projects will be a key feature of 2022 as we anticipate this trend to continue through the year.

2 **Policy changes**, including the changes to stamp duty, **have yet to be fully experienced**, with institutional investors likely to be most impacted (in the event of a purchase of 10 or more units) by increased stamp duty rates of 10%. How this will be received, how it will be incorporated into acquisition pricing, and what the impact will be on end pricing all remain to be seen.

6 **Continued uncertainty in respect of planning risk on high density development projects.** This uncertainty is driven by both government intervention and wider reform within the planning systems.

3 **The Draft Dublin City Development Plan 2022 - 2028** sets out policies and objectives to guide how and where development will take place in the city over the lifetime of the plan. **This has not been finalised and may present a challenge with a degree of uncertainty around some land use zoning.**

5 The **Land Value Sharing and Urban Development Zones Bill 2021** is a key part of the government's Housing for All plan, allowing local authorities to secure a proportion of the increase in land values arising from public decisions and **permitting them to designate Urban Development Zones which have potential for significant development for housing and other purposes, adding a layer of additional risk from a development perspective.** The Residential Zoned Land Tax introduced a 3% annual tax on the market value of certain specified lands, which is likely to impact up to 9,000 ha of land in Ireland.

4 **Monetary policy changes in 2022** such as rising interest rates and the Central Bank's tapering off of COVID-19 liquidity measures **will impact on the availability and pricing of capital.**

7 **The delivery of planning permissions through the Strategic Housing Developments (SHD) process has been severely curtailed** in recent times with a significant number of SHD planning approvals being **quashed or stalled through judicial reviews**. On top of the delay caused by this action, the vast majority of judicial reviews are successful, resulting in the permission being quashed and applicants forced to start the SHD process again. The Large-scale Residential Development (LRD) Bill 2021 has now replaced the SHD process, which will shift the control of planning decisions back to the local authorities, hopefully providing more clarity and certainty on delivery. However, many of the existing SHD applications will continue to operate well into 2022 for those applicants who were in the system prior to the commencement of the LRD arrangements, and so this challenge remains prevalent.

Commercial property

The office sector had a very strong finish to 2021, with 40% of all office transactions taking place in Q4, partly due to the completion of sites that had been delayed due to COVID-19 closures. The level of demand was very strong with 300,000m² of requirements in the last quarter of the year, and an overall vacancy rate of just 8.5%. We expect this strong demand to continue into 2022.

The strong take up of office space indicates that most employers still see offices as an essential part of the work experience and environment.

From discussions with our developer clients, it's interesting to observe that the overall office space that companies are seeking has remained much the same as pre-COVID-19, with only some small decreases. What has changed is the office configuration, with much more of a trend towards open plan, with meeting and collaboration spaces.

Hybrid working is here to stay, but offices are still required, and are key to enabling firms to engage with colleagues and clients.

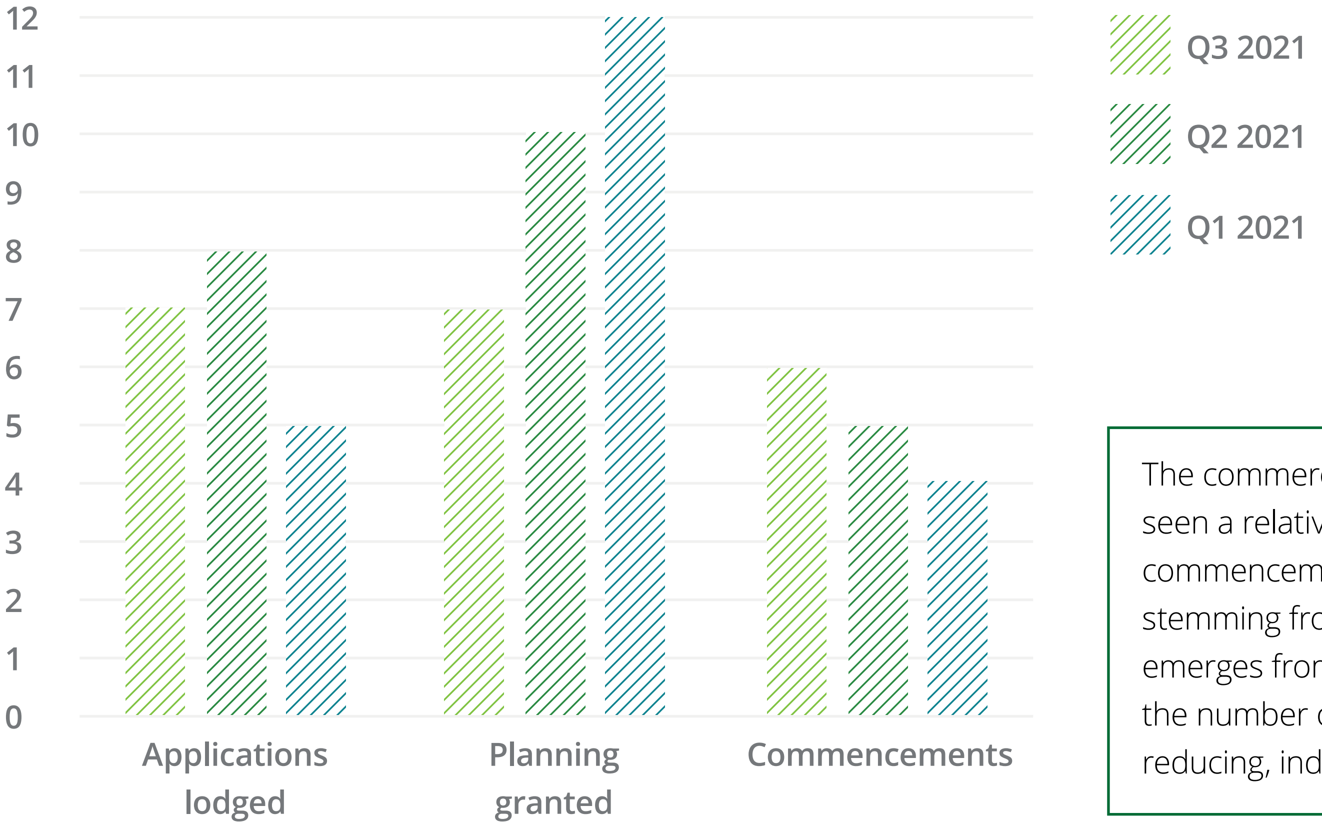
It is anticipated that rents and yields will therefore remain stable into 2022. From a development funding perspective, there is not a lot of appetite for speculative office projects. Developments tend to be pre-let, which de-risks the project and allows for appropriate capital to be deployed.

KEY TAKEAWAY

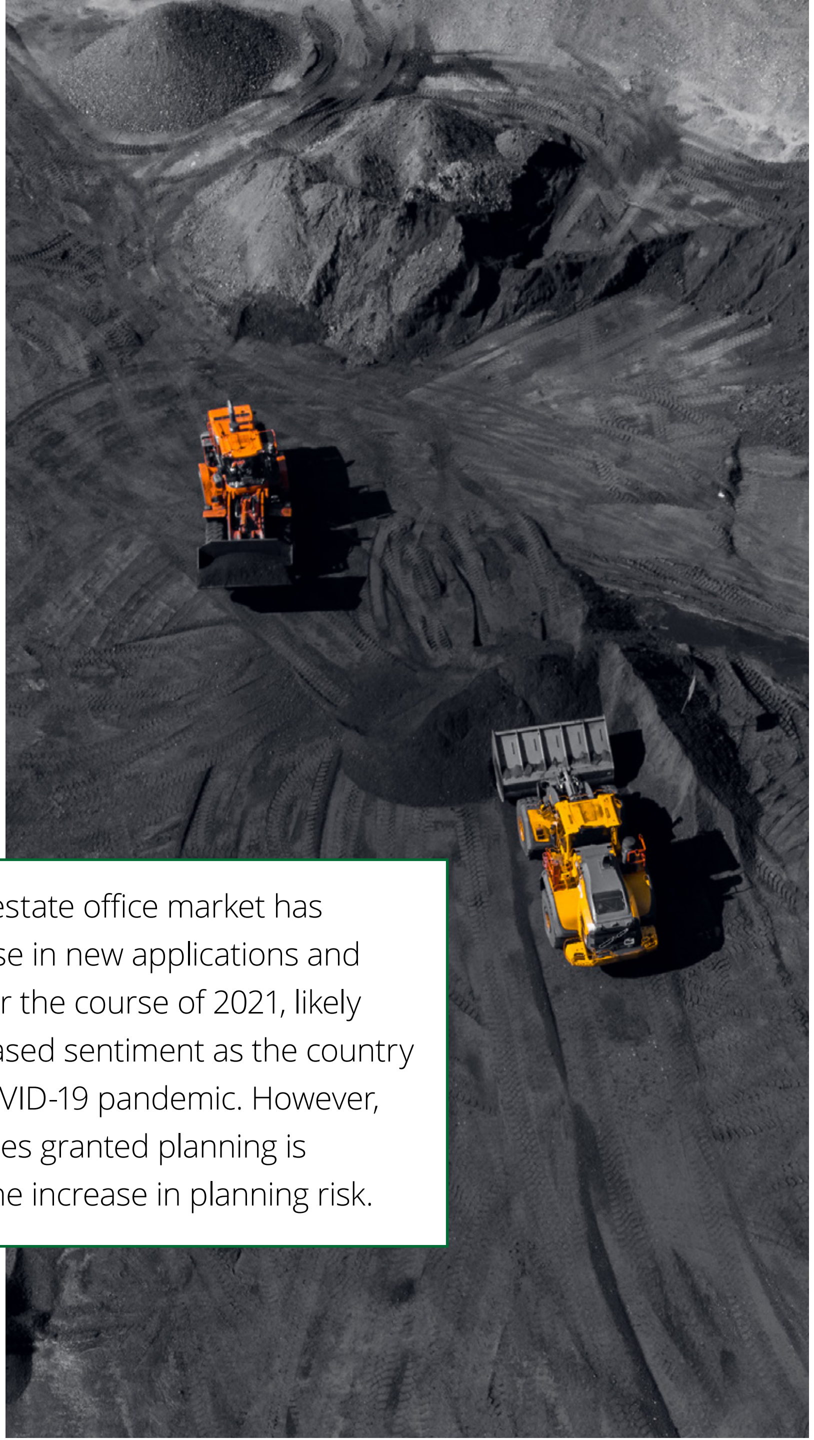
With an overall vacancy rate of just 8.5%, the demand for offices remains strong, making them a reliable investment – provided that they include plenty of meeting and collaboration space.

Office scheme development (10,000 sq ft +)

Quarterly comparison (number of units)



Source: Deloitte Planning and Development Statistics Q4, 2021.



The commercial real estate office market has seen a relative increase in new applications and commencements over the course of 2021, likely stemming from increased sentiment as the country emerges from the COVID-19 pandemic. However, the number of schemes granted planning is reducing, indicating the increase in planning risk.

Retail

The greatest levels of stress in the real estate market are to be found in high street retail. By now, it's well understood that COVID-19 accelerated the existing trend towards online shopping, and the past few years have seen the demise of some high-profile names, such as Debenhams. Community shopping centres and retail parks have performed stronger than high street stores, and we expect this to continue into 2022.

The key challenge for the high street is that the strength of the covenants and lease terms have changed significantly. We have seen a change in the types of leases available in high street retail, with tenant-friendly terms such as short-term deals, increased rent-free incentives and more regular break options. This sector is becoming increasingly more challenged as the successful performance of retail assets requires more pro-active asset management and strategic direction to attract and retain tenants. This has had a significant impact, reducing the value of bricks-and-mortar retail as an asset class, making it difficult to leverage and consequently hard to make equity returns from.

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KEY TAKEAWAY

Highly pro-active asset management and strategic direction to attract and retain tenants are needed for the high street to successfully perform going forward.

> Logistics has become a strong asset class due to an undersupply in the Irish market.

Industrial and logistics

The industrial and logistics sector is almost a counterbalance to the reduction in physical retail due to the move to online. Logistics has become a strong asset class, with good levels of yield compression and substantial capital (in excess of €1 billion) looking to invest in these industrial and logistics assets in 2022. There is an undersupply in the Irish market, so existing logistics developments are attracting strong valuations. There is strong demand and low vacancy levels for new buildings in or near large population areas such as Cork, Dublin, Limerick and Galway. By the end of Q3 last year, there was a 20% reduction in available space.

Data centres

The major data centre operators in Ireland, such as Microsoft, Google, and Meta (Facebook's parent company) continue to expand and see Ireland as a significant player in the sector. Looking beyond this year, the previous rate of expansion is likely to be hindered by several restricting factors. Recent reports have laid the blame for increased pressure on the electricity grid at the door of data centres. With the Irish government's plans for upgrading the power grid as part of the Planning and Development (Climate Emergency Measures) (Amendment) Bill 2021, there looks set to be a pause on data centre development around the Dublin metropolitan area. This could deflate the market if data centre operators simply look to other markets for new projects rather than locating them in other parts of Ireland.

Hospitality

Government supports have helped to shelter the hospitality sector, particularly hotels, from the worst impact of COVID-19. Resort hotels have done particularly well due to a very high level of domestic demand. However, for city hotels to return to pre-pandemic levels, corporate travel and events need to return. However, despite the challenges for hospitality over the last two years, we are seeing hotel values holding up well as investors predict high levels of post COVID-19 spending.

While we expect the hospitality sector to recover reasonably quickly, we are seeing across Europe that when government supports come away, there have been business failures and stressed sales.

Again, cost inflation is probably the biggest risk for this sector post COVID-19. To secure labour, wage inflation will definitely have a big impact, as will utility costs. So, although we will see a recovery in demand and hopefully international travel will pick up, will profitability recover to the same extent? Even if we get back to 2019 levels of occupancy, rates will need to increase to compensate for higher costs.

KEY TAKEAWAY

While the hospitality sector is expected to recover relatively quickly, profitability will depend on rate increases to counteract cost inflation.

Residential

Supply remains the key issue in this sector. Increasing supply into the residential market quickly is challenging, particularly in an environment of high-cost inflation creating viability issues for high-density housing schemes. However, there are a number of areas such as planning and connection to services that, if addressed, could significantly help to increase supply and reduce funding costs, thereby improving viability.

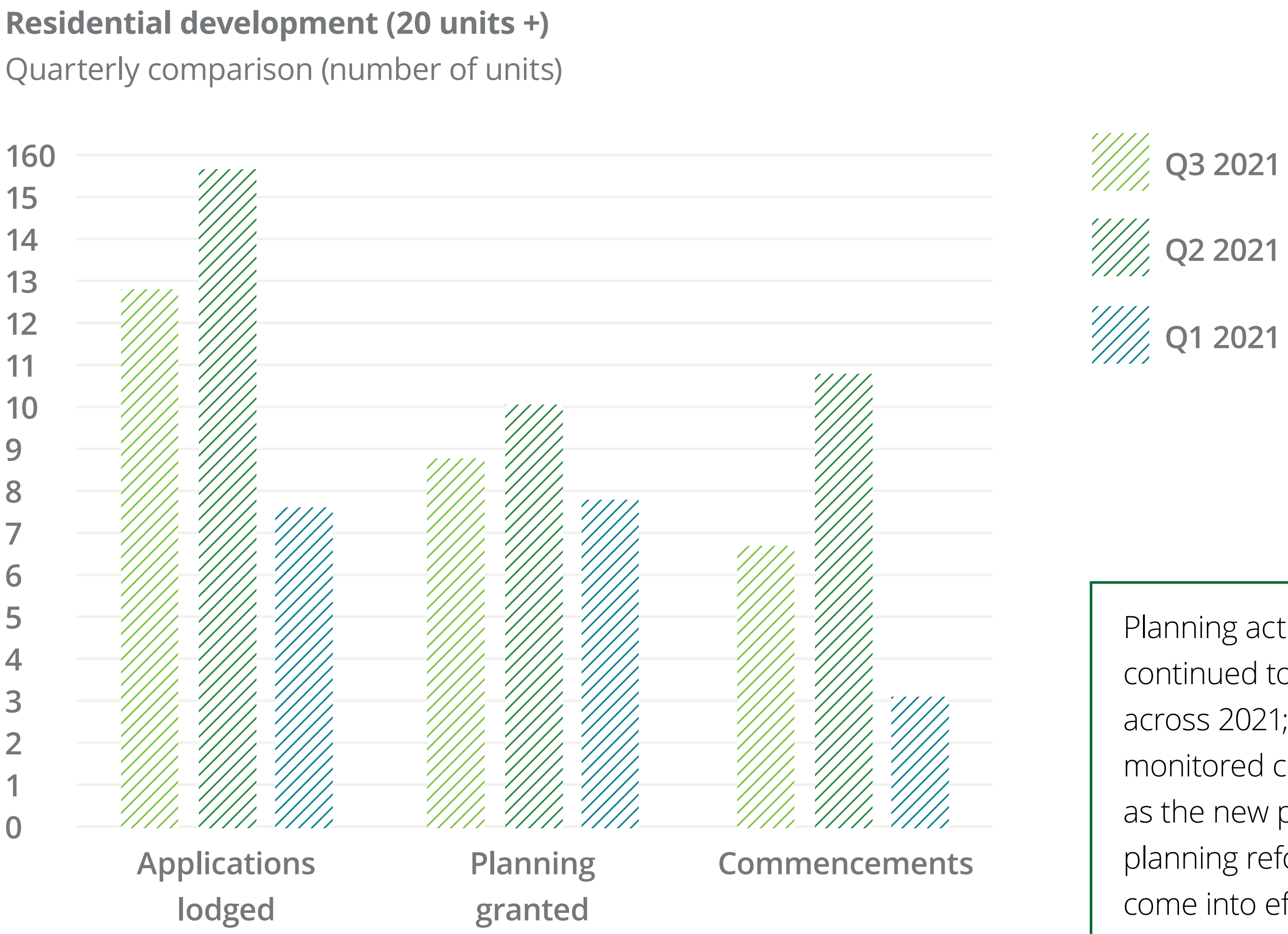
Our planning system, as currently configured, is seen by investors as unnecessarily complicated and risky. This forces the cost of capital to go up. The recent judicial reviews of high-density planning permissions has amplified this risk profile. Given this high level of uncertainty in relation to high-density schemes, we are seeing developers holding off on submitting planning applications until they have better visibility on the planning process. The planning application process is expensive and is predominantly funded by equity, so an unsuccessful application is a drain on the developer's resources. This will result in further delays to the delivery of supply.

In a bid to address this, the government's Planning and Development (Amendment) (Large-scale Residential Development) Bill 2021 replaces Strategic Housing Developments (SHD) with a new planning process for Large Scale Residential Developments (LRDs) and restores decision-making power for planning to local authorities. The government says this will expedite the delivery of housing supply while also providing certainty and stability to the construction sector by retaining some of the positive elements of the SHD arrangements. Coupled with changes to the Part V regulations and the government's Land Value Sharing and Urban Development Zones Bill initiative, it will be interesting to see what effect this has on the market in the year ahead.

Last year, the government changed stamp duty rules so that institutions buying 10 or more residential units in a 12-month period would be subject to a 10% levy. Clearly it is important that housing stock is delivered to the home buyer market. However, it is essential that measures taken do not push institutional buyers out of segments of the market that are not viable on a build-to-sell basis. If this is to happen it will result in a further reduction in supply.

KEY TAKEAWAY

The supply of residential housing remains a pivotal issue – but measures to increase it must be carefully managed to ensure viability of stock and to avoid further reductions.



Planning activity has continued to fluctuate across 2021; this will be monitored closely in 2022 as the new policies and planning reformations come into effect.

Source: Deloitte Planning and Development Statistics Q4, 2021.

Residential development (20 units +)
Quarterly comparison (number of units)

	2021 Q3	2021 Q2	2021 Q1
Applications submitted	**130** schemes **16,222** units	**159** schemes **13,967** units	**77** schemes **9,612** units
Granted planning	**89** schemes **18,993** units	**102** schemes **11,438** units	**70** schemes **8,078** units
Commencement notices lodged	**67** schemes **6,883** units	**109** schemes **10,999** units	**32** schemes **1,764** units

Conclusion

As we look out at the year ahead, with the economy opening again after COVID-19, there is a significant amount of capital out there seeking viable projects. We anticipate a continuation of the high levels of activity we saw towards the end of 2021.

Further out, we will have to wait to see what impacts the withdrawal of government supports, rising interest rates, and the Central Bank's tapering of liquidity measures will have on the availability of capital, but the impact of that is likely to be beyond 2022.

For our Global perspective, read our **2022 Commercial Real Estate Outlook**.