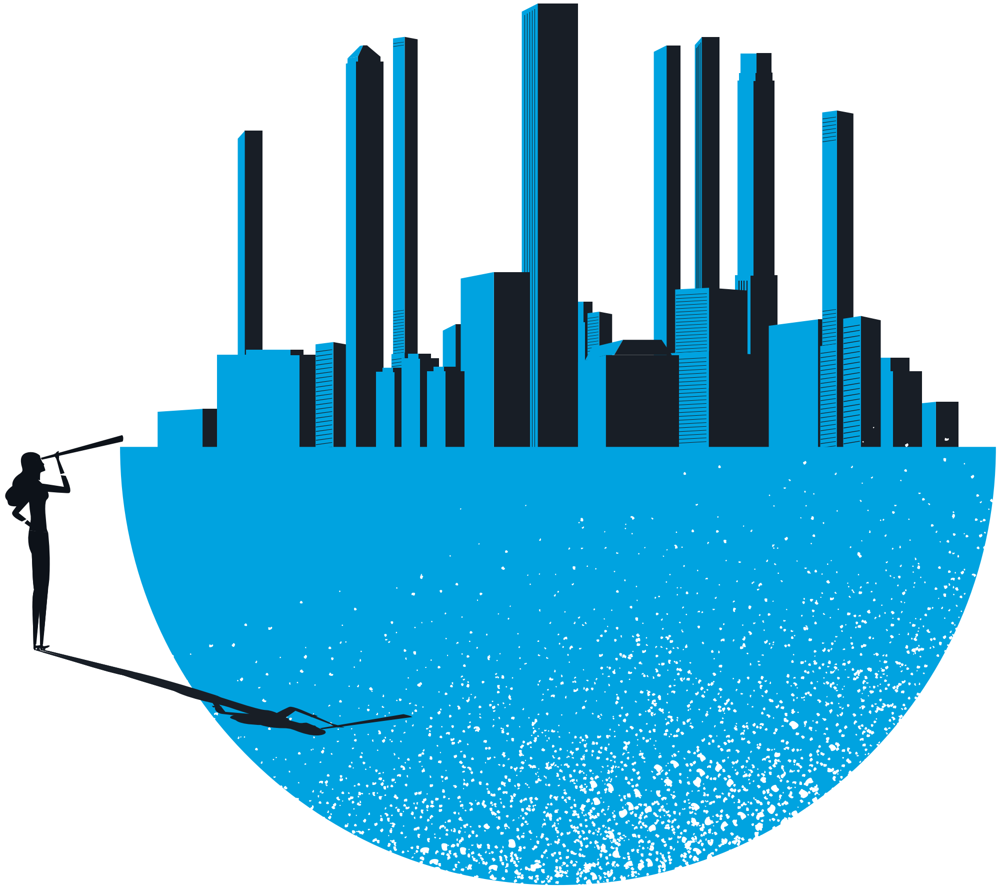
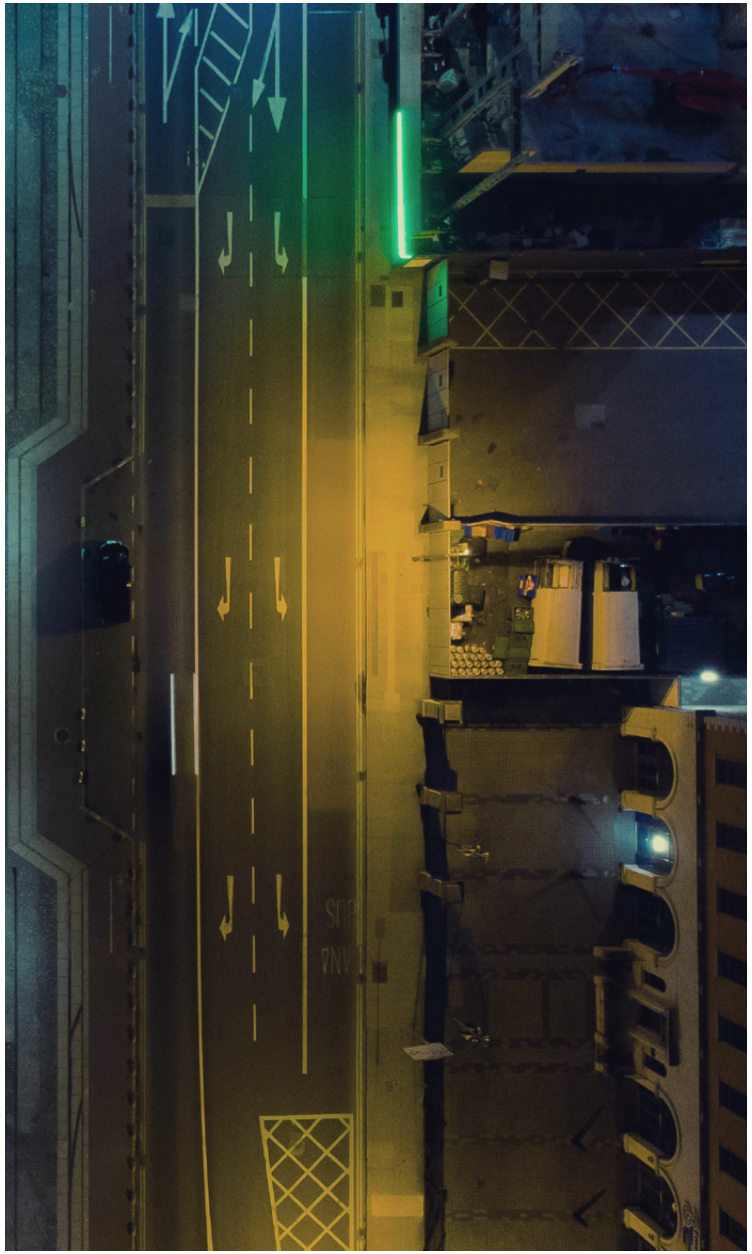


2023 Irish Real Estate Outlook

The outlook for the Irish Real Estate sector in 2023 remains uncertain, with market volatility prevalent in the sector. There are a number of factors playing into this volatility, including interest rates rises, FX rate movements, high inflation, reduced occupier demand, changing government policies, and more stringent ESG requirements.



While many of these issues are global, affecting most developed economies, it is worth noting that the fundamentals of the Irish economy remain robust. The country is almost at full employment (4.4% unemployment, November 2022[1]), has a highly educated workforce, and is the only native English-speaking country in the EU. Strong foreign direct investment has driven corporate tax take in 2022 to its highest level on record, and this corporate activity has continued to be a strong driver of demand for Irish real estate. Economic forecasts for 2023 have returned downward revisions, however, importantly many forecasts continue to show economic growth in Ireland in 2023 and place Ireland as one of the strongest economies in the EU.

Despite the strong fundamentals in the Irish economy, for the Irish real estate sector, an adjustment period is underway. This reflects the transition out of the historically low interest environment. To date, it is difficult to tell where this adjustment lies. Prime yields in Ireland have not yet recorded the level of correction which has been reported in some other jurisdictions such as the US and UK real estate markets. However, one certainty for 2023, is that this correction will develop further in Ireland.

1. 'Labour Force Survey Quarter 2 2022: Seasonally Adjusted Unemployment', Central Statistics Office, Ireland

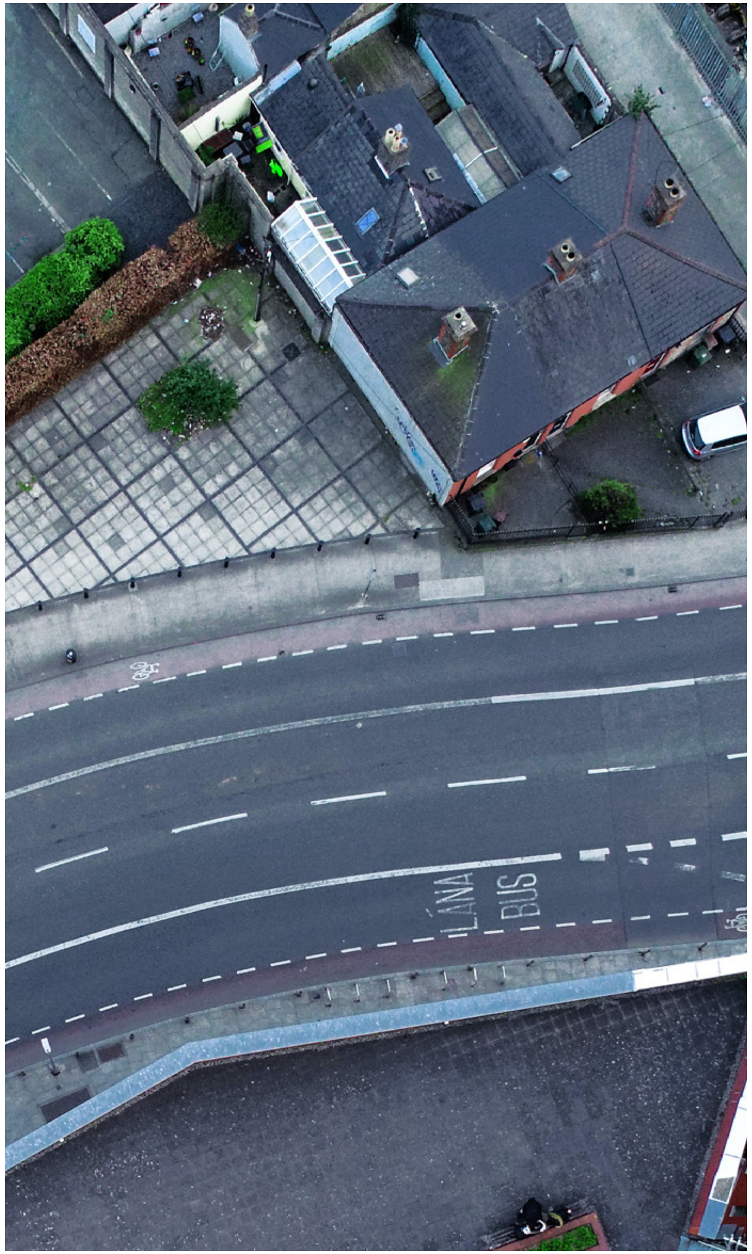
Furthermore, increased construction costs and prolonged lead in times in the delivery of construction materials, along with government policies such as proposed changes to planning legislation and the 5% levy on concrete blocks due to be implemented, all provide for an uncertain outlook in terms of sentiment for 2023.

Cost inflation in the construction sector reached 7.5% nationally for the first six months of 2022 and is running at 14% annually[2]. During the last six months, the highest ever rate of construction inflation increases since tracking began has been experienced. This is in part due to the impact of the war in Ukraine which is driving energy prices upwards and leading to higher costs for construction materials globally.

As the country emerged from its COVID-19 lockdowns, the impacts of the pandemic were felt through supply chain disruptions, leading to increased material costs, with pent-up demand for construction services forcing prices upwards. These issues, along with increasing labour costs in a tightening labour market, have resulted in record construction inflation of 22% over the past 18 months.[3]

As a consequence, developers and financers are exercising caution when considering short and medium-term development options. A number of high-density residential developments have already experienced delays, where promoters have either revisited the design of their schemes or paused construction until 2023.

2. 'Tender Price Index July 2022', Society of Chartered Surveyors Ireland
3. Idem



In the capital markets, the traditional lenders have paused new lending during the current price discovery period. While we expect these lenders to re-emerge in 2023 as the market stabilises, there are increasing opportunities for direct lenders to advance capital in areas where the banks typically were dominant. We are seeing lending parameters being more heavily weighted towards conservative cashflow lending than loan-to-value metrics.

ESG

ESG will remain high on the agenda across the Real Estate industry during 2023, with lenders, developers, and occupiers all striving to meet demands for reduced carbon footprints and increased sustainability measures.

The challenge facing the industry in this regard is not inconsiderable. According to the Whole Life Carbon in Construction and the Built Environment in Ireland report produced by the Irish Green Building Council (IGBC), the construction and operation of the Irish built environment is responsible for more than 36% of Irish greenhouse gas emissions (around 23 million tonnes of CO2), split in a 2:1 ratio between construction and embodied emissions . Emissions related to the residential sector account for almost half of these emissions.

While government figures differ in terms of overall emissions, the target set for reductions is no less challenging. The sectoral emissions ceilings set by the government in July will see a 45% reduction in emissions from commercial and public buildings by 2030 and a reduction in residential emissions of 40% by the same date.

In tandem with this, FDI investors have their own self-imposed ambitious climate targets to meet, with many of them targeting carbon negativity by 2030 as a means of making redress for past emissions. These corporations are demanding the highest platinum level of LEED (Leadership in Energy and Environmental Design) certification for the buildings they occupy. To achieve LEED certification, a building must adhere to standards that address carbon, energy, water, waste, transportation, materials, health, and indoor environmental quality.

These demands are already impacting the commercial and industrial property markets and that impact is likely to grow in the years ahead, with occupiers and purchasers favouring new ESG compliant buildings, resulting in significant negative value implications on older and inefficient buildings.

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Housing, Planning & Government Policy

Housing availability and affordability remains at the forefront of the political agenda. Increasing supply of housing is key to addressing these issues, however, it remains to be seen how effective the current government's Housing for All plan and Croí Cónaithe schemes will be.

- **Housing for All** aims to increase the supply of housing to an average of 33,000 per annum over the next decade. The plan provides for a mix of social, affordable, and private housing for sale and rent. The plan contains measures to support land availability, funding, and industry capacity to enable public and private sector actors to meet the targets.
- The **Croí Cónaithe (Cities)** Scheme is a fund which supports the building of apartments in cities for sale to owner-occupiers. The aim is to bridge the perceived viability gap where the cost of building apartments is higher than the market sale price.
- The Croí Cónaithe (Towns) fund provides a grant of up to €30,000 to refurbish vacant properties in rural towns to be used for residential purposes.

These initiatives are currently beset with the same problems affecting the overall real estate sector, including constrained industry capacity, planning delays, and rising costs. While it is to be hoped that they deliver on their aims, given current commencement data it is unlikely these targets will be met in 2023.

For private sector developers, planning risk in respect of high-density development projects is giving rise to considerable uncertainty. Changes to the planning system, in particular the replacement of the Strategic Housing Development (SHD) regime with the potentially longer and less certain **Large Scale Residential Development (LRD)** planning process, have brought about fundamental changes to the investment environment for developers.

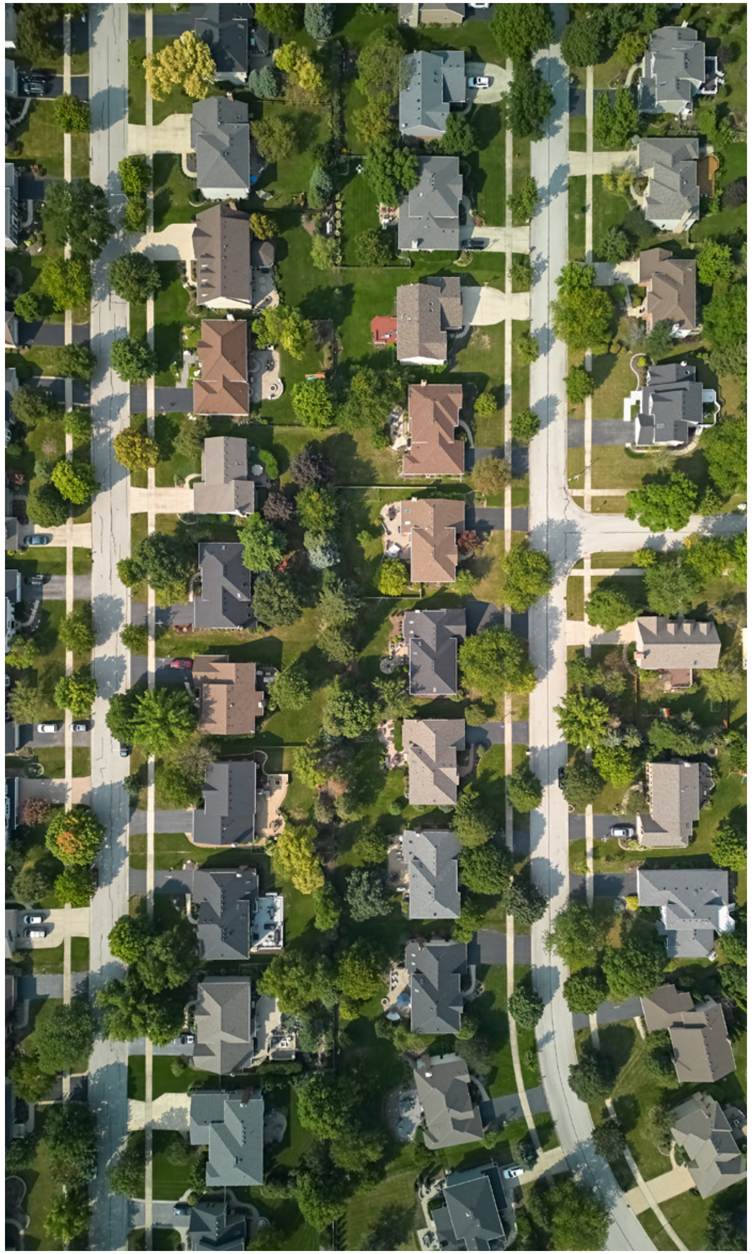
Under the former SHD regime, developers applied directly to An Bord Pleanála for planning permission for developments of 100 units or more with local authorities having a consultative role.

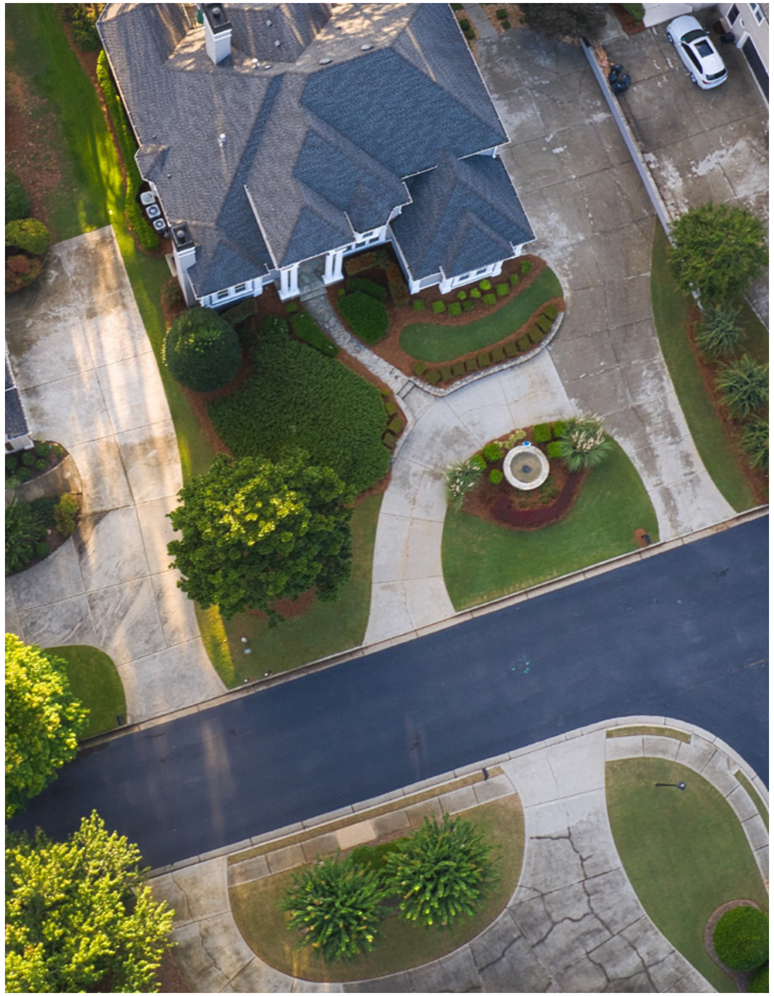
Under the LRD process, applications are made directly to the local authority in the first instance. Decisions by local authorities under the LRD process can be appealed to An Bord Pleanála. A Judicial Review of the decision by An Bord Pleanala is also possible, however it is anticipated that the re-introduction of the appeal stage to ABP will reduce the quantum of judicial reviews being taken.

The Minister for Housing, Local Government and Heritage, Darragh O'Brien, has also commenced new provisions amending the judicial review provisions in Sections 50A of the Planning and Development Act 2000, and further judicial review reform is planned in the near future.

The impact of the change from SHD to LRD is difficult to quantify at present and it will require close monitoring during 2023.

The proposed removal of the Build-to-Rent (BTR) standards in place since 2018 will add significant costs to upcoming residential developments, particularly those in urban locations which have yet to receive planning permission. This will likely result in further delays and present viability issues for developers to consider. It will almost certainly have an adverse impact on the delivery of much-needed housing supply.





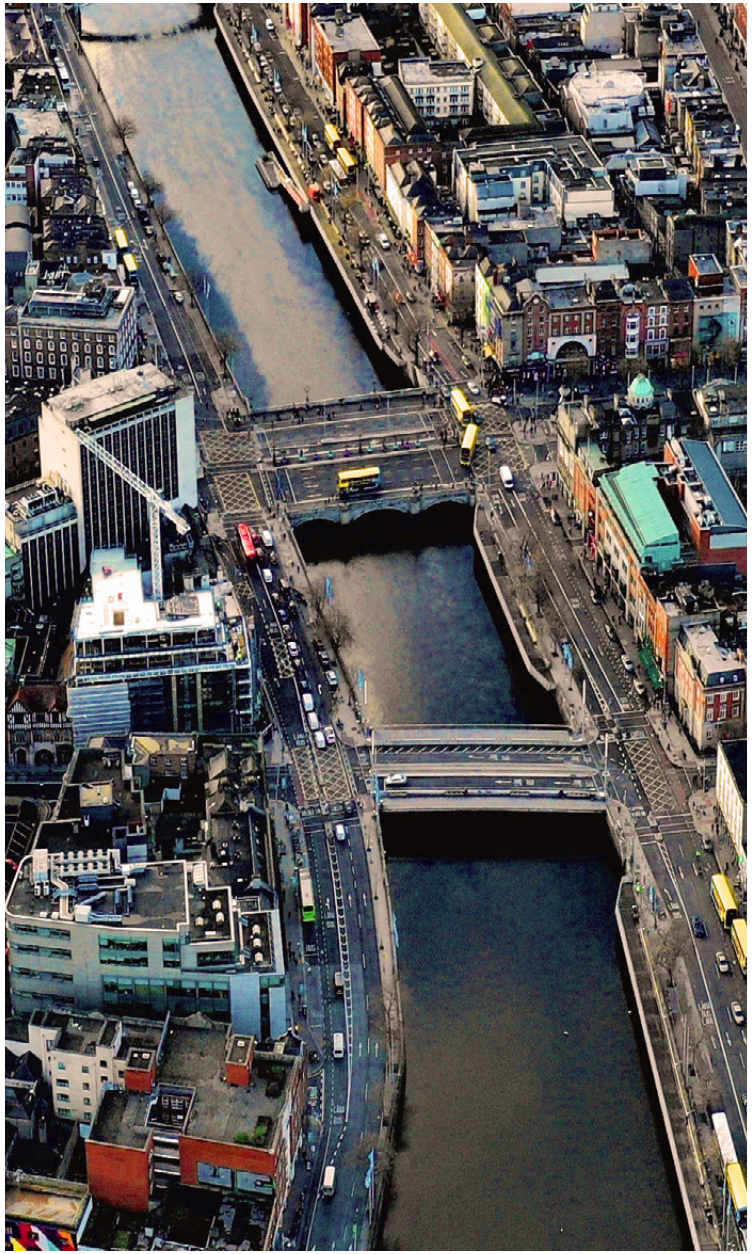
The incoming **Residential Zoned Land Tax (“RZLT”)**, an initiative geared towards activating land for residential development purposes, is likely to be contentious. This will operate as a 3% levy on the market value of certain lands on the relevant valuation date, and will likely be seen as yet another cost for landowners in an already challenging market for residential development, further tightening the viability gap of delivering housing units.

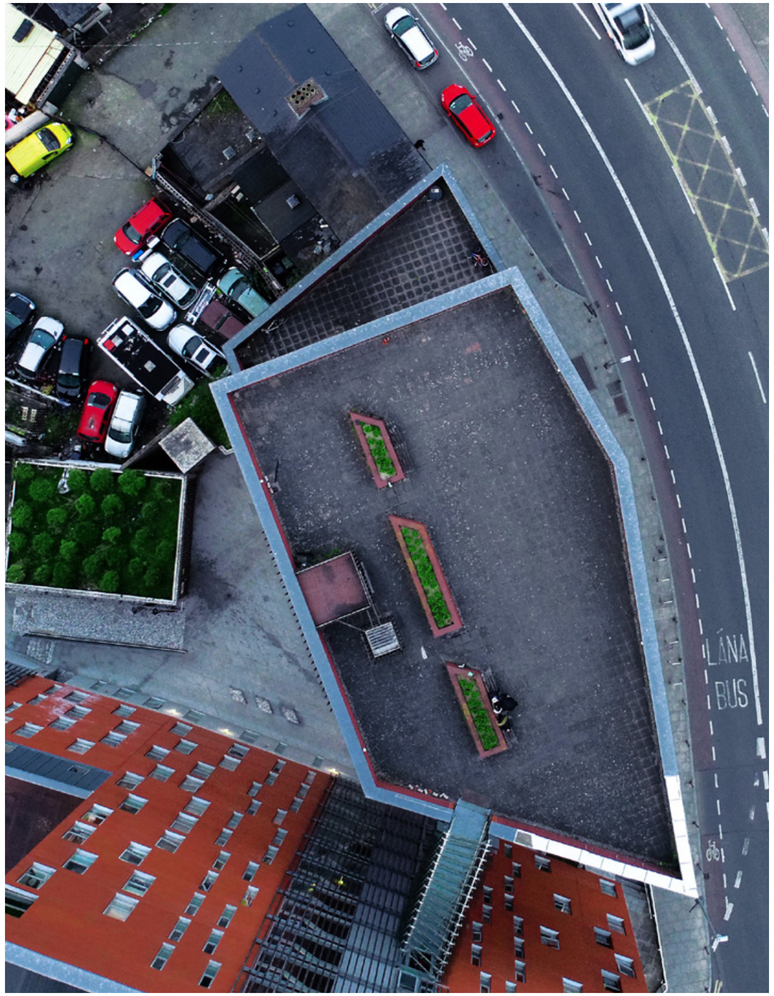
The recently announced freeze on evictions for residential tenants is unlikely to have a significant impact on the market. However, it adds to the sense of reactive policy making, rather than a proactive approach, and further adds to the overall climate of uncertainty.

Despite these headwinds, the fundamental and unwaning demand for housing is creating opportunities for developers that can navigate these issues. Extensions to the Government Help to Buy and new First Home Scheme will continue to drive the demand side for first time buyers.

Commercial

The outlook for the commercial property market is dependent on the sector under review, with differences emerging across the core sectors. To begin with offices, it is envisaged that rental levels achieved across the prime office market will largely remain unchanged across 2023, while secondary assets will likely fair different. The emergence of a two-tier market in this sector is likely to continue during the year ahead with best-in-class offices with top LEED certification and green energy ratings retaining sustained high rental levels. Conversely, the vacancy rate is likely to continue to increase for older stock which falls short of occupiers' sustainability and occupancy requirements. Vacancy within the Dublin office market in 2023 is likely to not only be confined to older stock, however, as the latter months of 2022 saw a rise in grey space released to the market, often within newly built stock. This emergence is likely to become a more established feature of the letting market in 2023, as large occupiers, particularly within the tech sector, who committed to new offices prior to COVID-19 reassess their footprint requirements. The extent of the volume of this type of space released to the market will be watched, as it may impact rental levels achieved not only in secondary stock but also newer stock.





Across all sectors, occupiers will likely be closely monitoring how the market reacts to economic conditions and may be reluctant to pay above quoted rents as they address their own increasing operational and occupancy costs. The exception here may be prime industrial assets. Industrial continues to struggle with an acute shortage of quality units available in the market. Construction activity and pipeline has increased within this sector over the past 1-2 years; however, the wider finance and economic conditions are likely to see this pipeline become paused, with new development only taking place on a pre-let basis.

It is anticipated that yields will continue to shift outwards, due to the correction which is taking place across all markets resulting from increasing interest rates and issues surrounding the cost of finance as discussed previously in this report.

Further feeding into our view of outward yield movement in 2023 is the availability of more attractive investment sectors, impaired market sentiment, the increased risk represented by downward pressure on rental income arising from the energy crisis, inflationary measures, interest rate increase, and other economic factors.

Conclusion

2023 will be an uncertain and unpredictable year for the Real Estate market. Economic factors and continuing government policy changes will play a key role in the performance of the residential market. Good quality commercial (office and industrial) assets are likely to continue to perform well, with older buildings having difficulty attracting tenants due to their poorer environmental performance. Construction cost inflation is anticipated to continue at relatively high levels but is expected to moderate somewhat. In the event of a contraction in market activity, this may result in capacity returning to the industry and increased competitiveness on tenders and downward pressure on prices.

While there are many headwinds for the real estate sector, there is no denying that there remains significant volumes of capital and interest to place it in the Irish market. With this in mind, we believe there will be a return to activity toward the latter end of 2023, with investors seeking value-add opportunities as valuations correct to the new macro environment, and the market begins to stabilise.

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For our Global perspective, read our **2023 Real Estate Outlook**