Resilience, Re-imagining and Responsibility

Ireland Real Estate Market Predictions 2021

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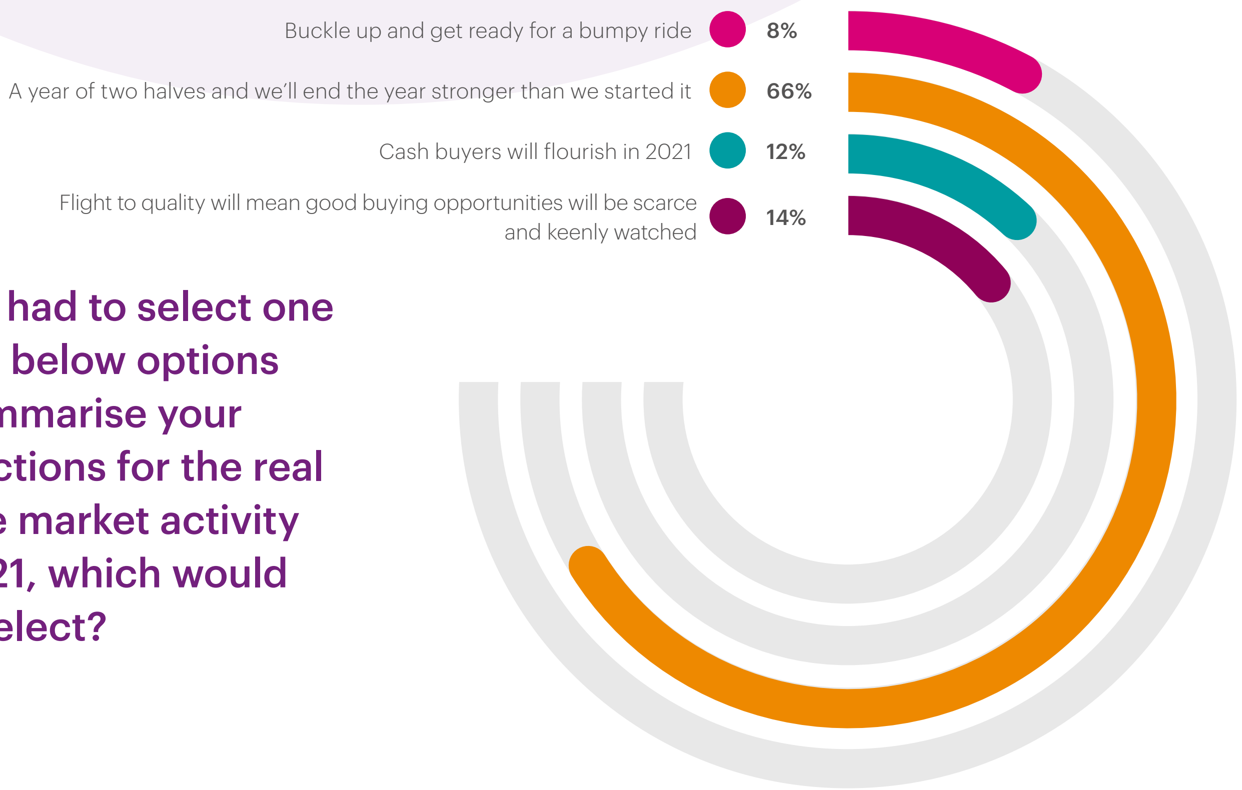
On 28 January 2021, Dentons Ireland held its inaugural Ireland Real Estate Market Predictions event at which industry experts **Claire Solon** (Greystar), **Thomas Dowd** (Avestus Capital Partners), **Justin Bickle** (Eagle Street Partners) and **Andy Tallon** (CBRE) gathered to share their views on the market. Despite the unprecedented disruption and challenges caused by COVID-19 in 2020, the outlook of both our panel and our audience were optimistic for the year ahead. The general view of our panellists and 66% of our audience was that 2021 would be a year of two halves and the stage is set for a strong return of investment in the latter part of 2021. While there will continue to be difficulties, in the latter half of the year we should see a strengthening of the market, growing confidence and strong appetite from both international and domestic investors to deploy capital here. Three themes emerged from the panel discussion – **resilience, re-imagining and responsibility**. In this summary note, we will take you through each of these themes in turn.



If you had to select one of the below options to summarise your predictions for the real estate market activity in 2021, which would you select?

Resilience

> The themes which allow good investments in Ireland are as strong as anywhere else
>
> – Justin Bickle, Eagle Street Partners

2020 was a year characterised by resilience and unprecedented challenges which we will continue to face in 2021. While transactional levels were lower in 2020, the panel noted that some sectors showed resilience in holding value and remained attractive to investors.

On a particularly positive note, our panellists agreed that there is a massive amount of capital ready to be deployed into Ireland and there is significant investor interest (both domestic and overseas) waiting on the sidelines for the right quality asset, with Dublin now viewed as a core European investment city primed for investment.

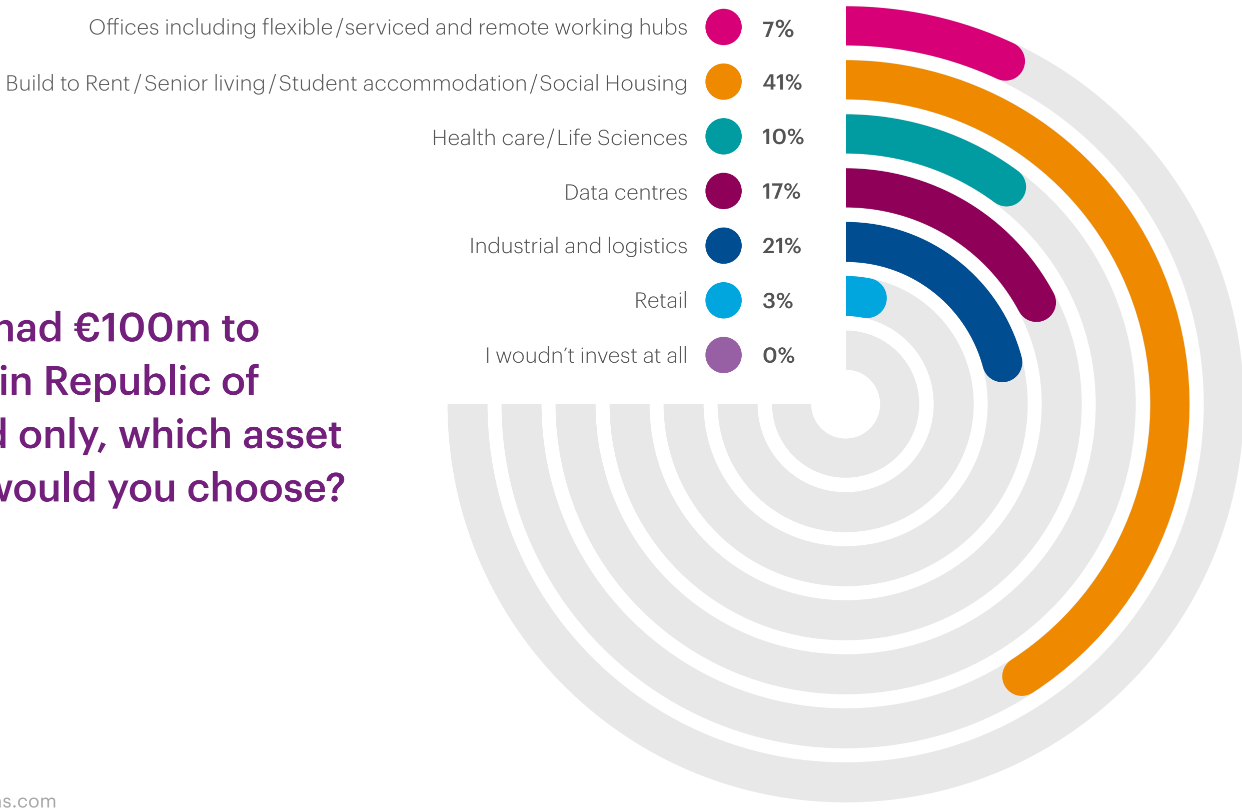
While certain sectors have been impacted more than others, the residential sector (including alternative sectors such as build-to-rent and social housing) and industrial and logistics sectors were clear winners for 2020.

Build-to-rent

The panel agreed that 2020 was an effective reset from the “bull market” of 2018/2019 and that there was now a greater balance between costs for the developer and acquisition value for the investor. Our audience poll showed that, if they had the capital, 41% would choose to invest in residential sector assets such as build-to-rent, senior living, student accommodation and social housing.

It was observed that, while build-to-rent is still in a relatively nascent stage in Ireland, this sector has

If you had €100m to invest in Republic of Ireland only, which asset class would you choose?



experienced phenomenal growth over the past four years. Since 2016, the market has moved from repurposing "build-to-sell" stock to a specifically constructed "build-to-rent" product, with particular emphasis being placed on designing stock that meets the demand and requirements of investors and tenants alike. This trend is likely to continue in 2021, largely driven by robust rent collection rates and ongoing supply-demand imbalance which continues to affect this sector.

In terms of geographic focus, the resounding view was that, while there are some exceptions, investors are expected to continue to focus on build-to-rent opportunities in Dublin and the Greater Dublin area. There may be some appetite from national capital to accept the risk premium of build-to-rent developments in regional areas. Affordability will, however, continue to be a critical issue for regional developments, but recent figures are starting to show that costs are starting to come down slightly within the build-to-rent sector as a result of regulatory changes. The impact of these changes on affordability has yet to be determined.

> From an international investor perspective, it's a Dublin/Greater Dublin Area story
>
> – Thomas Dowd, Avestus Capital Partners

Social housing

Within the alternative residential sector, our panellists agreed that there is significant demand and capital earmarked for social housing. Social housing is recognised as offering a long-term source of stable income for investors from local authorities and, importantly, ties into social impact investing.

So far as funding is concerned, the panel added that social housing is considered lower risk by lenders and financing may be easier to obtain where developers own the site, understand the construction costs and have an agreement with an approved housing body. In particular, the panel noted that the standard 25-year lease with an approved housing body (together with its funding backing from the Department of Housing) distinguished this product from the rest of Europe and was leading to keen interest from investors globally.

> The high level idea of a 25-year lease to local authorities is nearly unique on a European basis ... and it is seen by some as ticking the box for social investing
>
> – Andy Tallon, CBRE

Industrial and logistics

In addition to residential and alternative residential assets, the industrial and logistics market continues to perform well and also benefits from supply-demand imbalances, including a large amount of standing stock no longer being fit for purpose. With improving infrastructure and continued increase in online shopping, this is a sector to watch in the coming years.

Construction

The construction sector faced many challenges in 2020, with site closures in late March and the introduction of protocols and safe working requirements upon the reopening of sites in May. The cost and time impact of closures and new working practices did not impact all construction projects equally: projects nearing completion were most affected due to the requirements of closer working and the lack of time potentially available to mop up delays.

The panel view was that, while 2021 will see a significant number of COVID-19-related claims come through from contractors, the resilience of the construction industry in adapting to the new protocols and work practices has been a real positive. In general, construction sites were well managed, protocols were adhered to and rates of COVID-19 were low. The difficulty now is predicting how the current site closures will impact projects and the wider industry – the reopening of sites, sooner rather than later, will be key.

Given the impact of COVID-19 on the construction sector, there was an expectation that construction costs would increase. However, this is not yet being observed by our panel in the market. Whether this is a feature of less projects starting (meaning less pressure on construction inflation) or indicative of a wider reset of construction costs which will continue across 2021 remains to be seen, but this is definitely one to watch.

Re-imagining real estate

2021 will be a year in which real estate needs to discover the new norm and re-imagine how space is designed, adapted and operated.

Commercial lettings

COVID-19 has also allowed tenants to reset leasing models. Landlords, particularly within retail and the food and beverage industries, are under increasing pressure to offer shorter-term leases, with flexible lease terms and lower rents. In particular, one panellist observed that we are seeing a greater use of turnover-based rents or hybrid rents (consisting of a base rent coupled with a turnover element). In turn, this remodelling will impact valuations, investment and lending decisions by introducing a variable element into the calculation of rent.

Re-imagining the office space

The role of the office is of particular importance for those undergoing training and lends itself to collaboration and social inclusion. There has been a shift in perspective from high density working environments to being more conscious of space, and this experience has taught us that we need to re-imagine the manner in which we use office space. For offices, this means providing spaces that meet the needs of the workforce – from collaborative spaces and quiet thinking areas to wellbeing zones.

Within the office sector, our panellists shared the view that bricks-and-mortar offices will continue to have a very important role post-pandemic, albeit with an added dimension of remote working or indeed access to smaller satellite offices in the growing trend for "hub and spoke" office accommodation. Concerns as to the future of the office have been overstated. In terms of investment opportunities, as one panellist observed, there are still bargains out there for savvy investors to acquire assets with good blue chip tenants.

> "The rebound is going to be fast and strong and the capital is there to invest in good core office product
>
> – Andy Tallon, CBRE

Retail and hospitality

One of our panellists observed that, even within these asset classes, there are still pockets of value. Retail parks and district centres have performed relatively well, despite the challenges over the past few months. Further, the panel anticipates a move towards repurposing of these assets, be that through a redevelopment with a large residential element or indeed the adding of further floors to shopping centres to be used as offices and/or residential accommodation. While it may take time, our panellists shared the view that there will be a rebound for hotels in the months ahead and, within the hospitality sector, there are opportunities for the discerning investor to acquire hotels significantly below replacement costs.

> There were already cracks within [the food and beverage] market before COVID-19 and this lets us reset the balance going forward
>
> – Claire Solon, Greystar

Construction and planning

An increased need to collaborate to minimise delays to construction projects and mitigate the impacts of new working practices on sites was a feature of 2020. The unforeseen nature of the closures meant that risk allocation in contracts was not always clear and parties had to come to the table to agree a way forward. As part of the re-imagining of real estate, there are opportunities for the lessons learned from this collaboration to be channelled into a new approach for managing and minimising claims.

On the topic of planning, our panellists observed that strategic housing development legislation has been a positive addition to the planning system and particularly praised the collaborative nature of the fast track process which allows developers to get helpful feedback on planning applications through the prescribed consultation process. However, the large number of judicial reviews against decisions handed down by An Bord Pleanala is seen as a significant impediment to the efficiency of the planning system here and, moving forward, it will be important for a balance to be struck between the interests of local objectors and the need for greater certainty for developers. Achieving this balance would, in turn, encourage development and therefore alleviate the supply pressure which currently exists in the housing market.

Responsibility

Responsibility is a key theme for 2021.

Environmental, social and governance (ESG)

ESG will be of central importance to investors, developers and lenders in 2021. Investors and organisations realise the significant correlation between real estate and matters such as sustainability, community cohesion and mental health. An organisation that steps up to its ESG responsibilities, having a strategy that runs through its core, will be able to unlock these opportunities.

Lender and investor

Finance continues to be available, but there may be greater scrutiny of the asset, the cash flow, the occupier and, as we discuss below, their ESG value. Generally, there is good appetite for residential, industrial and logistics, data centres, and good core income. These trends show that debt funding closely follows the asset classes which are also being chased by private equity.

Lenders are establishing their own structures for evaluating loan opportunities and the governance around ESG investments, and borrowers are being incentivised to engage with ESG by offering them favourable terms. As one panellist observed, good assets with good income will be well supported by the lenders. On the investor side, the role of the ESG officer is becoming increasingly important on investment committees when considering capital deployment.

> [ESG] is the single biggest ... mega trend which is here and it is here to stay
>
> – Justin Bickle, Eagle Street Partners

> When you are part of a local community, it is really important that you actually interact and properly engage [to encourage community cohesion]
>
> – Claire Solon, Greystar

Residential

There is also a misunderstanding of the role that real estate can and should play in society and our panellists emphasised the shared importance of the social and governance elements of ESG, not just environmental drivers. Real estate developers and investors, as one panellist observed, have the potential to make a significant and positive social difference. This can be done by investing in certain assets, such as social housing or healthcare assets which provide for the community as a whole. It can also be done by considering the residents of the relevant asset and ensuring that there are amenities available to foster a sense of community, which is vital in the case of a multi-family asset and can make a significant contribution to the mental health of individuals.

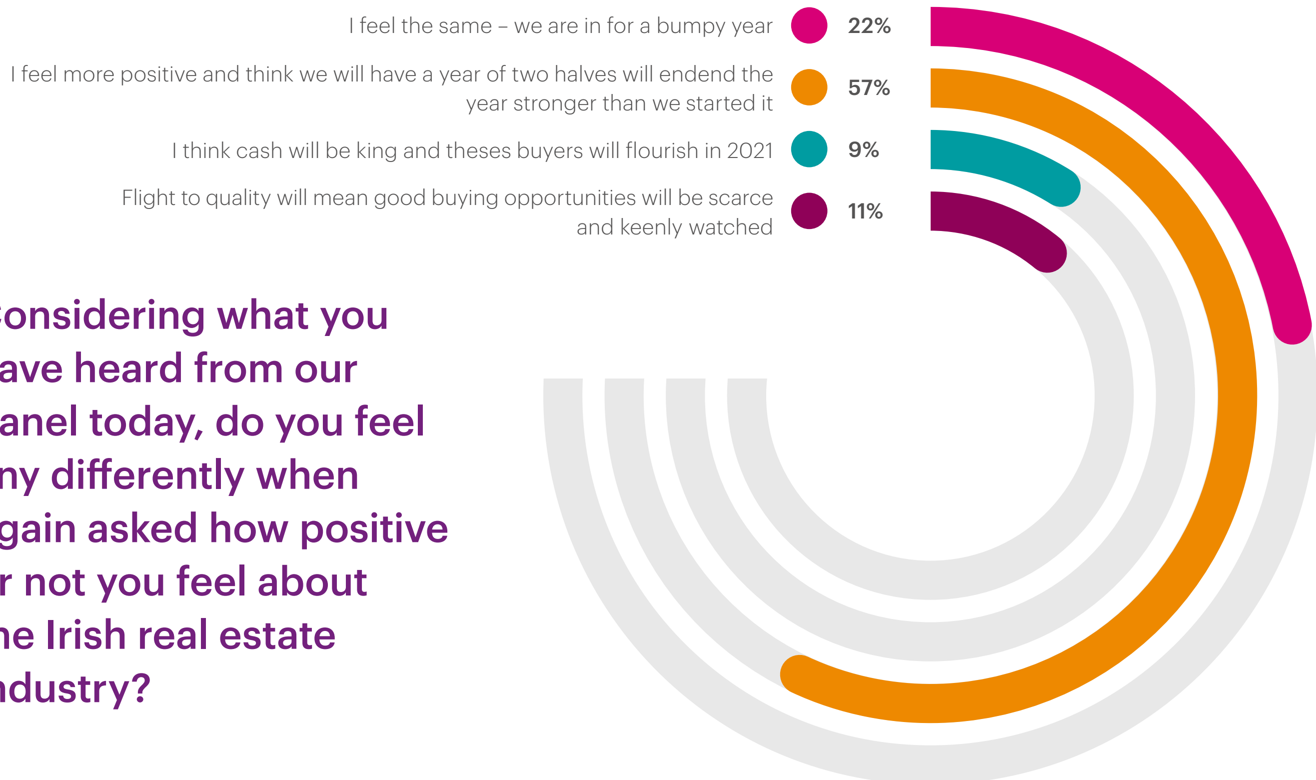
Construction

As ESG continues to become a focus for investors, the construction sector will become an important partner in delivering projects that meet ESG mandates. This is not only relevant for the environmental and social aspects of projects, but will be crucial in driving the "G" – governance. The role of the construction sector will be key in ensuring that international best practice in areas such as anti-bribery and corruption, supply chain transparency, modern slavery, and health and safety is observed and delivered from inception in Irish projects. This is an area which will undoubtedly increase in importance in 2021 and beyond.

Conclusion

There is no doubt that there will be challenges for the Irish real estate market in 2021. In the short term, travel restrictions, access to construction sites and the wait for roll-out of vaccines internationally will have the potential to cause further disruption. However, the market has shown resilience and this is expected to continue. In the longer term, trends such as the downward pressure on rents and the growing importance of ESG matters are likely to see real estate re-imagining the use of space and taking greater responsibility for the industry's wider role in society.

In our final audience poll, circa 58% felt more positive and thought that we will end the year stronger than we started, 22% thought we were in for a bumpy ride, 11% believed that there would be a flight to quality with good buying opportunities being scarce and keenly watched and a positive 9% thought that 2021 would be a year of opportunities for cash buyers. So, while 2021 will not be a year without difficulties, the view is that it will also not be a year without opportunity.



Considering what you have heard from our panel today, do you feel any differently when again asked how positive or not you feel about the Irish real estate industry?

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