ILIM

Life \ Pensions \ **Investments**

Quarterly Report Q3 2023
Pension Irish Property Fund

more **INVESTED**

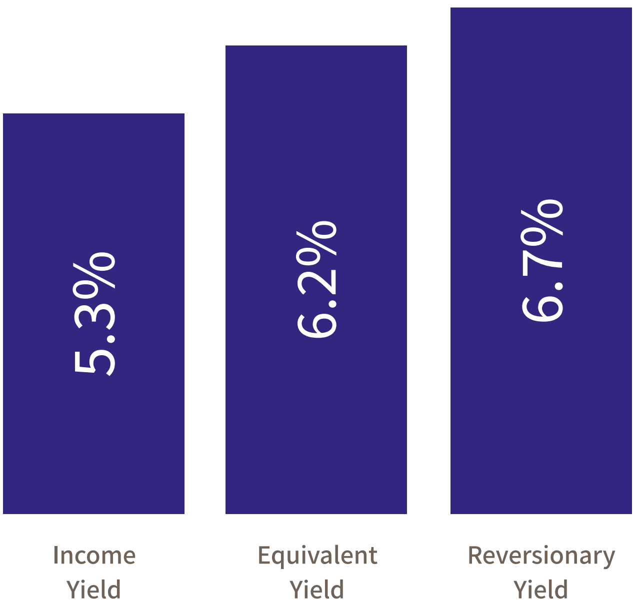
FUND CHARACTERISTICS

AT A GLANCE ▼

NAV	GAV	NO. OF ASSETS	
€1.33bn	€1.57bn	70	GRESB ★★★★★ 2023

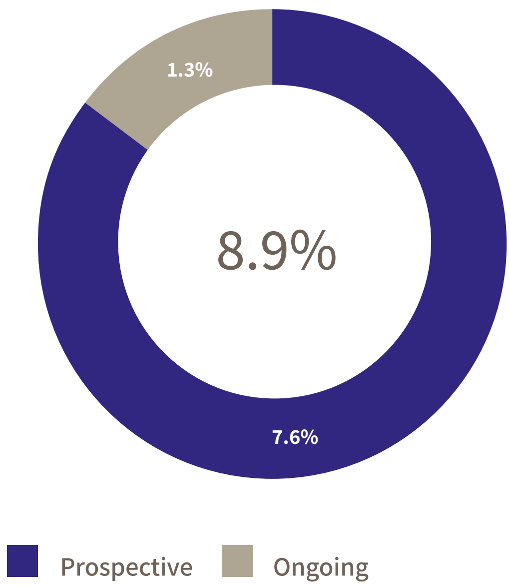
FLOOR AREA (SQ FT)	PASSING RENT PA	MARKET RENT PA	WAULT
3.45m	€76.94m	€96.61m	5.66 yrs

YIELD PROFILE ▼



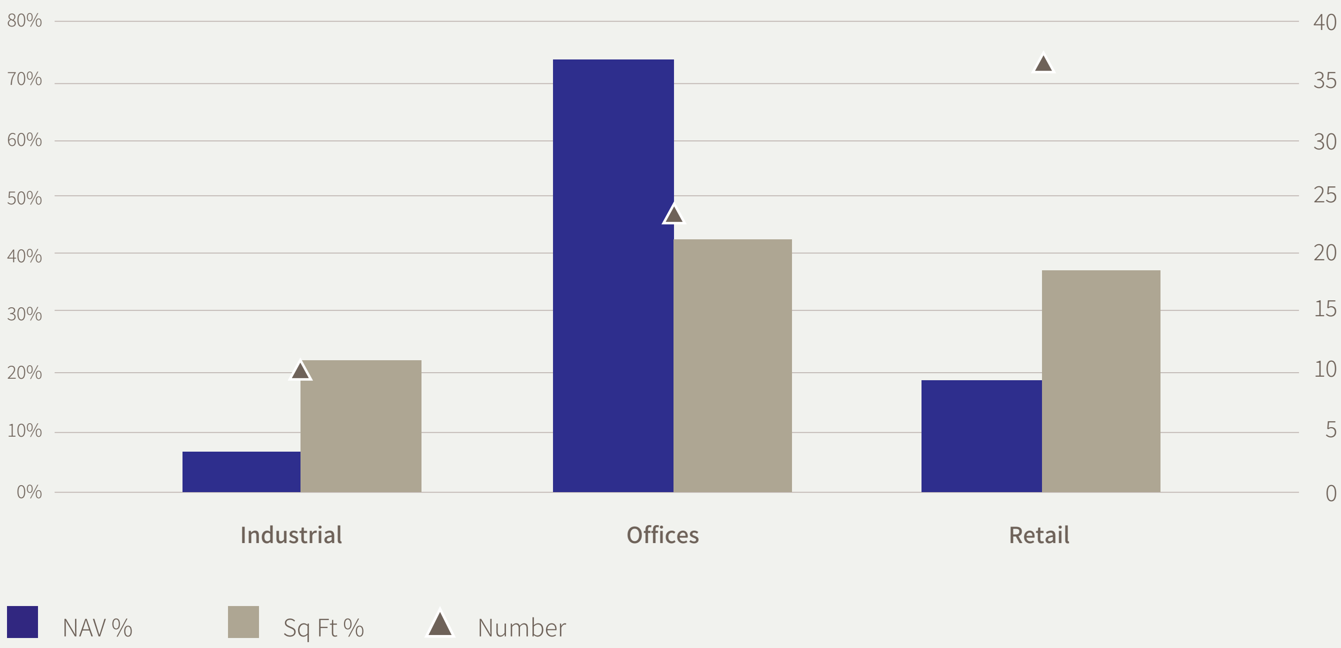
DEVELOPMENT ASSETS

as % of NAV

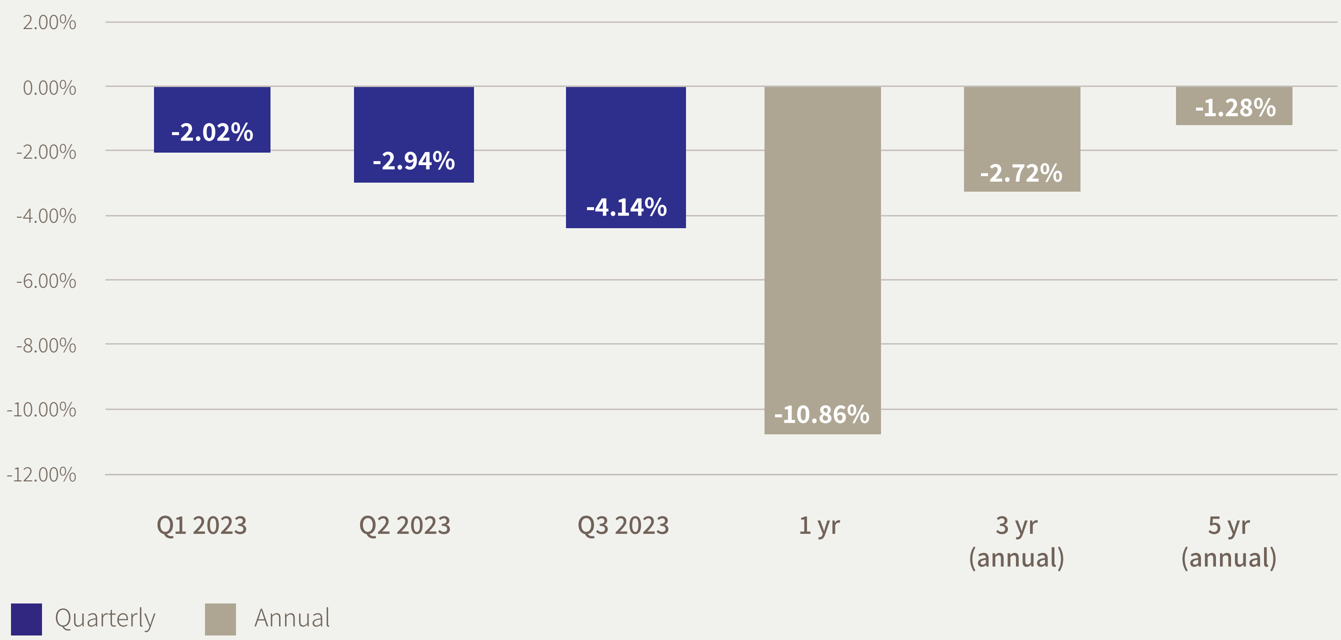


PERFORMANCE

SECTOR



FUND PRICE PERFORMANCE



MARKET COMMENTARY

Investment turnover in Ireland amounted to €444m in Q3, a similar quantum to recent quarters, but notably down on the long-term quarterly average of €1.1bn. The year-to-date (YTD) turnover of €1.4bn is not anticipated to reach €2bn for the full year. This pronounced decline in transaction activity is in line with broader European and global trends. Globally, investment volumes declined 54% year-on-year during Q2.

Institutional investors remain quiet on both the buy and sell side. Several factors are influencing this, including adjustment to the new cost of capital and rebalancing of allocations. There are limited instances of financial distress emerging which are forcing owners to dispose of assets, and the leverage impact is much less than in previous cycles. However, investors remain cautious and market headwinds persist.

Private and opportunistic investors targeting specific property types represent the demand in the market, with lower lot sizes and higher yields pervading. French SCPI funds still account for a sizable proportion of the market and acquired more office properties in Q3. These investors see an opportunity to acquire assets at attractive yields in a less competitive transaction environment.

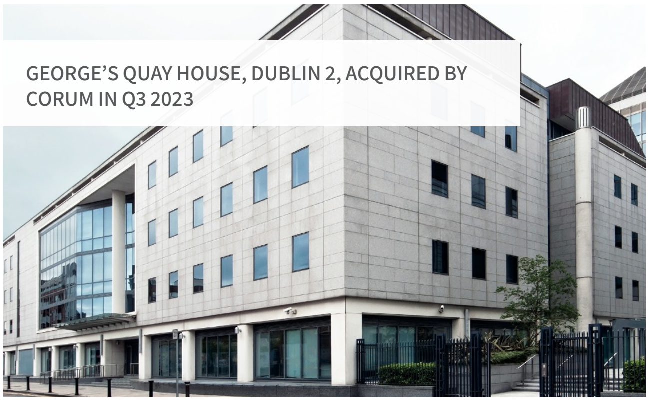
The largest reported transaction of the period was of George's Quay House, an office property extending to 105,000 square feet (sq ft) and multi-let to Fidelity, CIB, and WeWork. This was acquired by Corum, a French fund, for €81m, reflecting an income yield of 6.25%. That deal includes an obligation on the vendor to fund works required to bring the building up to a BER rating of B, from its current C status, highlighting institutional investors' focus on sustainability.

Otherwise, a Davy-managed fund is reported to have secured the 'Hexagon Portfolio' of retail schemes for €74m, comprising Donaghmede, Letterkenny, Galway, Laois, Parkway, Limerick, and Longwalk, Dundalk shopping centres. These schemes, which were developed by Harcourt Developments, had been under the control of fixed charge receivers. In addition, Davy acquired The Marshes Shopping Centre, in Dundalk, for €29.5m from Kennedy Wilson. In a break from its increasing activity in recent years, no residential investment transactions completed during Q3.

In the alternative sectors, Primary Health Properties PLC, a UK-based REIT, acquired a healthcare centre in Ballincollig, Cork from the O'Flynn Group for €31.4m in Q3, reflecting an income yield of 5.3%.

As with the earlier part of 2023, property valuations continued to trend weaker in Q3, with valuers reflecting lower liquidity and higher return requirements in market transactions by increasing yields in the office and retail sectors. Equivalent yields on prime offices now range from 4.50% to 4.85%, while the best industrial and logistics assets are now valued in the order of 5%. Following the completion of a small number of prime investment transactions in the retail sector during Q3, yields rose slightly following a period of relative stability in that sector.

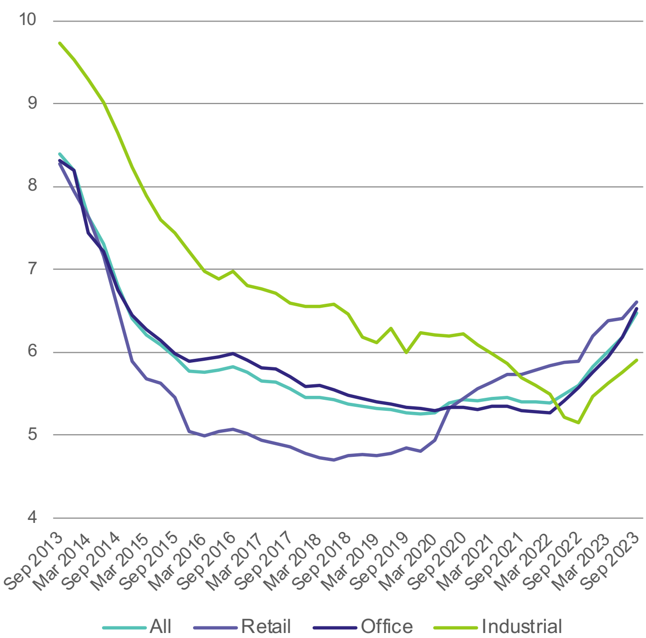
The graph opposite tracks the equivalent yield of all properties included in the index, by sector. This includes a range of quality within the three sectors, from prime to tertiary.



GEORGE'S QUAY HOUSE, DUBLIN 2, ACQUIRED BY CORUM IN Q3 2023

MARSHES SHOPPING CENTRE, DUNDALK: SOLD IN Q3 FOR €29.5M

MSCI Ireland Index – equivalent yield by sector



Source: MSCI

MARKET COMMENTARY (CONTINUED)

Office

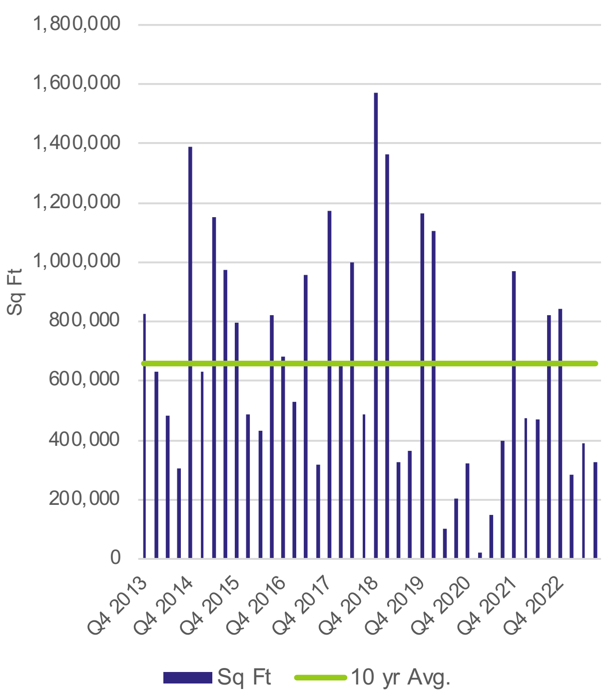
Take-up in the office market was at 327,000 sq ft in Q3, which brings the YTD total to excess 1m sq ft, according to Knight Frank. Activity in Q3 was a reduction on the just over 400,000 sq ft that was leased in Q2 2023. The financial services and legal sectors accounted for the greater part of letting activity in Q3, accounting for over 40% of activity. On a YTD basis, the technology sector still accounted for the largest proportion of letting volume (at 24%, according to CBRE), although this percentage is lower than in previous years when it accounted for approximately 50% of the market. CBRE also projects that this sector will account for the greater part of transaction activity at year end.

A notable trend in recent quarters is the reducing size of space being leased in individual deals. Of the 46 deals that closed in Q3, 41 involved space of less than 20,000 sq ft, and 35 of less than 10,000 sq ft. The largest, which was a vacant property purchase, was of approximately 35,000 sq ft in Citywest, and no leases in excess of 50,000 sq ft were entered into in Q3. This contrasts with the pre-pandemic norm when large-scale office lettings were prevalent. This type of demand typically emanated from the technology sector, in which some large corporations are currently holding excess space and are seeking to sub-let.

This lower aggregate demand for space, combined with an appetite for smaller floorplates, the availability of 'grey space' (i.e. leased offices that are sub-let), and the completion of new schemes, has caused an increase in vacancy across the city, which currently stands at 14.3%, according to Knight Frank. Approximately 480,000 sq ft of new space was delivered in Q3, with 24% of this pre-let. Roughly 2m sq ft is currently under construction and due for completion during 2024 and 2025. Notwithstanding the excess total supply, prime, new stock is still commanding premium rents of €60 to €65 per sq ft, highlighting the requirement for high sustainability space from corporate occupiers. There are currently active requirements for 2.4m sq ft registered with agents.

The chart below plots the office sector take-up for the past five years on a quarterly basis, compared to the 10-year average.

10-year office occupational quarterly take-up



Source: ILIM

Retail

The resurgence of investment into retail property, which accounted for 33% of trade during Q3, is underscored by the vitality of the occupational market. Evidence created in new leases during 2023 has been reflected in rental values on retail properties, which have increased to Q3. Bannon tracks occupancy levels across retail schemes and locations nationwide and reported an increase of 2% to 92% during the year to September. Similarly, footfall continues to recover in shopping centres and is now higher than ever in retail parks. High street footfall is trending higher than any year since 2019 but still lags the pre-pandemic period during weekdays – seen as a consequence of the impact of the growth in remote working.

Astrid & Miyu opened its first Irish store in 2 South Anne Street, a property managed by ILIM. In addition, a number of new deals were signed or stores opened in the major shopping centres in Dublin, including Lego and Bershka in Blanchardstown Shopping Centre, Penneys, Skechers, and Mango in Dundrum Town Centre, and Hobbs and Levi's in Liffey Valley.

Industrial

Leasing take-up volumes remained reasonably solid with almost 650,000 sq ft of take-up in Q3, which is very close to the Q2 level of absorption. This brings the year-to-date take-up close to 2.2m sq ft, which is notably 40% behind letting activity at the end of Q3 2022.

However, the constraining factor is the lack of available product to lease, as occupational demand continues to be very strong, and this is evidenced by continued rental growth in the sector. Another notable point is the fact that three of the top five deals (in terms of area of demise leased) were structured as pre-lease agreements, and these accounted for 25% of leases completed in Q3. This is supported by a vacancy rate in the top 36 Industrial and Logistics parks in Dublin of less than 2%.

Demand for leased space continues to outweigh supply. CBRE is currently tracking active demand of 1.45m sq ft. New supply of approximately 650,000 sq ft was delivered in Q3, and another 700,000 sq ft commenced construction during the period. Of all the stock scheduled to be delivered in the remainder of 2023 and 2024, 40% has been pre-let.

Prime rents are at €12.75 per sq ft for the best product, and the shortage of well-located buildings is pushing rents for secondary product to higher levels (at over €11.00 per sq ft).

The Dublin south-west corridor (roughly along the N7) witnessed the most activity, accounting for over 30% of deal volume, followed by 26% and 17% in the North-East M1 and M2 corridors respectively.

The fundamentals that have driven recent strong growth in the industrial market continue to operate, including the growth of e-commerce, adapting and more efficient supply chains, and geopolitical instability resulting in more localised oversight.

OUTLOOK

The investment market will remain relatively quiet for the remainder of 2023. We understand that the active French SCPI funds are beginning to focus on higher yield investments and, in particular, retail schemes, which could further reduce investment demand for non-prime offices. It is unlikely that institutional investors will re-emerge until interest rate stability is established in 2024. Some positive signs have emerged recently in this regard as the European Central Bank maintained rates at 4.5% at its latest monthly meeting, post quarter end. The five-year swap rate has also declined through 2023.

Activity in the sub-€30m market is providing valuers with evidence to mark values to market in some sectors, particularly the retail sector. However, a paucity of evidence for prime assets and large assets across the sectors remains, and yield selection is more challenging. We expect valuers to remain cautious and track sentiment and international trends when assessing these assets. That said, the MSCI Index, which is based on valuations, suggests that equivalent yields are now at similar levels to 2015, a time when many investors sought and secured significant value in the Irish market. Interest rates had reduced markedly at that time.

The occupational market for offices is continuing to adapt to hybrid working environments. This will continue to drive demand for smaller floorplates on flexible lease agreements in the short term, and the extent of vacancy in the market will contribute to lower rents being achieved for secondary space. However, best-in-class space with strong sustainability ratings in prime locations will continue to appeal to the market, and we expect rents to remain stable in this segment.

FUND UPDATE

The Fund's Q3 performance has been heavily influenced by the decline in values in the office and retail sectors, in line with the wider market. Yields have continued to move out, reflecting a paucity of investment demand for prime offices and completed sales of secondary offices and retail schemes. The Fund has a 72% weighting to the office sector and 20% to retail, including both retail schemes and high street shops.

The industrial portfolio, which accounts for 8% of the Fund's assets, delivered positive capital growth in Q3, reflecting rental value growth and, more significantly, the completion of Unit 1 Vantage Business Park. This property is now leased to Healthcare 21 on a 20-year lease, subject to an initial rent of €542,000 p.a.. In addition, a new lease was entered into with Serfac, an existing tenant of the Fund, in a unit in Belgard Industrial Estate, extending to approx. 46,000 square feet (sq ft).

The positive performance in the occupational retail market is reflected in the letting of 2 South Anne Street to Astrid and Miyu, their first store in Ireland. A number of new leases have been concluded in the Fund's office property at 80 Harcourt Street in 2023. Most recently, the AA took a new lease of the third floor, joining Artmax, who entered a new lease from June 2023.

The Fund received a maximum five-star rating from GRESB (Global Real Estate Sustainability Benchmark) for 2023 in Q3. This is an improvement from the four-star rating achieved in 2022. Greater detail on the Fund's ESG strategy is provided below.

UNIT 1 VANTAGE BUSINESS PARK: COMPLETED AND LEASED IN Q3 2023

2 SOUTH ANNE STREET: LEASED TO ASTRID & MIYU IN Q3 (MANAGED BY ILIM)

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. This year, for the first time ever, the Pension Fund has been awarded the maximum achievable five stars in the 2023 GRESB Real Estate Assessment for both its Standing Investments and its Developments. This is a strong success in both aspects, with clear advancements in their scores from the previous year when they each achieved 4 stars. GRESB also awarded the Pension Fund a Green Star status. This means that the Pension Fund sits within the top 20% of over 2,000 participants globally in GRESB. Perhaps an even stronger indication of the success the Pension Fund has experienced within GRESB 2023 is that it placed first in all of Europe in the Management section of the GRESB Assessment out of over 1,000 funds.

GRESB ★★★★★ 2023

In defining a net-zero pathway for the reduction of greenhouse emissions, a particular focus has been placed on data collection over the past 24 months. Analysing this data provides the Fund with a transparent and reliable view of each of the assets within the portfolio. This allows for decarbonisation strategies to be put in place as well as confirming that reduction targets aligned with the Paris Agreement in relation to greenhouse gases (GHGs) are met. This has involved working closely with property managers and 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 is targeting net zero for these projects.

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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The author cannot make a personal recommendation for any person and you should seek personal investment advice as to the suitability of any investment decision or strategy to your own needs and circumstances. Any comments on specific stocks are intended as an objective, independent view in relation to that stock generally, and not in relation to its suitability to any specific person.

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