ILIM

Life \ Pensions \ **Investments**

Quarterly Report Q4 2022 **Pension Irish Property Fund**

more **INVESTED**

FUND CHARACTERISTICS

AT A GLANCE ▼

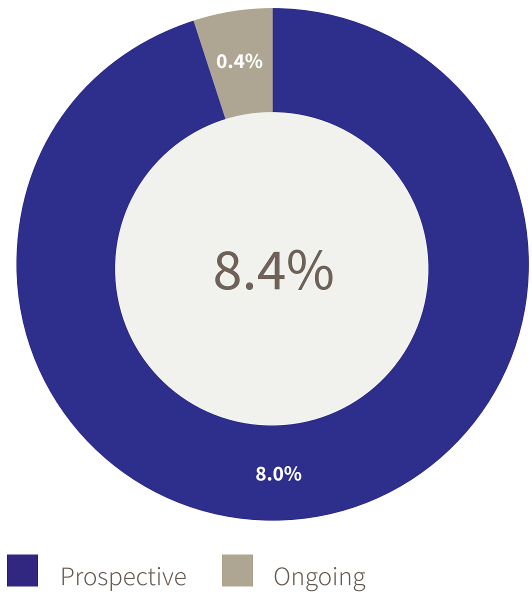
NAV	GAV	NO. OF ASSETS	GRESB 2022
€1.50bn	€1.77bn	69	★★★★☆

FLOOR AREA (SQ FT)	PASSING RENT PA	MARKET RENT PA	WAULT
3.45m	€84.0m	€93.5m	5.98 yrs

YIELD PROFILE ▼

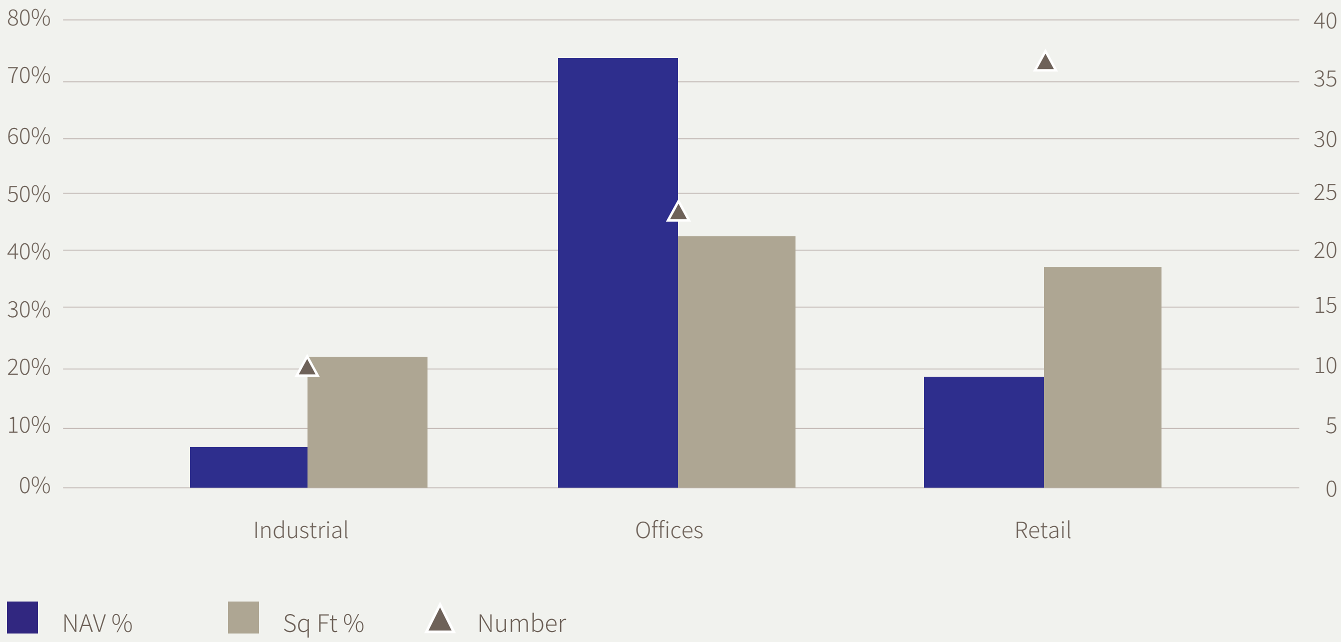
DEVELOPMENT OF ASSETS

as % of NAV

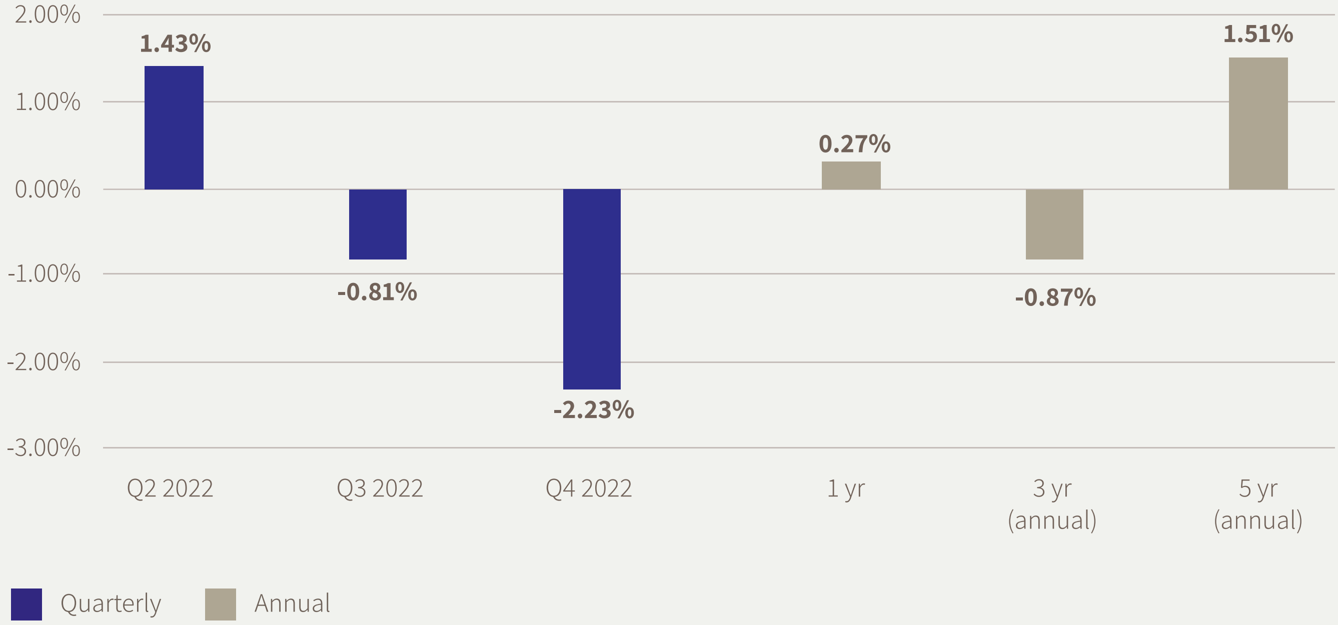


PERFORMANCE

SECTOR



FUND PRICE PERFORMANCE



MARKET COMMENTARY

The travails of 2022, triggered by the war in Ukraine in February, precipitated a decline in investment markets and a surge in inflation, due mainly to the rise in energy prices. Inflation peaked across the Eurozone at 10.6% in October. Equities suffered heavily in H1 (the ISEQ Index declined approximately 15% in these six months), characterised by significant falls in technology stocks.

The resulting rises in interest rates by the European Central Bank (ECB) on four occasions in H2 2022 brought the main ECB deposit rate from 0% in July to 2.0% in December. Further increases in 50 basis point (bps) increments have been signalled to occur in 2023. An increase in SWAP rates had preceded the actual rate rises and have continued to December, more than halving the spread to the MSCI Ireland Index equivalent yield.

These factors impacted the property market in a number of ways. The decline in equities and bonds in H1 gave rise to the denominator effect, which prompted many balanced funds to hold off on property investment as allocations exceeded targets. In addition, rising interest rates caused yields to expand, particularly in the prime European markets, which negatively impacted real estate capital values. As was noted in Q3, the Irish market appears to be less affected than many prime European markets where yields had compressed to record low levels on the back of a persistently low cost of debt.

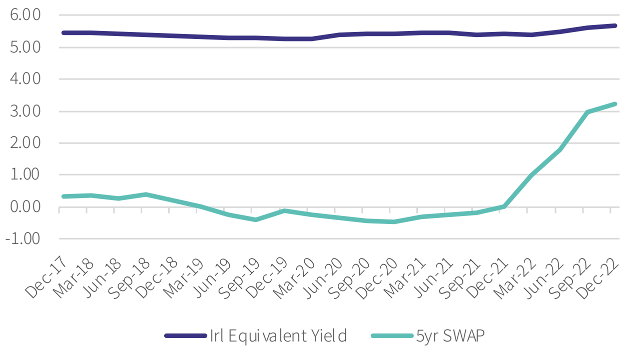
Inflation historically delivered a net positive return for property in the form of rental growth. However, due to high proportion of energy costs manifest in the initial price rises, the main impact in 2022 was an increase in construction costs, an issue the industry has been contending with for some years. In December the S&P Eurozone Construction PMI recorded a drop in the index across all sectors (housing, commercial, and civil), which was in line with the trend for the year.

Despite some large deals during the year, notably Brookfield's buy-out of Hibernia REIT for €1.09bn, activity cooled significantly in the latter half of the year on the back of the ECB's interest rate rises. The full year turnover of €6.12bn compares favourably to the long-term annual average of approximately €4bn, however that headline figure includes the Hibernia REIT transaction. In addition, the acquisition of a large healthcare portfolio of excess €300m by John Laing is included in the Q4 numbers.

The Q4 data highlights that the traditional commercial sectors attracted low levels of investment – a total trade of €227m was recorded across the office, retail, and industrial sectors. Due to the relatively small number of deals occurring post interest rate rises, valuers' rationale for capital declines in H2 was based on sentiment and market evidence emerging in other European markets.

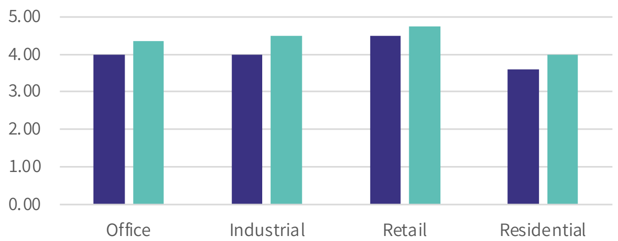
Notwithstanding that, several themes are evident in the current market. Residential and industrial / logistics remain the most sought-after sectors as institutional investors seek to rebalance portfolios and take advantage of positive occupational dynamics. The office market is in a somewhat bifurcated state as environmental considerations and more focused occupier demand are directing interest to strategically located, modern buildings at the expense of older, tertiary stock. Investor interest in retail is concentrated on value, evidenced by several higher yielding schemes transacting during the year, including Dundalk Retail Park for €25m and Tullamore Retail Park for €18.5m, both in Q4.

Irl All Property Equivalent Yield vs. 5yr SWAP Rate



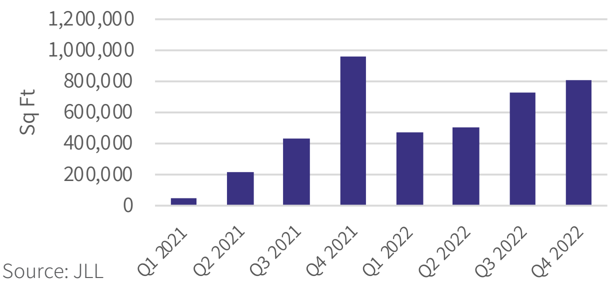
Source: MSCI, Bloomberg

Prime Sectoral Yield Moves 2022



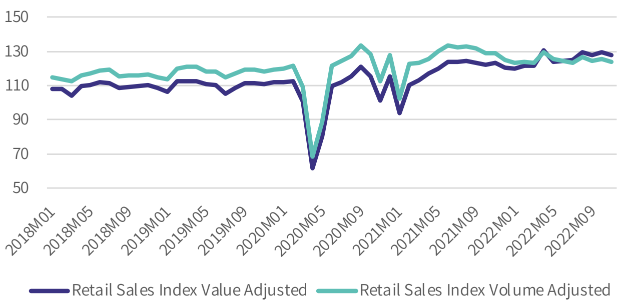
Source: CBRE

Office Occupational Take-Up



Source: JLL

All Retail Sales Index



Source: CSO

MARKET COMMENTARY (CONTINUED)

Despite the market challenges of 2022, the underlying attractiveness of real estate within balanced portfolios remained positive. The 2022 Institutional Real Estate Allocations Monitor, released in Q4 2022 by Hodes Weill & Associates and Cornell University, recorded an increase in international target allocations to real estate to 10.8%, up 10bps from 2021.

Office

Take-up of office space in 2022 exceeded that of 2020 and 2021, years that were severely hampered by the pandemic. CBRE recorded new take-up of approximately 2.5m sq ft of space for 2022 (including 800,000 sq ft in Q4), which is slightly above the ten-year average of 2.4m sq ft. Despite the recent contraction in hiring in the technology sector, some firms remained active in the leasing market during the year. Tik Tok, Etsy, and Pinterest took more space during the latter months of the year.

Headline rents for the most prime stock (i.e. those which boast high-profile locations and high environmental specifications) increased beyond €60 per sq ft during the year. However, demand for older stock was noticeably weaker.

Industrial

Great occupational demand for industrial and logistics space in the Greater Dublin Area continued to drive rents for all grades of stock in 2022. This trend, which has been developing for a number of years, is in line with demand expressed across other European markets and worldwide. Prime rents for new-build developments are at all-time highs, in excess €11 per sq ft. Older stock of significant scale or in strategic locations is attracting rates close to, or even in excess of, €10 per sq ft. Vacancy is negligible across the region.

Retail

Retail is typically the first property sector to reflect the fortunes of the wider economy as sales drive occupiers' demand for space. A somewhat stable post pandemic trend demonstrates the impact of inflation on the relationship between volume and value of sales, which have trended in inverse directions since mid-2021. Consumer sentiment however, which is tracked by KBC Bank, declined 30 points y-o-y to June 2022 following a post-pandemic surge.

No material drop-off in activity has registered in the market following a significant uptick in demand for prime space during the year and an occupancy rise across the various sub-markets. Bannon tracks occupancy rates of 88% across the prime high street in Dublin, 95% in the M50 shopping centres, and 98% across Dublin retail parks. Notably, this increased demand has not fed through to the Henry and Mary Streets sub-market, which is suffering from a heightened degree of vacancy despite high levels of footfall.

Outlook

> Further pricing and yield adjustment is expected as the market and valuers reflect the sharp increase in interest rates.

> While inflation appears to be receding, following the stabilisation of energy prices, relatively high input costs for construction could undermine the feasibility of new development.

> Ireland remains in a relatively positive position compared to its European peers. The European Commission predicts GDP growth of 3.2% and 3.1% for Ireland in 2023 and 2024 respectively, which are the highest and second highest predicted rates in Europe and compare to EU-wide rates of 0.3% and 1.6%.

> Despite a recent curtailment of technology sector hiring, continued demand for prime office stock is expected to persist into 2023.

> Remote working and rising recession risks have softened demand for traditional office space. However, a tenant 'flight-to-quality' will drive outperformance of new, sustainable office properties.

> Notwithstanding demand for industrial and logistics space, the rise in interest rates and continued upward pressure on construction costs may hamper the roll-out of new supply into 2023 and beyond.

> Continued inflation is a real threat to retailer performance over the short term. However, Ireland's retail landscape is perhaps better prepared to weather the impacts of the crisis given its high levels of employment, low personal debt levels, and high occupancy levels across retail stock.

FUND UPDATE

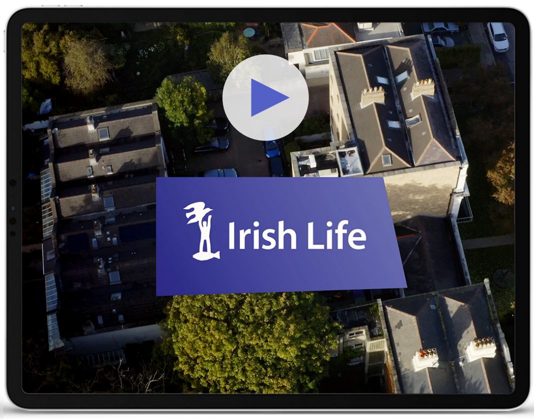
The fund returned -2.2% in Q4, heavily influenced by yield movement in all sectors, especially the office sector. This was the weakest quarter since the height of the pandemic when retail values were most adversely affected. A total year return of +0.27% was held positive by an income return of 4.6%, set to rise to 5.1% on expiration of on-going rent-free periods in various leases across the portfolio.

The trajectory of values during the year mirrored those across the Irish market. As noted in the market summary, other European regions that generated lower yields coming into 2022 have seen greater value corrections over the course of the last year, in response to interest rate rises.

The income return of the fund is sustained by a diverse tenant base, a consistently high rent collection rate, and a rent reversion premium of 12%. In addition, the fund has a pipeline of strategically located development assets, currently constituting 8% of NAV, for which progress is on-going at different stages of maturation. These projects will form an important component of long-term capital return into the future.


Photo of existing Hume House, Ballsbridge and CGI of approved redevelopment

The latest office development in the fund, Cadenza, reached practical completion during Q4 and was handed over to Intercom, the tenant, for fit-out. This property forms a landmark HQ office property, extending to 113,000 sq. ft. and will boost the fund's annual income by €6.8m on expiration of a rent-free period.



Construction progress also continued at Unit 1 Vantage Business Park, Ballycoolin, where the fund is developing a new logistics facility of 46,000 sq ft on a 2.5 acre site. The completed building will include four dock levellers, 12 metre clear internal height, and office accommodation extending to ~6,000 sq. ft.

In the retail portfolio, a notable uptick in occupier interest was witnessed throughout 2022 and, in Q4, a new lease was completed with Shake Dog, which will operate a restaurant pod in Limerick One Shopping Park at a rent of €100,000 p.a. In addition, new, long term lease agreements were finalised in Pavilions Shopping Centre, Swords with existing tenants Mango and Footlocker. That scheme, in which the fund holds a 15% stake, is currently fully occupied and achieving an average rent collection rate of 98% at the end of each quarter.

Also at Pavilions, an agreement was signed by the co-owners with ESB to build a solar panel system on the roof that will generate 300kWh of electricity, resulting in an emissions reduction of 89 tonnes of CO_2 per year (-19%) and assisting with the goal for the Centre to be net zero for carbon by 2030.

Unit 1 Vantage Business Park, Ballycoolin

Pavilions

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.

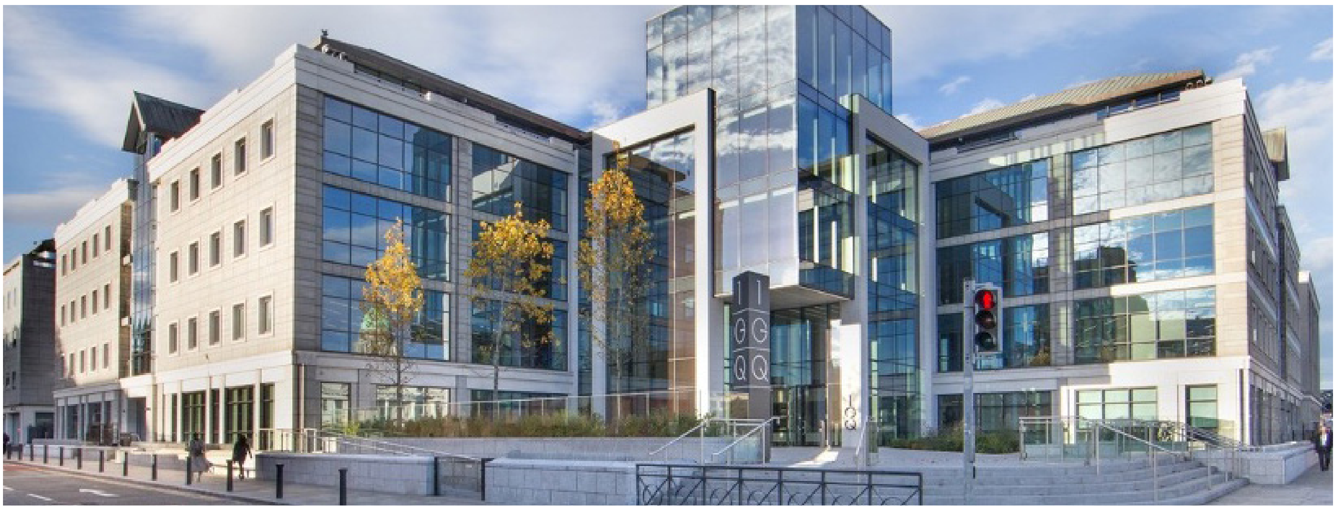
As a responsible investor, ILIM adopts an active ownership approach across its real estate assets, which aims to maximise the medium to long-term value for its clients. ILIM uses its ownership to constructively engage with property managers, encouraging better standards and management processes covering 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 and has been awarded four stars in the 2022 GRESB Real Estate Assessment for both its standing stock and developments, with a score of 85 for standing stock. In defining a net zero pathway for the reduction of greenhouse emissions, a particular focus has been placed on data collection over the past 12 months. Analysing this data provides the Fund with a transparent, science-based decarbonisation pathway to identify and measure greenhouse gas (GHG) reduction targets aligned with the Paris Agreement. This has involved working closely with 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 targeting net zero for these projects.

During 2022, ILIM Property undertook a materiality assessment covering key areas including environmental, social and economic issues. A broad range of internal and external stakeholders, including investors, were contacted to gain a better understanding of the key issues to their business and what steps ILIM Property should be making to enhance ESG performance. The materiality assessment recognised that ESG targets are becoming critical to investment value as potential EU legislation will mean more stringent measures being imposed on the built environment.

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