ILIM

Life \ Pensions \ **Investments**

Quarterly Report Q2 2024
Pension Irish Property Fund

more **INVESTED**

FUND CHARACTERISTICS

AT A GLANCE

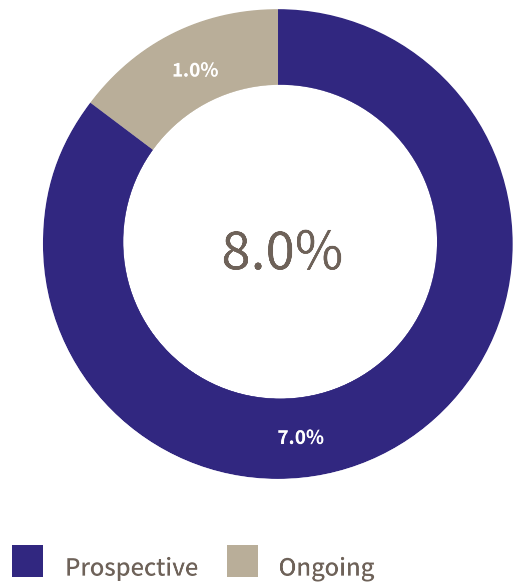
NAV	GAV	NO. OF ASSETS	GRESB ★★★★★ 2023
€1.48bn	€1.35bn	64	

FLOOR AREA (SQ FT)	PASSING RENT PA	MARKET RENT PA	WAULT
3.30m	€67.58m	€90.49m	5.57 yrs

YIELD PROFILE

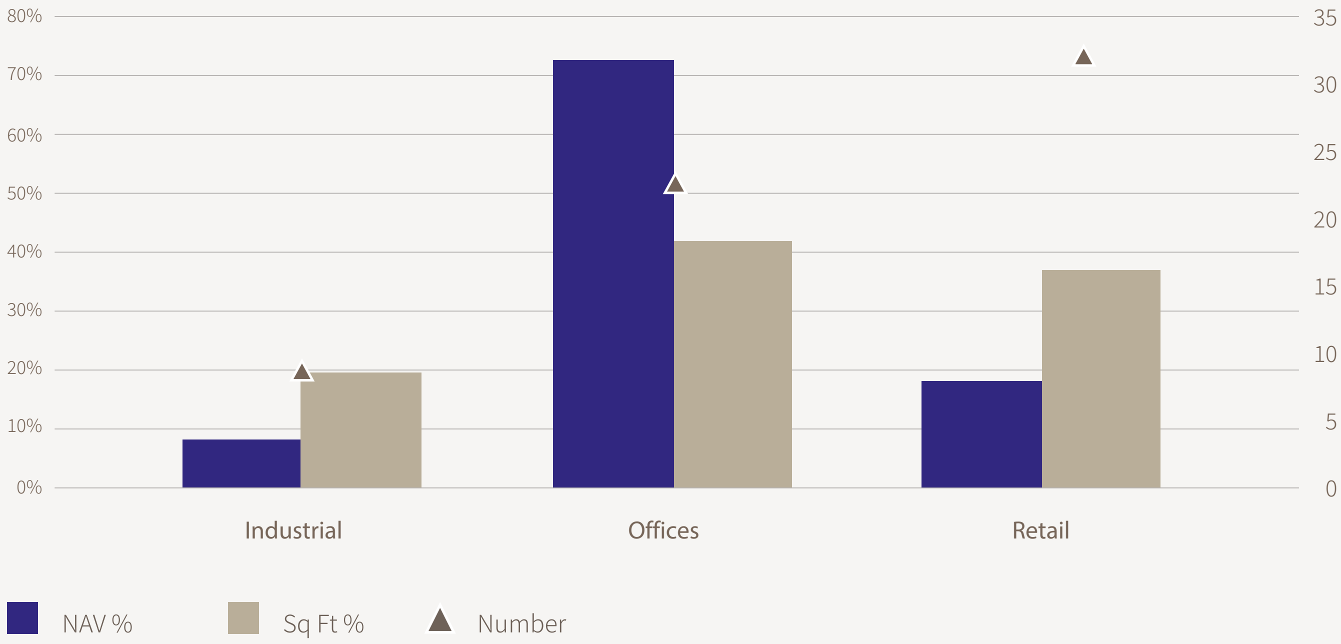
DEVELOPMENT ASSETS

as % of NAV

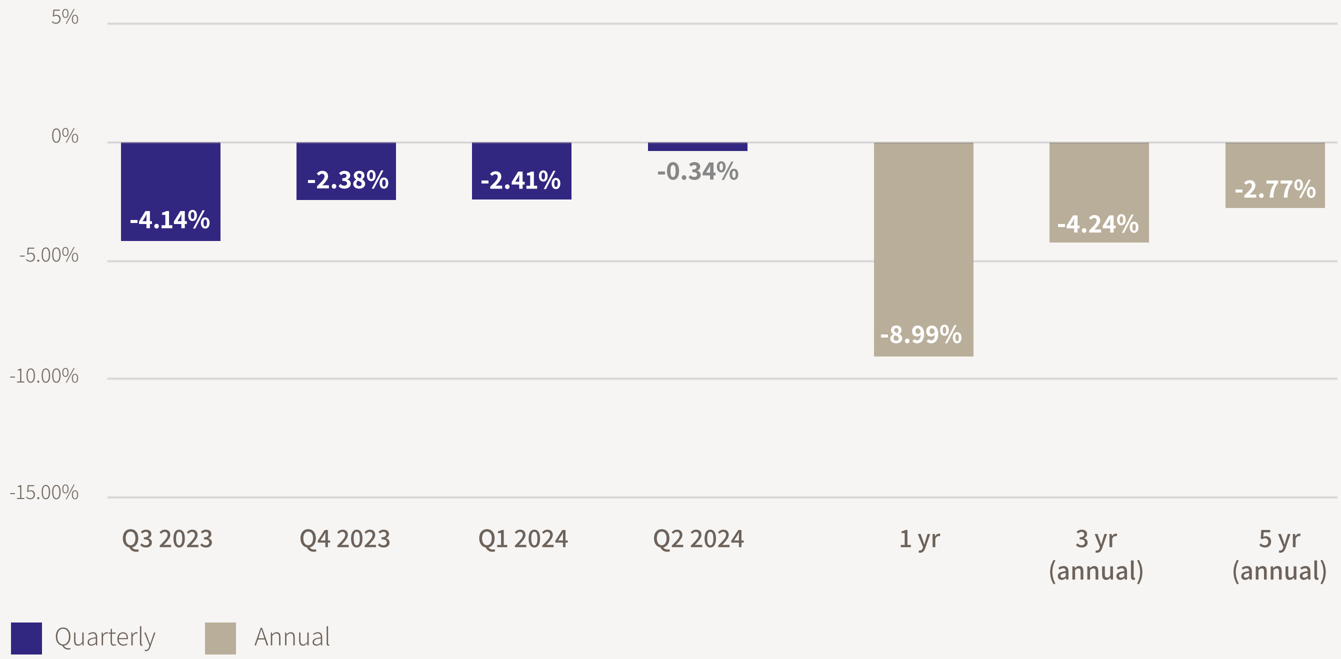


PERFORMANCE

SECTOR



FUND PRICE PERFORMANCE



MARKET COMMENTARY

There has been a notable increase in investment activity in Q2, following a subdued start to the year in Q1. There was €514m invested across 29 deals in the quarter, including 40 Molesworth Street, an office property majority leased to DLA Piper, sold to Deka (a German investment manager), which was the first transaction of a prime office property for some time. The sale price of €37.5m reflects a net income yield of 5.16% and a rate per sq. ft. of €1,120. This was a particularly important piece of evidence for valuers of office stock, the values of which had moved significantly following the rise of interest rates. The uptick in activity is encouraging, and sits well beside an improving macro environment, as inflation continues to abate across Europe, and the European Central Bank (ECB) made its first interest rate cut in June 2024, with further interest rate cuts expected to occur before year end. While transaction activity increased in Q2, it is important to note that the market is still recovering, with initial estimates for Q2 trending 49% below the long-term annual average.

According to JLL's most recent Real Estate Sentiment Survey in May 2024, 45% of investors believed that market conditions would improve in the next six months, an increase on 32% when the survey was last conducted in November 2023. The main driver of this improvement was interest rates, and stabilisation in this regard is helping to improve sentiment and bring investors back to the market.

Investors have continued to acquire retail schemes in Q2. Mahon Point Retail Park, Cork was bought by French SCPI fund manager, Corum, while private investors bought Letterkenny and Deer Park Retail Parks from Davidson Kempner. Sale prices for these properties remain confidential; however, all are believed to represents income returns in excess of 7%.

Outside of the traditional sectors, healthcare has been particularly active in Q2, with 14.9% of investment volumes, €76m of which came across two deals.

Office

Office take-up amounted to approx. 930,000 sq. ft. in Q2 (BNP Paribas), with 59.5% of this in Dublin city centre. The suburban market, which has been worst affected by the advance of hybrid working, was the subject of two large transactions in the period. The HSE acquired the Seamark Building in Elm Park, which extends to 182,000 sq. ft., and APC took a lease for 60,000 sq. ft. in Cherrywood.

Strong employment growth was represented in the take-up of spaces. 90% of the companies that signed deals for office space in Q2 were taking larger spaces. Larger deals led activity levels in Q2, with the most notable being the Seamark Building and Stripe's move to 156,000 sq. ft. in One Wilton Park, through an assignment from LinkedIn.

Q2 reflects the busiest quarter for this sector since Q1 2022. Demand has improved, with accumulating evidence that the hybrid business operating model is stabilising, providing clarity on space requirements. However, despite the increase in take-up this quarter, vacancy has risen from 14.5% to 15.2%, caused by significant completion of new stock. Long-term demand for space continues to focus on modern, high-specification space. This is now a highly competitive market for tenants, and, although prime rents are stable, landlords are offering more generous rent-free periods and other incentives to sign new occupiers.

SEAMARK BUILDING: ACQUIRED ON BEHALF OF THE HSE IN Q2.

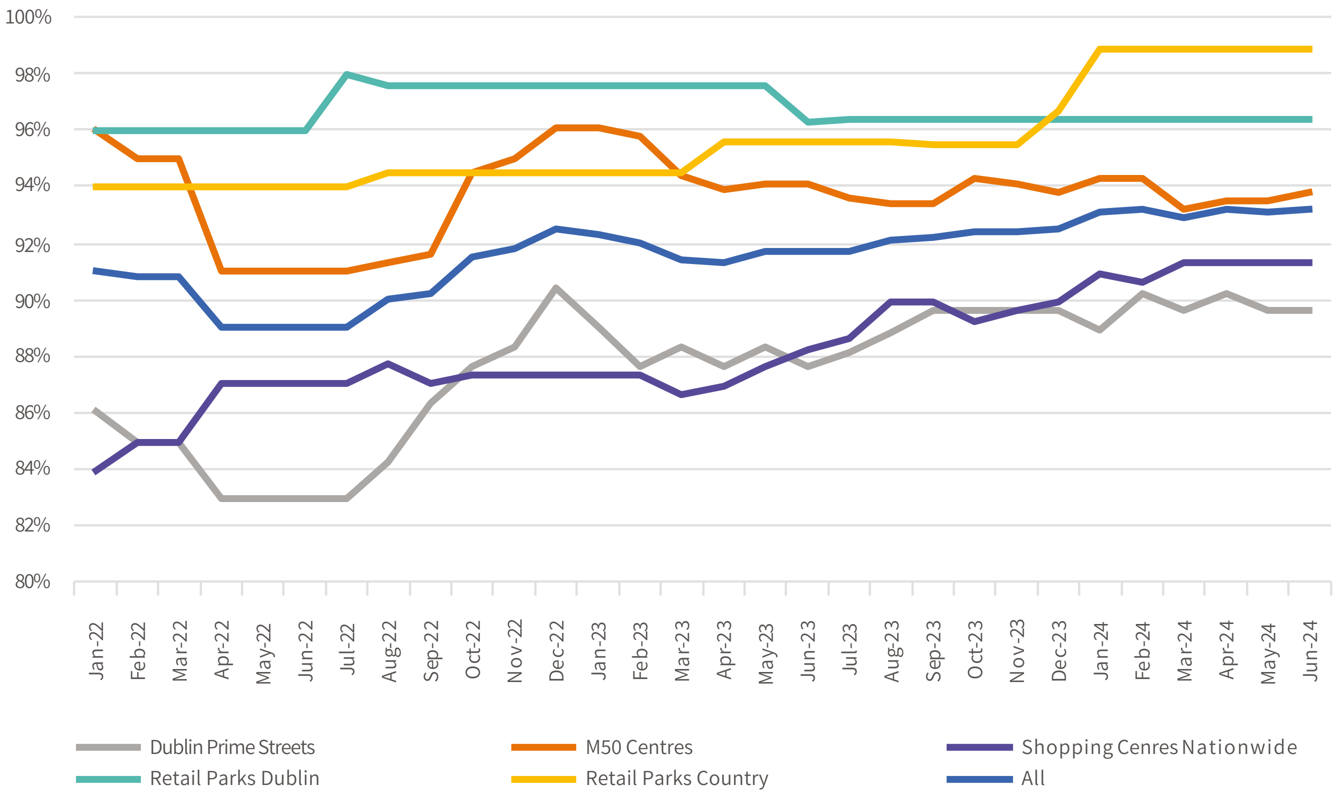
MARKET COMMENTARY (CONTINUED)

Retail

Retail activity continues to increase due to the attractive income returns it provides, which are derived from an improved occupational market. This strong performance is reflected in the 41% share of investment transactions in H1, as well as several deals in 2023. Activity in this sector is spread more broadly across the country than other sectors, with 65.5% of volumes outside of the capital in H1 2024 and 66% in 2023. Several other retail schemes are currently on the market and expected to contribute significantly to commercial trade in the remainder of the year.

New and expanding brands that are actively committing to new retail space include Lovisa, which has taken space in properties managed by ILIM in Henry Street and Pavilions Shopping Centre, Pret a Manger, Oak Berry, Dubray Books (leased 39 Mary Street, managed by ILIM), and Swatch (assignment of 80 Grafton Street, managed by ILIM).

Retail occupancy levels



Source: Bannon

Industrial & Logistics

Investments in this sector are relatively low at present with only €53m invested across seven deals in Q2. The sector is still in favour among institutional investors, and low activity is primarily a factor of availability.

JLL has reported take-up of 363,000 sq. ft. across 19 deals in Q2, which is relatively low and approximately half of the past 10-year quarterly average. Again, availability appears to be the driving force, as rental terms continue to strengthen in a competitive market for space. Prime rents are now comfortably above €13 per sq. ft., and approx. 564,000 sq. ft. of space is reserved. Several large lot-size requirements are currently in the market, including An Post, which is seeking a new Dublin distribution facility of 500,000 sq. ft.

OUTLOOK

As prospects of a further interest rate cut loom and the monetary cycle seems to have turned, signs have begun to emerge that core institutional money may be starting to mobilise. It is also notable that Q2 spending has still increased 56% year-on-year, with foreign investors also remaining active again in Q2.

Additionally, forward looking indicators are also improving, with overall liquidity recovering as the estimated value of product on the market has risen by 25% in Q2.

€675m of assets have traded at the halfway point of the year, which is promising for a recovering market. Forecasts suggest that further progress remains realistic for the year as a whole. A number of potentially large transactions are likely, particularly in the retail market as Blanchardstown and The Square Shopping Centres continue to be marketed.

Included in that pipeline are some secondary offices, for which demand is currently subdued, and it remains to be seen at what level investors will price this type of stock. Greater risk surrounds the reversionary outlook for these buildings as rental values have become less certain and capital expenditure requirements have increased for them to compete with more modern, higher specification stock.

FUND UPDATE

While negative, the Fund's performance in Q2 of -0.34% represented its best quarter since Q2 2022, when the rise in interest rates precipitated the rise of yields, causing sustained valuation declines for investment property. Capital declines have now moderated, with interest rate impact now fully factored in and moves more aligned to market evidence, which is emerging.

The Fund's high weighting to the office sector (73%) has exposed it to the worst of these market moves. This office portfolio has a high reversionary potential in terms of both income and, significantly, repositioning due to schemes of development at advanced stages of progress.

The first of these developments to commence will be 1 Adelaide Road, for which planning permission has been secured to construct a high specification office extending to excess 150,000 sq. ft. that is due to complete in 2027. Demolition of the existing building, which extends to 60,700 sq. ft., will commence in Q3. As a function of its design and method of construction, the new office building will be a net-zero property, offering occupiers market-leading, energy-efficient space. This development is in line with the Fund's long-term strategy to upgrade its existing stock, which is well-located, and improve the environmental credentials of the portfolio.

In that regard, the Fund recently submitted data for its 2023 GRESB rating. The 2022 score, which was certified in 2023, returned 91 out of 100 for standing assets and 95 out of 100 for development assets, which put it in the top quintile of similar funds across Europe and awarded it five out of five stars.

ESG

ILIM believes that prudent integration of ESG factors into physical property investment decisions will lead to more sustainable long-term returns, helping to manage risk and enhance growth opportunities. ILIM adopts an active ownership approach across the real estate assets in which it invests on behalf of its clients, and aims to maximise the medium- to long-term value for its clients.

Regarding standing assets, this involves constructively engaging with property managers, encouraging better standards and management processes covering financially material sustainability risks. At asset level, ILIM has developed an Environmental Management System (EMS) to manage sustainability impacts, risk and opportunities across its clients' real estate portfolios. The EMS also aims to improve resilience and performance in clients' portfolios and assets, thereby avoiding a significant diminution in value which might result from poor environmental management, and which may lead to the 'stranding' of a real estate asset.

In all new developments, key elements of globally recognised sustainability standards, including LEED (Leadership in Energy and Environmental Design), WELL Building Standard and net-zero carbon, are integrated, while being mindful of broad environmental considerations.

As part of the real estate acquisition process, a comprehensive due diligence is conducted that includes financial, physical, governance, regulatory, market, environmental and social considerations. The due diligence process includes a technical assessment against material ESG themes. These technical assessments result in Property Improvement Plans which seek to improve ESG impacts and put the asset on a pathway to net zero to reduce its carbon emissions.

ILIM participates in the Global Real Estate Sustainability Benchmark ("GRESB") and has set specific ambitions relating to energy, water, and waste and wellbeing, together with a robust reporting regime to monitor performance against those aims, and to provide a basis for engagement with tenants and other stakeholders across its clients' property portfolios.

This process is implemented for acquisitions, refurbishments and new developments. LEED platinum is explicitly focused on new developments. These procedures provide guidelines to reduce the exposure of ILIM's clients and their assets to risks associated with or arising from environmental problems or issues. In 2023, ILIM was awarded green stars in all the managed property funds that participated in GRESB, and is the largest participant in Ireland in GRESB. A green star is reserved for the top 20% of over 2000 participants globally in GRESB.

The Pension Fund received five stars in GRESB in 2023 (based on an assessment of 2022's activity). In addition, ILIM was ranked first in Europe in management out of over 1,000 participants, demonstrating its leadership in sustainable property management and development.