Life \ Pensions \ **Investments**

Quarterly Report Q1 2023

Pension Irish Property Fund

more **INVESTED**

FUND CHARACTERISTICS

AT A GLANCE ▼

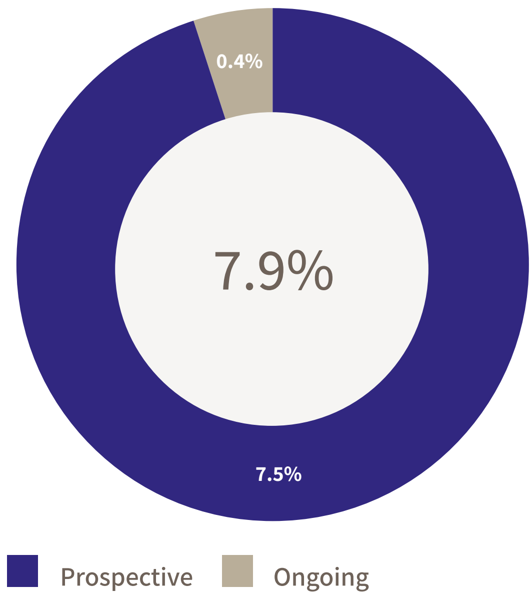
NAV	GAV	NO. OF ASSETS	GRESB ★★★★☆ 2022
€1.45bn	€1.71bn	69	

FLOOR AREA (SQ FT)	PASSING RENT PA	MARKET RENT PA	WAULT
3.45m	€79.96m	€97.47m	5.96 yrs

YIELD PROFILE ▼

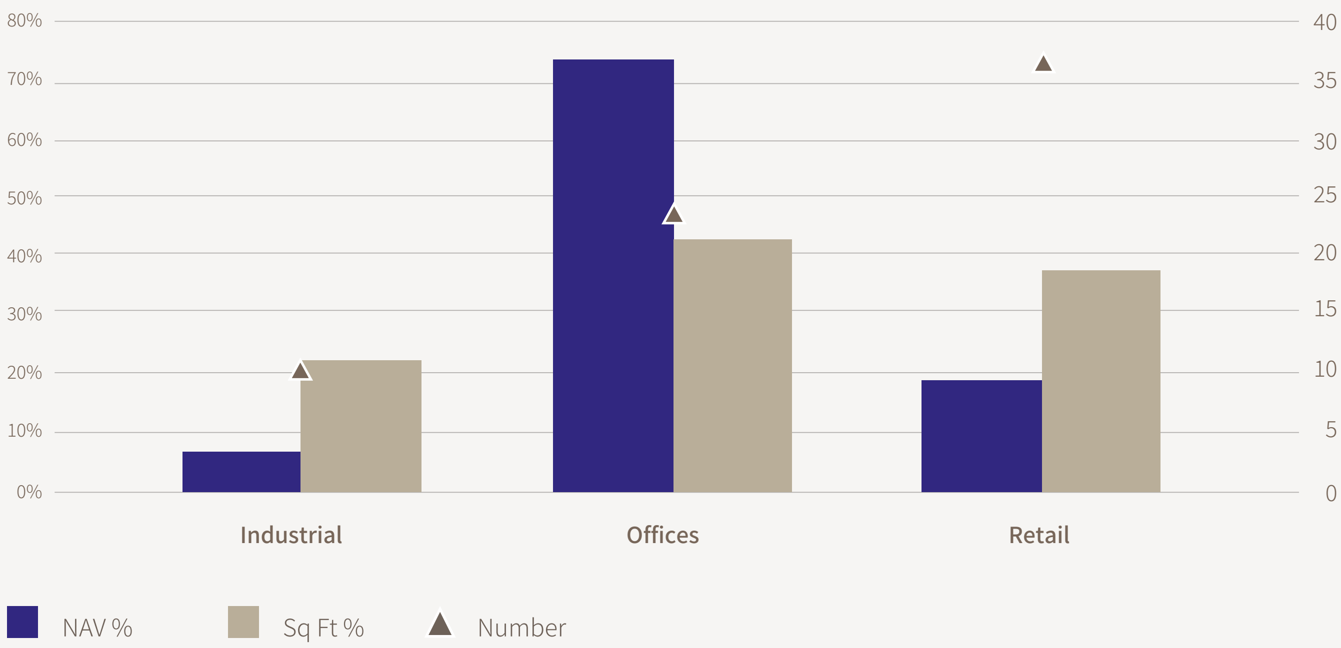
DEVELOPMENT ASSETS

as % of NAV

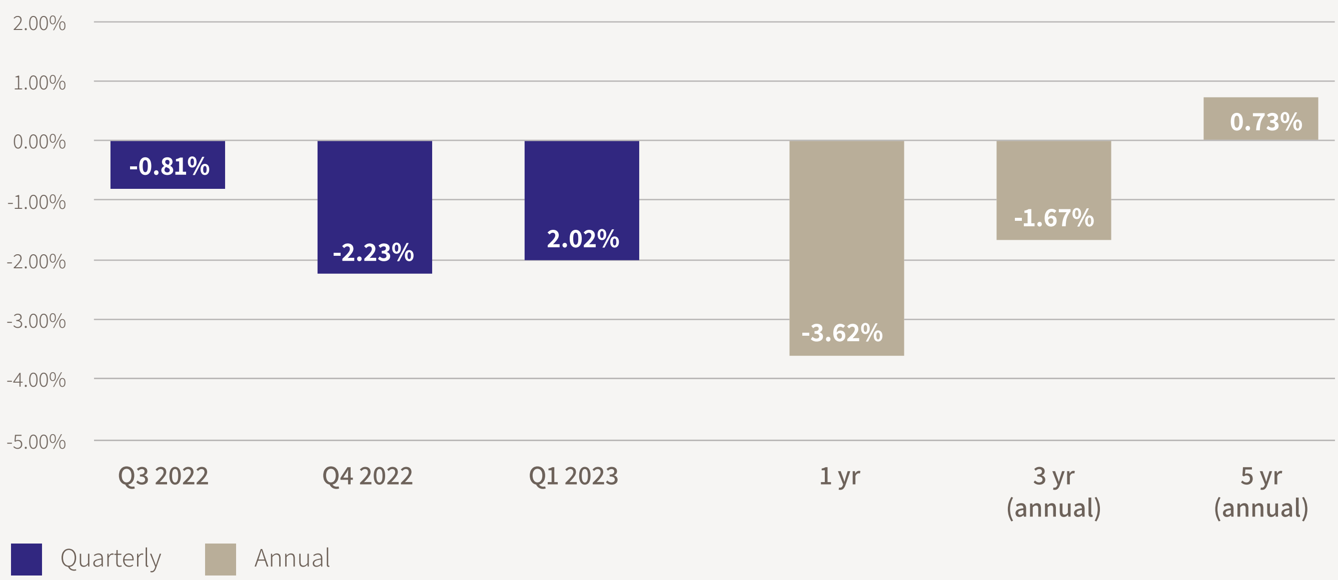


PERFORMANCE

SECTOR



FUND PRICE PERFORMANCE



MARKET COMMENTARY

The increase in interest rates and general market volatility caused a reduction in property market activity from Q3 2022, with valuers marking down values on the back of negative sentiment, in the absence of specific evidence, in the latter months of 2022. This year has started off in the same vein, with relatively low levels of investment due to increased costs of equity and debt capital, limited stock being placed on the market, and reduced vendor confidence of deals completing.

The recent increase in the cost of debt over a short time frame has reduced the availability of finance for all sections of the property market and has given rise to concerns about the viability of lower yielding properties facing refinancing over the short term. While the five-year swap rate has contracted to 2.9% at the end of Q1, down from 3.2% at end Q4, this compares to an average quarterly rate of 0.4% since Q4 2012. Lenders' margins have also increased over the period, reflecting their reduced risk appetite and available liquidity.

The graph opposite illustrates the spread between the bond rates on offer in the countries that provide the main sources of capital in the Irish real estate market and the All Property MSCI equivalent yield of Irish property. It also shows the movement of the five-year SWAP rate during the same period.

The MSCI Ireland Index returned -1.3% for the full year of 2022, heavily influenced by capital declines registered during the latter half of the period. The divergence in performance across the two halves of the year is illustrated below. At year-end, the All Property Index was yielding 5.2%.

Putting Ireland in context, prior to the current market downturn, capital growth had already rebased more significantly than in other European markets in the period 2018 to 2022. Yields were therefore higher on average in the Irish market than in other European markets, which has provided a better cushion in respect of the relative impact of interest rate rises.

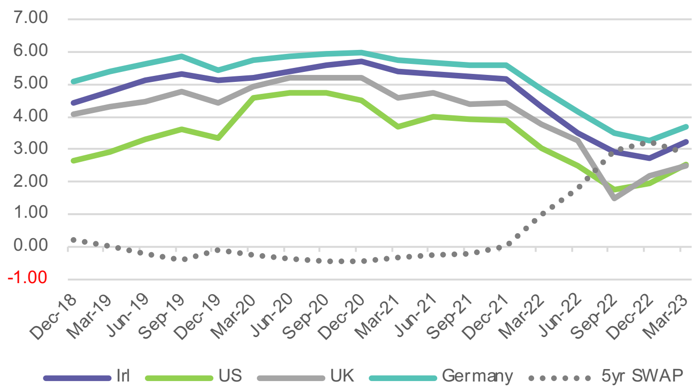
The property investment market recorded a relatively weak turnover of €623m during Q1, across 26 individual deals. Three of the top four acquisitions were of residential schemes, accounting for €293m / 47% of the total. The major transactions in each sector provide the most relevant evidence for current pricing levels. On the buy side, institutional investors are significantly less active in the market at present, with private, predominantly local, investors responsible for a higher proportion of deals.

Pontegadea, an investment vehicle controlled by the Ortega (Zara) family, acquired Opus, Hanover Quay for a reported €101m. This property comprises over 120 high-end residential units with a minor retail element at ground floor level. The sale price reflects a net initial yield on the residential element in the region of 4.35%.

The sale of Units 1 & 2 Greenogue Logistics Park for an undisclosed price in the region of €100m concluded in Q1, following the leasing of Unit 2 that triggered the pre-agreed sale. The purchaser in this instance was an investment arm of the IKEA retail group.

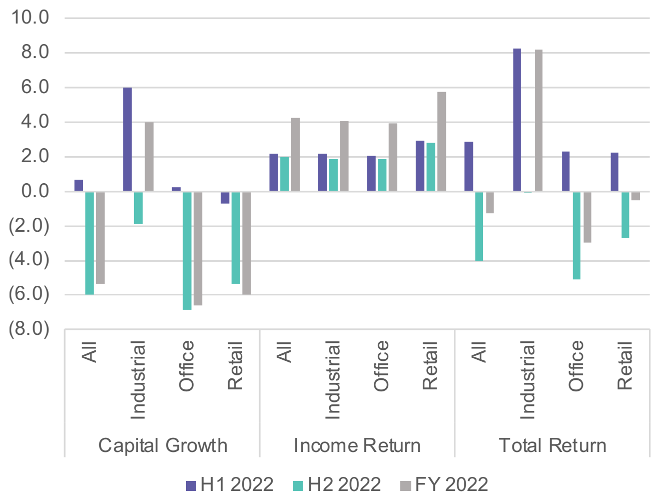
Two significant retail schemes sold during Q1. Douglas Village Shopping Centre, Cork was bought by Urban Green for €23m, reflecting an income yield of 9.6%, and a private investor acquired Fairgreen Shopping Centre, Carlow for €20m, for which they will receive a net income return in excess of 10%.

Yield Spreads vs. All Ireland MSCI Property Index Equivalent Yield



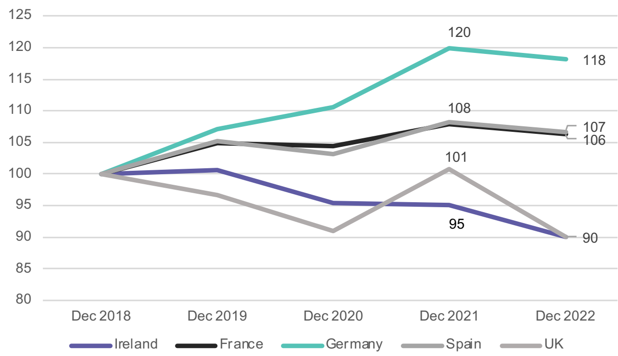
Source: MSCI, Bloomberg

MSCI Ireland Index – Components of Return 2022



Source: MSCI

Capital Growth Index 2018-2022



Source: MSCI

MARKET COMMENTARY (CONTINUED)

The largest office transaction of the year so far was of Waterside, Citywest, a 220,000 sq ft, modern suburban office development, majority leased to SAP, Fidelity, Glanbia, and Astellas Pharma. Fine Grain, an Irish property investment company, acquired the scheme from IPUT and Davy at a sale price of €65.5m, reflecting a net initial yield of 7%. There is vacancy of 12% in the existing buildings and planning permission to construct an additional 180,000 sq ft of space.

Occupational markets

The office market recorded a take-up of 285,000 sq ft of space in Q1, which is the second lowest quantum during the corresponding quarter since 2010. However, 46 deals were completed, which is close to the long-term average, suggesting a higher demand for smaller floorplates and perhaps indicative of modern, flexible working patterns. In line with trends seen in recent years, the technology and financial services sectors were the most expansionary during the period. However, there remains a large quantum of ‘grey space’ on the market, i.e. leased space available to sub-let, as well as a large quantum of floor area that is leased but yet to be furnished for occupation.

According to CBRE, the vacancy rate in Dublin currently stands at 13% and 11% for Grade A accommodation. That firm has also reported that 693,000 sq ft is reserved going into Q2.

Prime rents remain stable, in excess of €60 per sq ft. However, the evolving definition of prime is becoming more specific to modern, well-located buildings that have attained the highest environmental credentials. In that regard, as well as A-rated BER certificates, LEED (Leadership in Energy and Environmental Design) platinum or gold status, as well as NZEB (Nearly Zero-Emission Building) accreditation, are becoming increasingly important attributes to attract significant tenants at profitable rents.

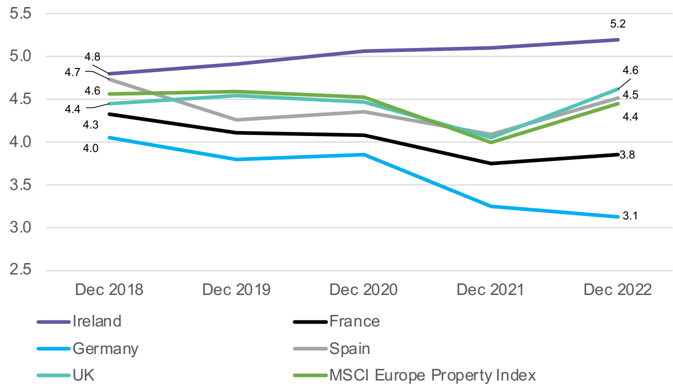
The positive performance of the occupational retail market in 2022 has continued into Q1 2023. Vacancy declined dramatically in Grafton Street during 2022, with nine new retailers taking occupation.

The Henry / Mary Street district had suffered greater level of distress since the pandemic. Sports Direct group acquired the former Debenhams department store in late 2022 and is expected to open multiple brands from the building following a fit-out period. So far in 2023, retailers such as Footlocker, Dubray, Levi Strauss, Aldo, and Paco have committed to new leases on the streets (four of these are in ILIM-managed properties). Negotiations are on-going with other brands, and the rental tone across the two streets currently ranges from €250 to €290 per sq ft, in terms of Zone A.

Overall occupancy at the end of Q1 is reported by Bannon property consultants at close to 90% for prime Dublin high streets, 98% across retail parks, and 94% in shopping centres. Footfall trends are also positive, with levels edging closer to what was the norm pre-pandemic.

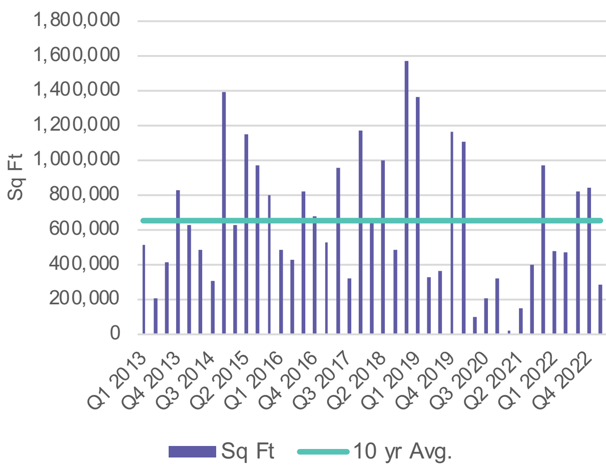
Over 4.2 million sq ft of industrial and logistics space was taken up during 2022, which is the second highest annual absorption on record and indicative of the on-going demand for space in this sector. The shortage of supply of modern, high specification space, relative to demand, has buoyed the performance of older stock and reduced vacancy to a negligible amount. CBRE reports over 2.5m sq ft of space currently under construction in the Greater Dublin Area that is due to be delivered over the course of 2023 and in early 2024 – 65% of which is already pre-let or in legals. That compares to an active demand of 5.4m sq ft, according to CBRE. Prime rents are now quoted at €11.50 per sq ft.

Net Income Yields 2018-2022



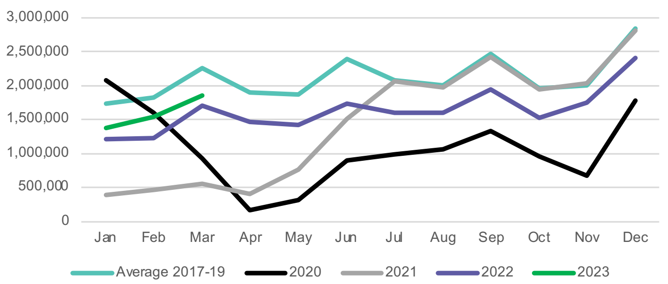
Source: MSCI

10 year Office Occupational Quarterly Take-Up



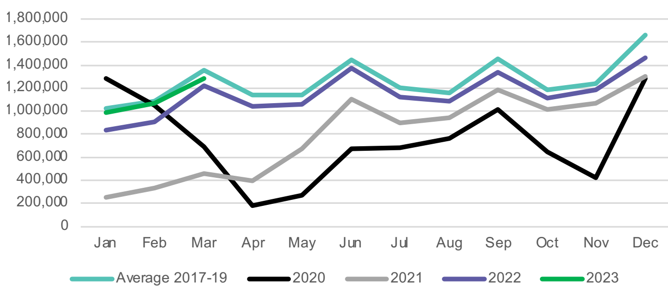
Source: Savills

Grafton Street Footfall



Source: Savills

Henry / Mary Streets Footfall



Source: Dublin Town

OUTLOOK

The investment market is projected to remain relatively quiet during 2023 as investors monitor their exposure to real estate in the context of their wider holdings. We believe real estate will remain an important component of balanced investment funds, and it continues to deliver strong income return from underlying occupational markets.

Pricing will be challenged over the short term, and opportunistic investors could take advantage of stress in the debt markets. Ireland remains an attractive target for international investors. However, in common with other European markets, activity will be constrained by a lack of supply.

The accelerated focus on ESG-related attributes or targets will help define investment demand in 2023, and we expect older offices to attract a 'brown discount' as higher capital expenditure is reflected in pricing models. Conversely, prime, energy efficient property in the office, residential, and industrial sectors will have a stabilising impact on performance.

The general economic environment in Ireland relative to European peers, as well as a continued supply/demand imbalance, suggests that the occupational markets will remain in good health over the short term and will continue to deliver stable income return. Older offices remain an outlier in this regard and will require time to reposition.

FUND UPDATE

The Pension Irish Property Fund returned -2.02% over the first quarter, reflecting an outward movement in yields and corresponding decline in capital values, particularly in the office sector. The net decline in capital values of approximately -3.3% was offset by income. As the Fund does not hold any debt, the impact of interest rate rises since 2022 is limited to the influence it has had on market values of properties held.

The current income return of 4.5% is scheduled to rise to 5.0% on expiry of on-going rent-free periods in 2023, to a value of an additional €8.3m of income per annum across the portfolio. The weighted average unexpired lease term of the portfolio currently stands at six years, and that income is diversified across in excess of 400 tenancies. This income return is maintained by consistently high rent collection, which stands at 99.1% for Q1.

In addition to this, the Fund has significant longer term reversionary potential, particularly in office development opportunities in prime Dublin locations. Notably, in Q1, Deloitte announced that the Fund's prospective scheme at 1 Adelaide Road is the preferred location for its new Ireland headquarters. This property is currently subject to a planning application with Dublin City Council.

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.

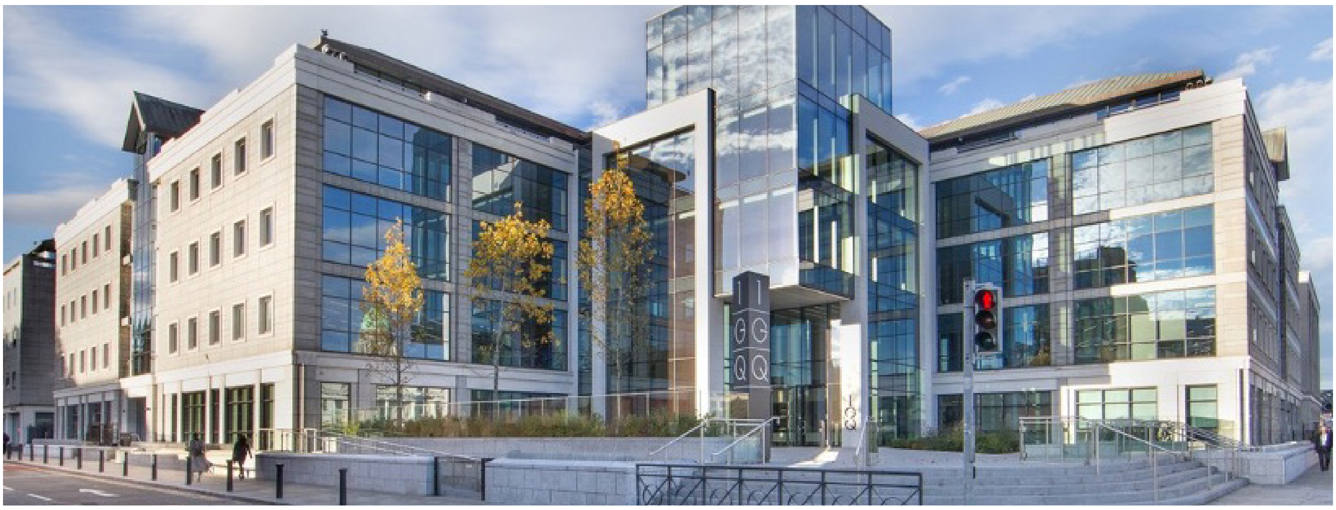
As a responsible investor, ILIM adopts an active ownership approach across its real estate assets, which aims to maximise the medium to long-term value for its clients. ILIM uses its ownership to constructively engage with property managers, encouraging better standards and management processes covering 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