

Market update Q3 2018

AIB Real Estate Finance



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Strong Irish economy continues to support property market

The strong performance of the Irish economy continued in the third quarter of 2018, which in turn underpinned the Irish commercial and residential property markets. The monthly unemployment rate for September was 5.4%, compared with 6.6% in September 2017 and a high of 16% that occurred in 2012, and places Ireland in the vanguard of European countries with low levels of unemployment. Investment volumes increased by 25% annually in Q3, totalling €655 million across 47 transactions. The general consensus is that economic growth will be in the region of 6.5% this year and should average close to 4% in the coming two years.

Irish CRE market now fully recovered

The IPD Irish All Property Total Return Index is now 24% above previous peak levels. The annual rate of growth decreased slightly from the 7.08% seen at the end of Q2 with an annual increase of 6.3% in the 12 months to September 2018. These gains have been underpinned by a strong economy and a low interest rate environment. However, close attention will have to be paid to future market returns. Returns broadly in line with the growth of the economy are sustainable – growth much higher will be a cause for concern. The all property net initial yield was 4.8% in Q3'2018. Yields appear to have stabilised around the 4.7% to 4.8% region over the past year, as per the IPD data. While this may not prove to be the absolute low in the current cycle, it would be a positive if the market could form a base around current levels.

Dublin office market – Record take up as rents near peak

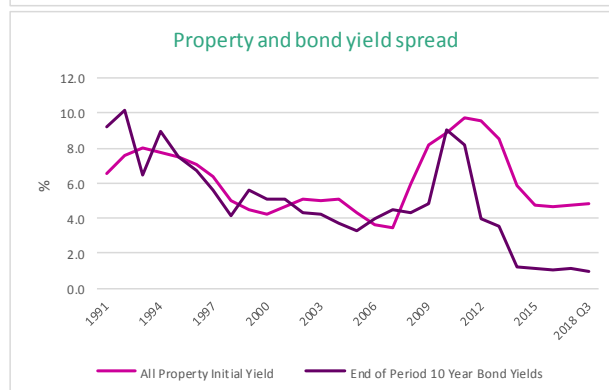
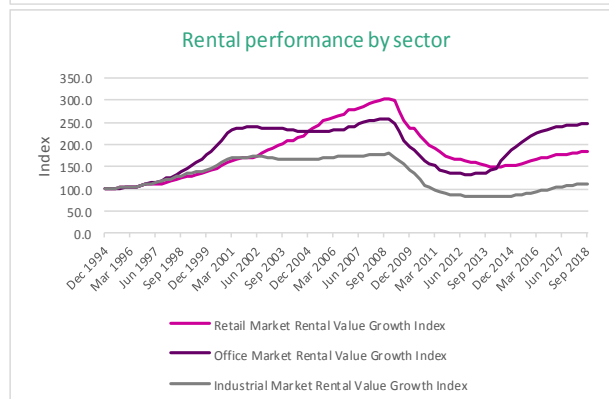
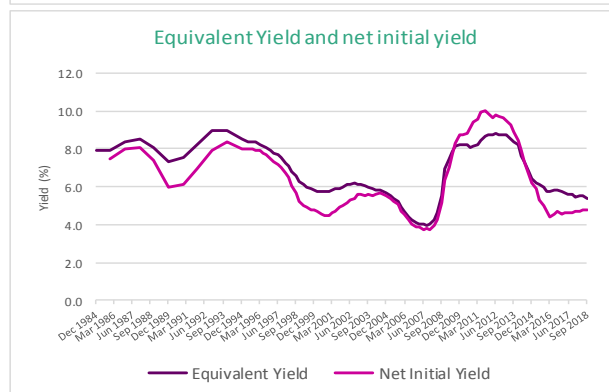
Dublin office take-up reached 165,000 sq. m. in the first half of 2018, a 10.7% increase on H1 2017, and the strongest ever take up in the first half of a year. Dublin's office vacancy rate stood at 7.32% in Q3, compared with 6.17% in the previous quarter, according to CBRE.

Given the increased level of supply, rents should moderate - In the absence of a large scale influx of investment banks into Ireland due to Brexit, prime rents are expected to peak in 2019 / 2020 at around €70 sq.ft.

Yields—Substantial spread provides buffer for property values

With the MSCI all property yield at 4.8% in Q3, the yield gap between Irish property and the 10 year Irish government bond is at close to 400 basis points, which provides Irish property with a substantial valuation buffer.

The yield spread should give some protection to property values in the event of rising bond yields, assuming that any rise in bond yields is contained and expected.



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Retail market – retail sales strong leading into the busiest period of the year

The KBC Bank/ESRI Irish consumer sentiment index fell to 96.4 in September from 102.4 in August, it's lowest level in 21 months. According to the ESRI, the fall represented a clear drop in confidence among consumers and reflected a significant downgrade in views on household finances and the broader economic outlook, particularly regarding Brexit.

Despite this, retail sales in Ireland have continued to be strong, with the seasonally adjusted volume of retail sales increasing by 2.6% in the year to August, while sales grew in value by 1.9%. In addition, expenditure on personal consumption increased by 4.8% in year on year terms in the second quarter of 2018, a significant increase from 2.4% in the previous quarter. This is supported by an increase in average earnings, which rose by 3.3% in the year to the end of Q2, and leaves retail in a positive position heading into the traditionally busy period in the lead up to Christmas.

While the increasing popularity of E-Commerce presents challenges for traditional high street retail, growing demand for services that cannot be delivered online (e.g. dining, healthcare, fitness etc.) is fostering demand for well-configured retail space in the right locations.

In terms of retail rents, there was an annual increase of 3.4% in Q3 2018 according to MSCI, stronger growth than both the office (+2.6%) and industrial (3.2%) sectors. Prime Dublin high street yields stood at 3.15% in September, while prime Cork yields moved to 5.00%.

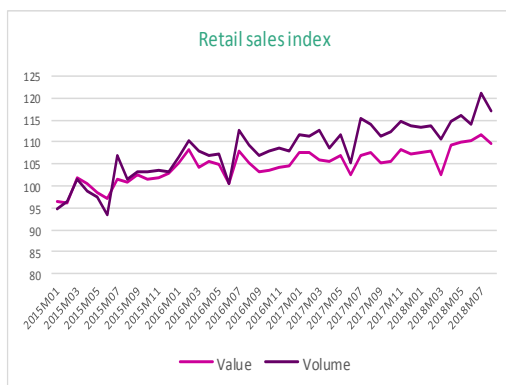
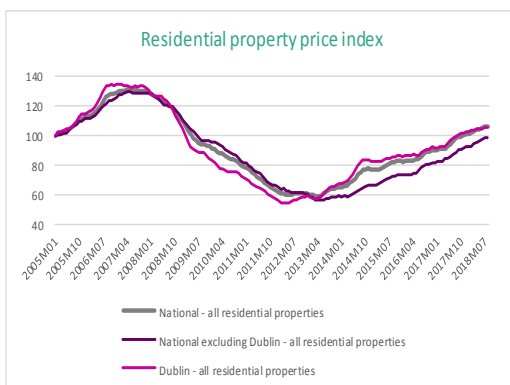
Residential house prices continue to increase, although at a lower rate

In the year to August, residential property prices at national level increased by 8.6%. This compares with an increase of 10.0% in the year to July and an increase of 11.8% in the twelve months to August 2017. In Dublin, residential property prices increased by 6.1% in the year to August. Residential property prices in the Rest of Ireland (i.e. excluding Dublin) were 11.4% higher in the year to August. Overall, the national index is 20.4% lower than its highest level in 2007.

Recently released CSO figures indicate that new housing supply in 2017 was 14,446, 25% lower than the ESB connections data that have been used as a proxy until now. However, the trend appears to be positive, with a 34% year on year increase in supply in Q3 2018, following a rise of 26% in Q2. Nevertheless, with estimated demand running at approximately 35,000 per annum, it will be 2020 at least before supply and demand are in balance.

There were 7,381 mortgage drawdowns in Q2 2018, valued at €1.66bn. This represents an increase of 14.8% in year-on-year terms, bringing the size of the mortgage market to €7.6bn in Q2 2018.

Source: CBRE	Sep. 2018 Rent (€ psm)	September 2018 Yield (%)
Retail		
Prime High Street Shops (Zone A)	6,500	3.15
Good Secondary High Street Shops (Zone A)	4,500	4.50
Prime Cork Shops	4,500	5.75
Provincial High Street Shops	3,250	6.75
Super Prime Shopping Centres (Zone A)	4,600	4.00
Prime Shopping Centres (Zone A)	3,000	4.75
Secondary Shopping Centres (Zone A)	2,750	7.00
Prime Retail Warehouses	376	5.00
Secondary Retail Warehouses	169	6.75
Offices		
Prime City Centre Dublin	700	4.00
Secondary City Centre Dublin	306	5.25
Suburban Dublin	296	6.00
Prime CBD Cork	315	5.75
Prime Provincial	135	7.00
Industrial		
Prime Dublin	102	5.50
Secondary Dublin	64	8.00
Prime Provincial	60	10.00



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