Ireland

Dublin your money

It has been a bumper year for the country's property market, but the nature of ownership is changing. **Guy Montague-Jones** examines what the future holds for Irish real estate

The sheer volume of Irish real estate assets and loans that changed hands last year was staggering. More assets were sold than in the previous six years combined, and on top of the €4.58bn (£3.35bn) of bricks and mortar deals was an extraordinary €21bn in loan sales (source: CBRE).

The 'great deleveraging' of the post-crisis years has transformed the nature of ownership in the Republic of Ireland. Gone are the days of colourful Irish entrepreneurs leveraging themselves up to the hilt with Irish banks to buy real estate. The dominant force in the buyers' enclosure since the crisis has been the US private equity firms.

However, as one agent says, "they are here for a good time, not a long time", so once the market returns to some degree of normality, who will be the long-term owners of Irish real estate? The early movers have certainly been rewarded. Total returns from Irish real estate in 2014 hit 40.1% as rents recovered – particularly in Dublin offices – and capital values surged. After such a bumper year, the question now is how much value is left in the market for the next wave of buyers?

PATRYK KOSMIDER/SHUTTERSTOCK.COM

Life on the Liffey: domestic buyers now make up more than half the market

Exit of private equity

Private equity firms looking for really big returns are now turning their attention to other markets in Europe that have yet to experience the same sort of recovery as Ireland. They will also be looking to cash in on their Irish investments and explore their exit options.

"Private equity investors came in when Ireland was still a very risky place to invest capital," says Hibernia chief executive Kevin Nowlan. "As returns start to fall, some will look to refinance to add more debt and some will look to sell assets as another exit route."

Private sales are already happening. Last month, Hibernia acquired the Garda Siochána headquarters in Dublin for €70m from an entity controlled by Starwood Capital, which in 2013 acquired the loans secured against the property as part of the acquisition of Project Aspen.

Refinancing deals are also on the agenda. Lone Star recently hired Eastdil to help line up €400m in new finance, secured against a portfolio of Dublin offices, although some insiders predict it will be sold rather than refinanced. Securitisation is also being discussed as a possibility. "Those that purchased large loan portfolios, either commercial or residential, need firstly to get the loans performing and then will see securitisation as an obvious exit," says Kevin McGillycuddy, managing director of Brehon Capital.

The shift from US private equity to other sources of capital is already reflected in the transactions data. Whereas in previous years overseas buyers, made up largely of US private equity firms, accounted for the lion's share of asset sales, in 2014 domestic buyers made up 54% (source: Knight Frank).

The most active domestic buyers last year were the Irish REITs, Hibernia and Green REIT, which launched soon after the introduction of the Irish REIT regime in 2013. It is widely expected that others will follow. Private equity firms could use a REIT structure to exit some of their investments.

There is also thought to be room for a retail-focused REIT, which the former executives at Treasury Holdings made an abortive attempt to exploit last year with Burlington REIT. Whereas Hibernia and Green REIT were able to raise the money blind, in "cash boxes", the sharp recovery in the market now means investors will want to see assets, as well as a credible management team, for a new REIT to get off the ground. »

WILLIAM MURPHY/FLICKR

Dundrum Town Centre: the largest shopping centre in the country

"I think there is certainly scope for more REITs, perhaps a retail play or a resi REIT, but it will be harder for cash boxes," says Nowlan. "They'll have to come seeded with assets."

The two other big and growing sources of domestic capital are the unlisted fund IPUT, which has committed about €650m into the Irish market since January 2013, and the pension fund Irish Life, which snapped up 2 Grand Canal Square for €120m in the largest single office sale of 2014.

"As the different sectors stabilise, institutional funds should play a bigger role in the market as their cost of capital is comparatively low," says Jonathan Hillyer, managing director at HWBC. "Irish pension funds already have substantial sums to invest, but as the average Irish private investor gains confidence in the recovery, these institutions are likely to see a bigger inflow of funds."

Institutional buyers from overseas markets, particularly German funds such as Union and GLL, are also starting to bid for properties. "With the recovery, we are seeing a change from opportunistic buyers to more core buyers," says Johnny Horgan, head of investment at CBRE Ireland. "Over the past year, the European funds such as Standard Life, Credit Suisse, Union and GLL have been bidding. We've not seen much of the Middle Eastern or Asian buyers but they will come."

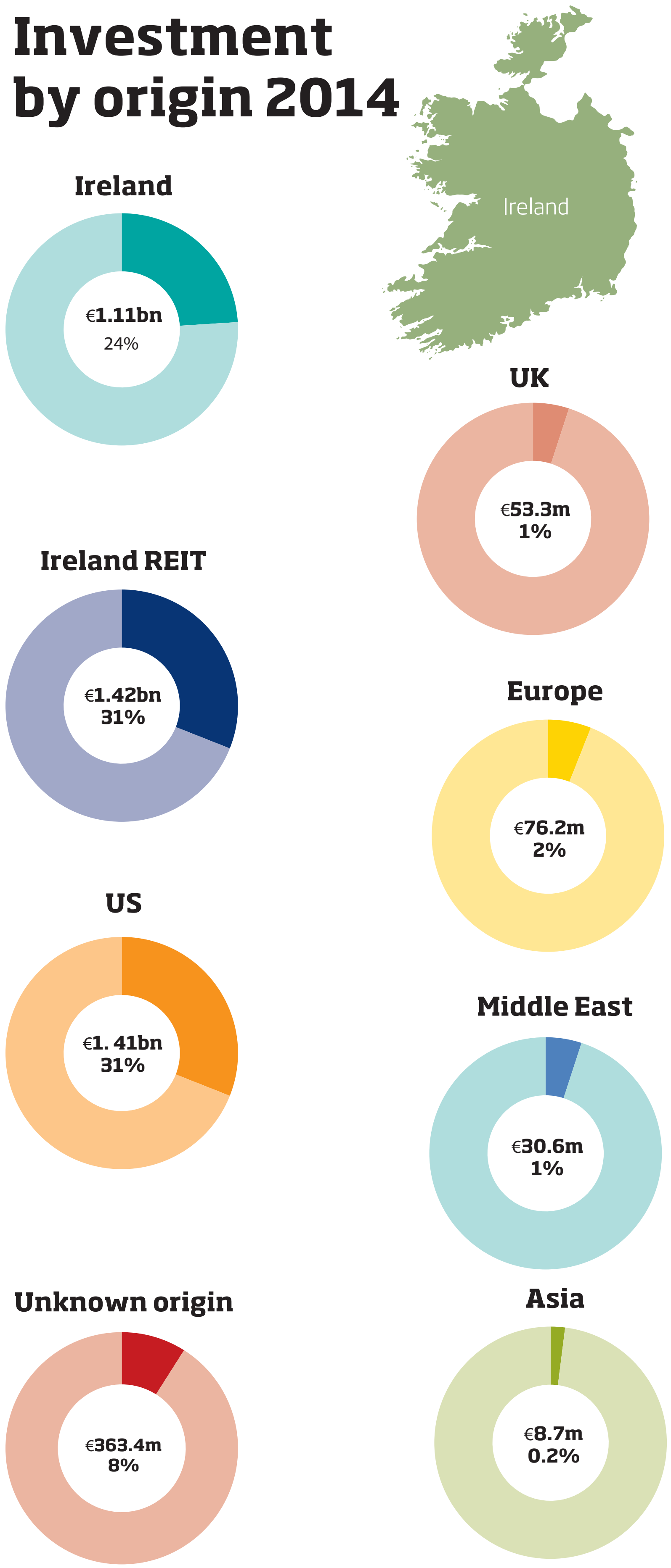
Falling yields

The new wave of buyers is unlikely to enjoy quite the same returns as some of the early movers. Yields have already come in a long way for prime assets, but in 2014 they fell for secondary properties. In the case of prime Dublin offices, yields have fallen from over 7% to 5%. Although they remain some way above their pre-crisis lows of less than 4%, it is unlikely that they will drop much lower.

"Capital values are still some way below peak, but that peak was wrong so the comparison is invalid," says John Moran, managing director of JLL Ireland. "We are now starting to look fully valued for offices."

However, buyers today are eyeing up the potential for strong rental growth in the office market. After years of no construction and with Irish GDP growing by 4% to 5% a year, rental »

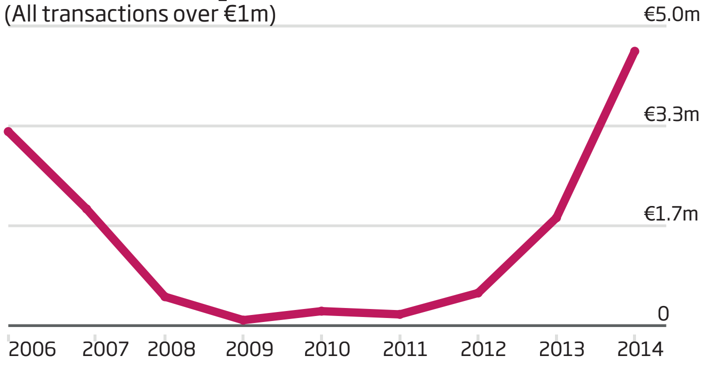
Investment by origin 2014



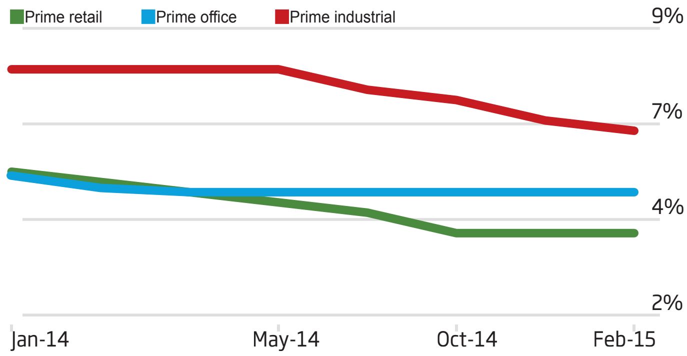
Ireland investment overview

Investment spend 2006-2014

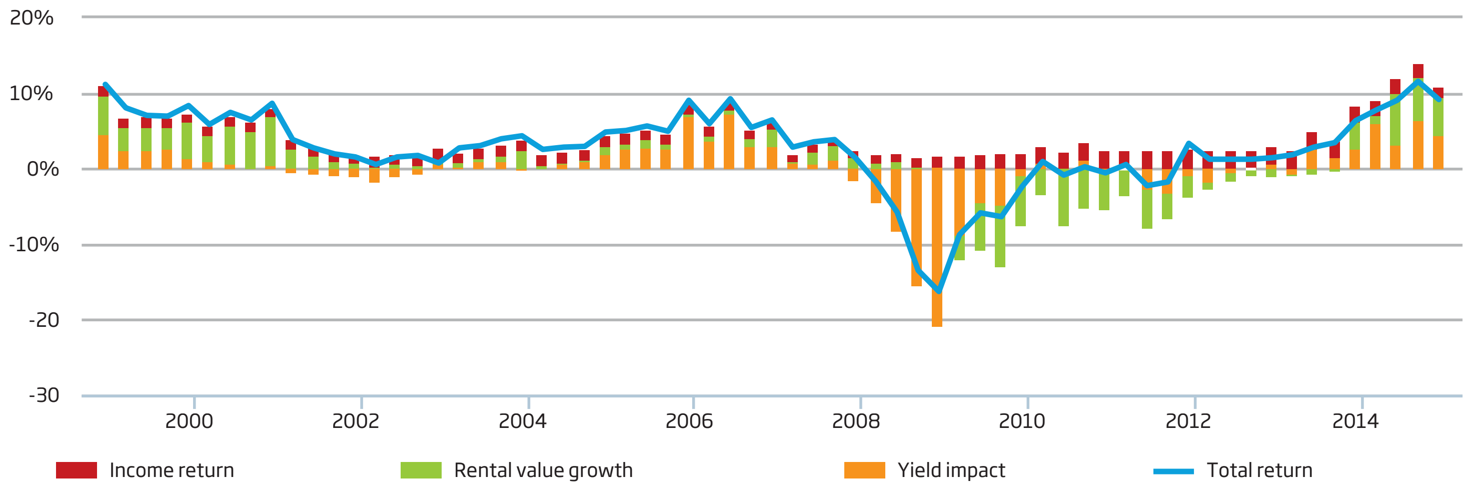
(All transactions over €1m)



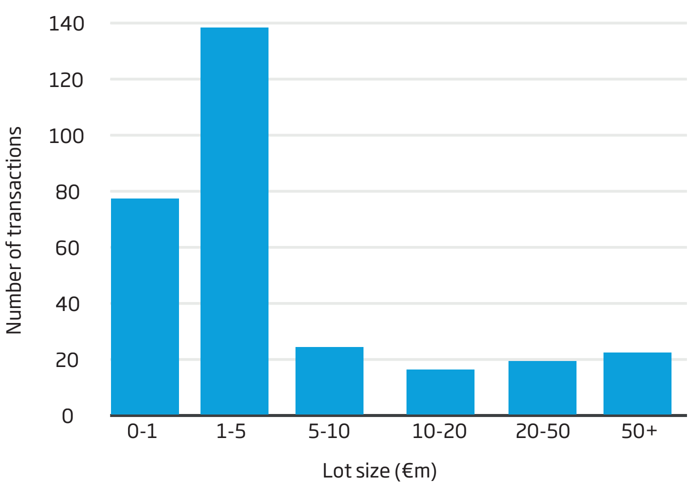
Prime yields 2014-2015



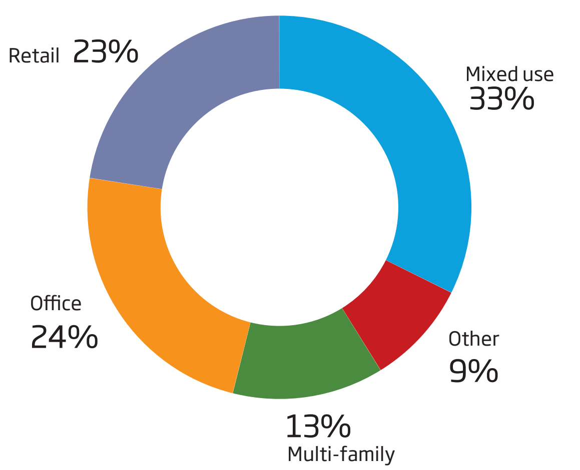
Drivers of total return - % increase quarter on quarter



Investment spend by lot size 2014



Investment spend by asset 2014



Sources: CBRE, Murphy Mulhall, IPD

PropertyWeek.com

« growth in Dublin is currently far higher than any other market in Europe. Last year, rents rose by 30% and this year HWBC is forecasting 20% growth. After that, growth is expected to moderate as the first developments since the crisis are completed. Plans for a number of developments totalling some 1.2m sq ft in the Strategic Development Zone in the Dublin Docklands emerged last year and are expected to be delivered by 2017. Although this is a substantial amount of new space, it is still only 3% of the existing stock, well below the 6% average that was built every year in the two decades running up to the crisis. The new developments will relieve pressure on the office market rather than create a destabilising glut.

"We had been watching the market closely to see where rents and capital values will support development again," says McGillycuddy, who recently shifted Brehon Capital's focus from investment to development. "That inflection point where it starts to make sense again has come."

Availability of debt

The lack of debt financing available for speculative development will restrict activity. Availability of debt has improved, but it is still more expensive than in other European countries and more restricted. The large banks still have a policy of not doing development financing.

Without going back to overexuberant lending, McGillycuddy believes there is a place for development finance to help provide not only office space, but also housing. Dublin is suffering from an increasingly severe shortage of housing as the number of workers in the city grows.

"Given the need for commercial office space and residential, there has to follow a financing solution. Does the National Asset Management Agency have a role to play? It has the manpower and the capital," he contends.

Dublin offices and resi are not the only games in town. The pick-up in economic growth and fall in unemployment mean that retail has become an increasingly attractive sector. In 2015, the largest property deal is expected to be the sale of Dundrum Town Centre in south Dublin. It could sell for about €1bn and there are several shopping centre portfolios expected to trade in the coming months. Rents have bottomed out in retail and although pricing has already shifted in 2014, agents are optimistic that there is more to go.

"There is a good story around retail, and prime retail especially. It should be the best performing sector this year," says Moran, who is also optimistic about industrial, where there is already "pent-up demand".

For the next year or two at least, the outlook appears to be set fair for Irish real estate. Once this period of intense deal flow ends, the market will return to some kind of normality, but the nature of ownership in Ireland will not return to pre-crisis norms. The bank model that supported smaller developers to punch above their weight has gone and isn't likely to be back any time soon. Irish property will be in fewer and larger hands. ■

Digital Hub: provision of student housing will add to the current mix

Academic ambitions

With two sites purchased and more in the pipeline, Knightsbridge Student Housing is moving in on the Dublin market. Hannah Brenton reports

Knightsbridge Student Housing has an appetite for Dublin development sites. The developer and operator has recently purchased two sites for new purpose-built schemes, and is eyeing more. The Oaktree Capital-backed company embarked on a European-wide expansion in 2012 and has since snapped up assets in Madrid, Spain and Brittany, France. Thomas Storgaard, European acquisitions director, tells *Property Week* why the company is excited about Dublin.

How long have you been interested in Dublin?

We have been looking at the Irish market for quite a long time – definitely for the past three years, probably a little bit longer. We embarked on our European strategy three years ago. We have managed to secure two developments and we have a third one in legal negotiations that is almost secured. Assuming the last one materialises, we will have around 1,500 bed spaces in Dublin.

What are the schemes called?

The first one we refer to as the Digital Hub deal. This is located in Dublin 8, and it will be a 471-bed scheme that we expect to complete in 2016. The second one we secured just before Christmas and is still in development from a planning and design perspective, but we expect to get to about 550 bed spaces. That's located in Dublin 1, just north of the river, and is expected to complete in 2017. We are in exclusive talks on a third deal that would be about 450 beds.

What is the attraction of Dublin?

Ireland appreciates the importance of investing in a knowledge economy and creating the link between education and the country's long-term prosperity. It is never going to be the biggest student housing market in Europe, but there are some fundamental supply and demand dynamics that are interesting – in particular, there is a very low provision of purpose-built student accommodation compared with other markets.

How does Dublin compare with other European capitals?

You can always convince yourself that there is a latent opportunity in any major European university city. Dublin is particularly attractive right now, partly because of the financial crisis and the fact that property prices have come to a level where we can go in and buy sites in central locations near universities.

With the number of beds that you have now, would you want to achieve any greater scale?

We have an appetite for more – how much more is a little bit difficult to say. We have got 1,500 bed spaces secured and we could probably take on another 1,000, taking us up to about 2,500 in total. This is just in Dublin. There are also some other interesting university towns in Ireland, such as Galway, Cork or Limerick, where there is the same low provision of student accommodation. ■