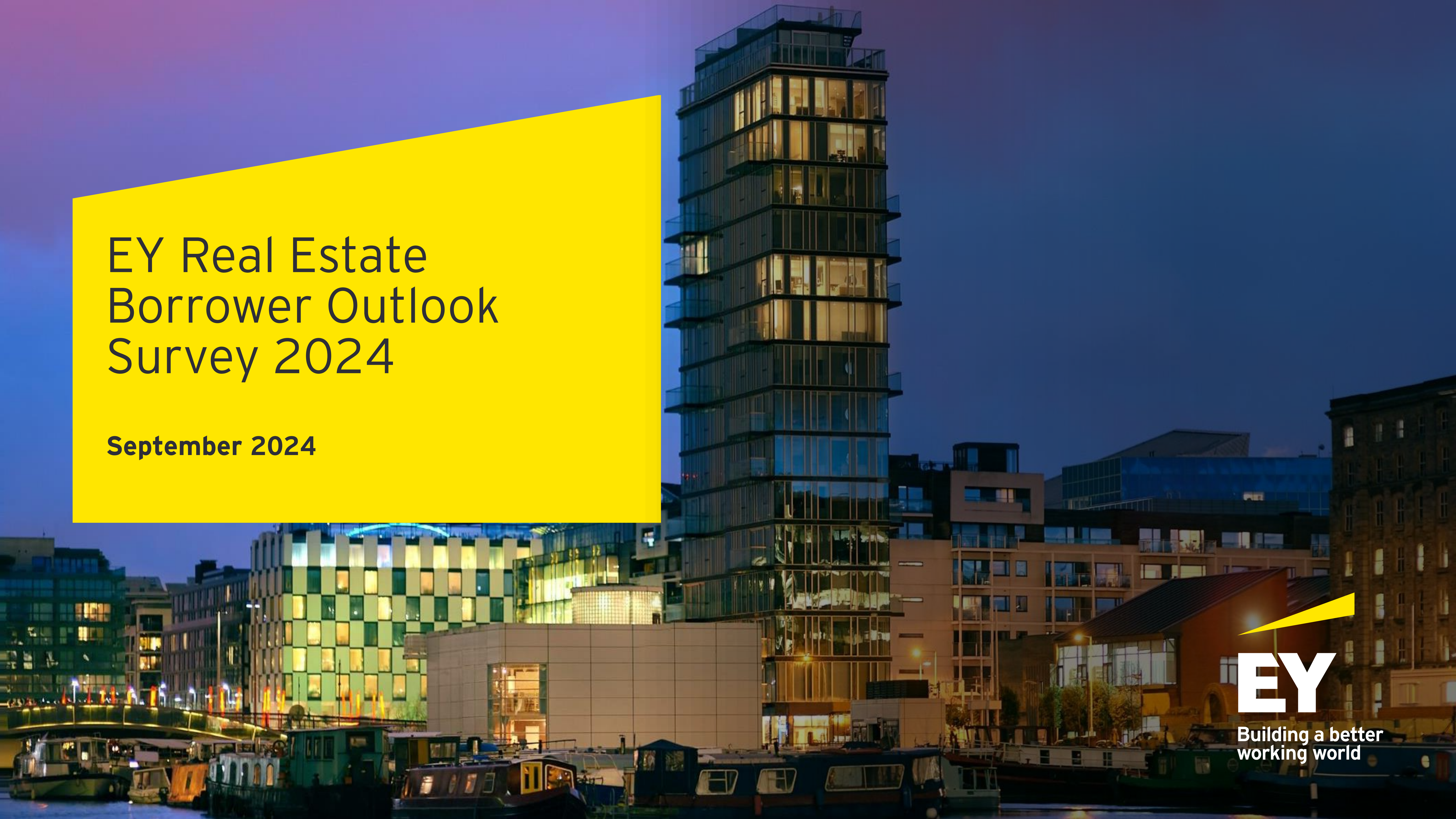


EY Real Estate Borrower Outlook Survey 2024

September 2024

Building a better working world

Contents

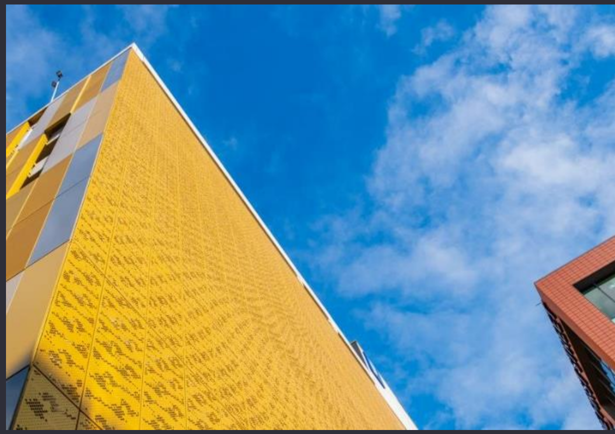
Click on each section tile above to find out more

Authors

David Martin
Partner
Head of Capital & Debt Advisory

Michael Armstrong
Director
Capital & Debt Advisory

Executive Summary



Last year posed numerous macro-economic headwinds for the real estate sector including high inflation resulting in a significantly higher interest rate environment coupled with geo-political conflicts.

However, the general real estate market outlook at the beginning of 2024 was "cautiously optimistic" and as inflation began to slow the majority of market commentators forecast rate cuts of 50bps – 175bps throughout the year.

Against this backdrop EY's Capital & Debt Advisory teams Real Estate Borrower Outlook survey sought to establish key industry leader's view of the debt markets over the next 12 months. Below is a synopsis of the key themes running through the responses.

Debt & Equity Financing

Senior bank debt and equity are the products identified as the greatest gaps in the financing structure in the real estate market.

The Irish lending landscape has experienced a period of significant change over the past 15 years with the retrenchment of traditional banks and the rise of non-bank lenders.

Despite the proliferation of non-bank lenders over the past number of years, borrowers are facing challenges in securing senior debt at their preferred level and cost.

EY's recent European bank lending forecast signals an optimistic outlook, following two years of little-to-no growth, provided economic growth settles in.

Equity financing is becoming more established for residential development with the emergence of new sources of capital over the past 12 months. However, given the recent requirement for rent caps and the interest rate environment, Institutional Equity with a focus on investment remains subdued.

Our Capital & Debt Advisory team have direct relationships with over 75 international and domestic capital providers.

Interest Rates

As cost pressures began to moderate and with inflation falling in certain geographies, the European Central Bank ("ECB") commenced the rate cutting cycle in June with a 25bp reduction on the three key interest rates (refinancing operations, marginal lending and deposit facility) to 4.25%, 4.50% and 3.75%.

This was followed by a second cut in rates in September to 3.65%, 3.90% and 3.50%, respectively. With additional easing in rates expected by the year end, the pathway to a more favourable interest rate environment for commercial real estate markets has commenced.

If the rate cutting cycle continues, as it is projected to do so, it will establish a more stable environment for real estate yields and valuations. A reduced cost of capital and reduction in the risk-free yield should also boost capital allocations to the sector.

EY note that many of its clients are now availing of hedging products, which can be structured to create a bespoke and tailored solution that meets borrower needs, providing certainty on the cost of funding.

Sectoral Trends

The residential asset class is the most active in the Irish financing market, buoyed by strong underlying fundamentals and government support. Development financing is experiencing the greatest activity however challenges, such as planning delays and utility connections, remain around the delivery of product.

The residential asset class continues to be supported by an array of Government entities from Approved Housing Bodies, Local Councils and the Land Development Agency providing forward sales and leases, which has been seen as broadly positive, particularly in the relative absence of Institutional Equity and Private Rental Sector buyers.

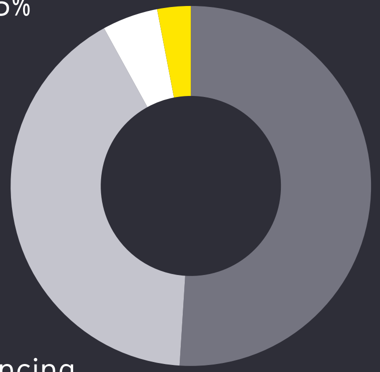
The hotel sector continues to perform well, with several significant sales completing year-to-date and new rooms coming to the market, particularly in Dublin. Lender appetite is generally strong, with continued focus on sources of revenue and location.

Similar to international convention, the volume of new office stock coming to market, coupled with low occupancy rates, has adversely impacted the sector year to date, with notable decreases in valuations. However, a number of recent high-profile lettings and return to work mandates may indicate that green shoots are beginning to emerge. Lenders' appetite for the asset class remains selective, with a focus on locations and best in class sustainability practises.

Strong demand and limited supply of logistics assets ensures the asset class remains active. Lenders have a strong appetite for well located assets with strong environmental and sustainability credentials.

EY's 2024 Survey examines the industry's current market outlook from a Real Estate Borrowers perspective:

Q1. Where do you expect to see the most lending activity in the next 12 months?



Respondents expect the vast majority of financing activity to be development related at 51% followed by refinancing of existing borrowings at 41%.

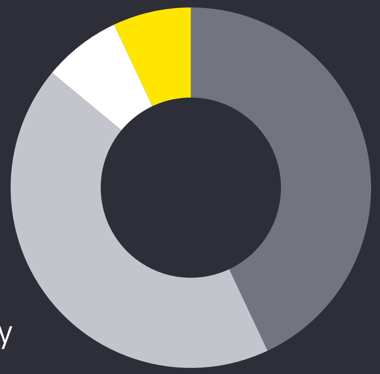
"Years of undersupply coupled with strong demand and government support for the residential sector is driving strong demand for residential development finance. The Central Bank of Ireland anticipates up to 50k new homes a year will have to be built between now and 2050. This will require not only Bank debt but strong support from Government, Institutional Equity and Non-Bank Lenders.

David Martin
Partner, Head of Capital & Debt Advisory

"Survive to 2025 was the mantra at the beginning of the year and the anticipated volume of refinancings may be a result of this as borrowers begin to take advantage of a lower interest rate environment and initiate refinancing processes for loans maturing over the next 12 – 18 months.

David Martin
Partner, Head of Capital & Debt Advisory

Q2. Where do you see the greatest gap in availing of financing across the capital structure?



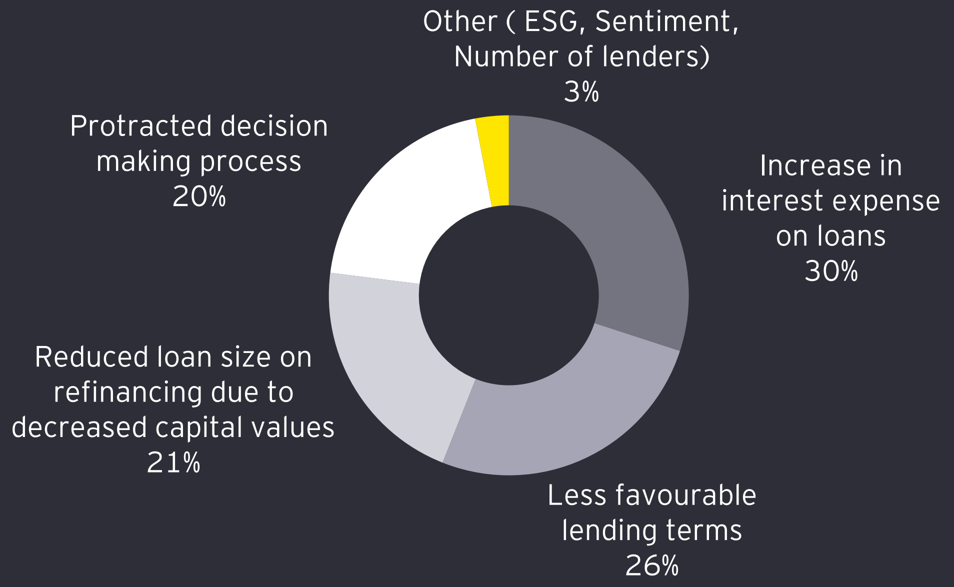
The provision of senior bank debt and 3rd party equity are ranked equally, at 43%, as the financing products lacking in the Irish market.

"It is acknowledged that Ireland is underbanked in comparison to competing markets. However, the continued emergence of non-bank lenders provides an alternative solution for those seeking finance and the gap between the cost of bank and non-bank finance is closing.

Given the macro-economic conditions, additional 3rd party equity is in greater demand to bridge the financing gap. This impacts projects of all scales and there are positive signs as market conditions improve, with Institutional Equity beginning to consider opportunities again and smaller scale equity solutions emerging for particular areas of the market.

David Martin
Partner, Head of Capital & Debt Advisory

Q3. What are the key challenges when sourcing new or refinancing existing debt?

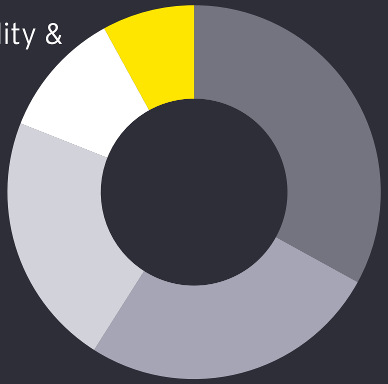


30% of companies ranked interest expense as the greatest challenge when sourcing new or refinancing existing debt. This was closely followed by less favourable lending terms and reduced loan sizes for borrowers with 26% and 21% of respondents ranking it as their most challenging issue.

> Between December 2023 and September 2024 3-month Euribor has reduced from 3.96% to 3.47% respectively and with analysts forecasting a further 1% reduction by Q2/3 2025 the all in cost of financing should be less of a challenge for borrowers.
>
> Reduced loan size is most evident in the office sector, where both international and domestic values have experienced the biggest correction.
>
> There’s no denying credit standards have tightened over the past 24 months, enhancing the importance of a well structured and positioned loan request.

Michael Armstrong
Director, Capital & Debt Advisory

Q4. Which of the following are envisaged as potential obstacles to financing activity in the Irish market?

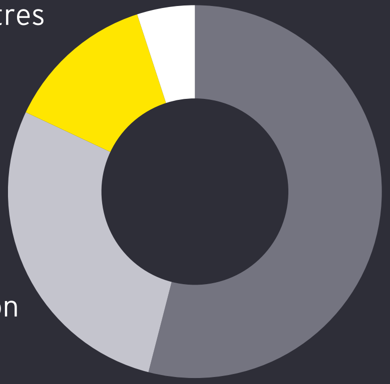


The availability of capital is cited by 33% of companies as the primary obstacle to financing activity in the Irish market. This is followed by valuations, at 26%, with this parameter directly related to the quantum of capital accessible to borrowers.

“The capital provider universe in Ireland is ever-growing and while there have been a number of high-profile bank exits over the past number of years there is an ever-increasing cohort of non-bank lenders and 3rd party equity providers. Identifying the appropriate capital providers to approach is the key to a successful capital raise.

Dan Murphy
Director, Capital & Debt Advisory

Q5. Which sectors do you believe will experience the greatest increase in value over the next 12 months



Over 50% of companies surveyed believe that the residential sector will experience the greatest increase in value over the coming 12 months, followed by Student Accommodation at 28%. 5% of respondents expect office assets to experience the greatest uplift in value compared to other asset classes.

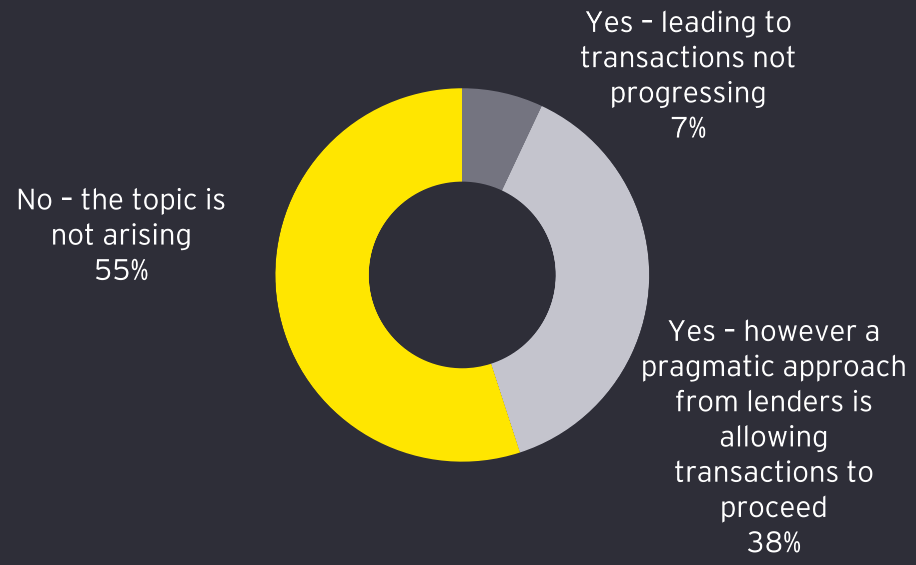
> Given the supply/demand imbalance in the Residential sector the number of respondents expecting an increase in values is not a surprise. A key component to increasing output will be the recommencement of large-scale apartment developments. However, financing projects (without an off-take) remains challenging. We also note given the current and projected shortages in student accommodation this is an asset class with increased valuations expected by our respondents.

David Martin
Partner, Head of Capital & Debt Advisory

> The recognition of more realistic housing targets, combined with record employment levels, the moderation in inflation, the lowering of interest rates, and the range of interventions introduced by Government over the past few years to speed up the delivery of new homes and support housing demand, means that we can continue to build on the momentum which already exists, to further address the higher demand levels over the medium-term.

Annette Hughes
Director, Economic Advisory

Q6. Are you experiencing any challenges in securing debt financing due to lenders ESG requirements?

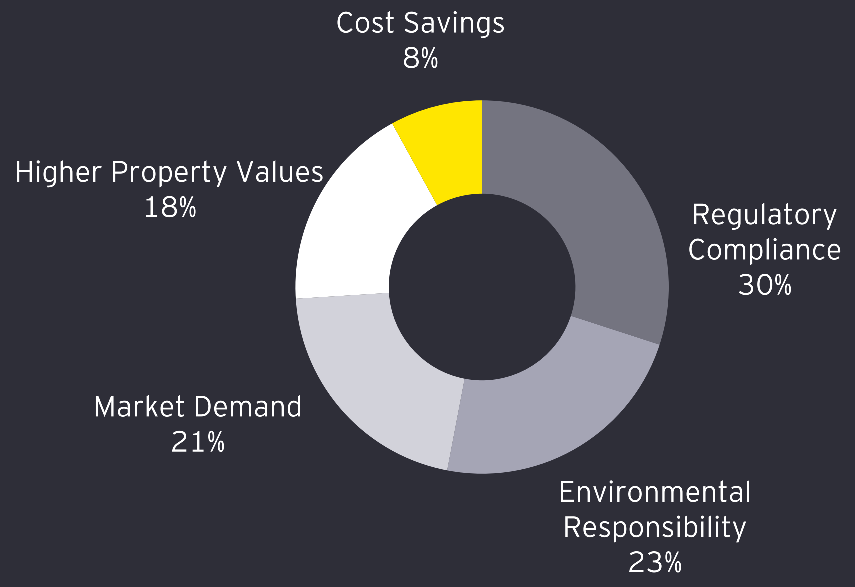


Despite the societal focus on sustainability, 55% of companies are not experiencing engagement from lenders on the topic when raising new or securing debt financing. More reassuringly 38% of companies are proactively working with lenders to address ESG criteria allowing transactions to proceed. With 7% of companies not being able to complete transactions due to ESG requirements highlighting the importance of the topic.

> “For lenders and investors, the increasing regulatory pressures and new frameworks are ushering new lending in line with ESG principles and in turn capital providers are becoming more sophisticated in assessing sustainability. Addressing the topic in in loan requests streamlines the overall financing process.

Michael Armstrong
Director, Capital & Debt Advisory

Q7. Please rank the following in terms of motivators for incorporating sustainability into your projects?

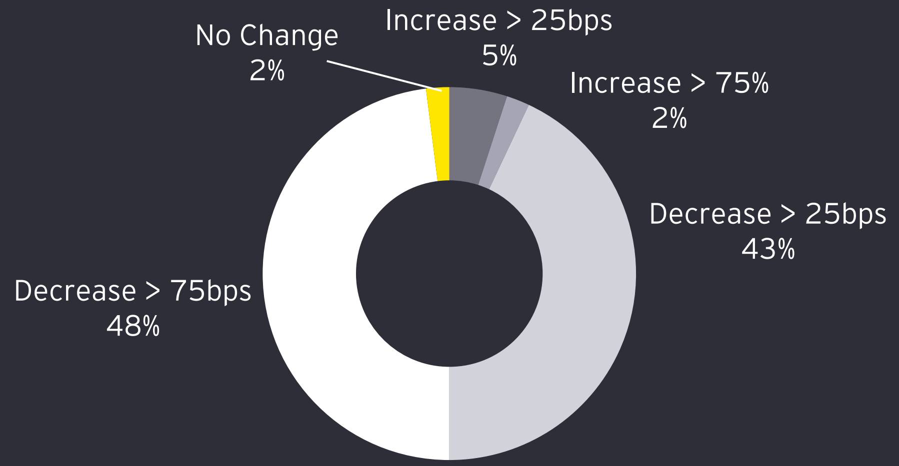


Ireland's high standard of building and environmental regulations is the primary driver for companies to incorporate sustainability into projects, with 30% of companies citing this as their primary motivator. Environmental responsibility and market demand were the second and third at 21% and 18% respectively, highlighting the importance that developers, asset owners and tenants are placing on sustainability.

"2024 has seen the emergence of several specialist real estate transition funds purposed to transform older energy inefficient spaces into sustainable spaces. Given the volume of new Grade A office space coming to market this may prove to be an important source of finance for retrofitting older stock from brown to green.

Michael Armstrong
Director, Capital & Debt Advisory

Q8. Over the next 12 months do you expect interest rates to?

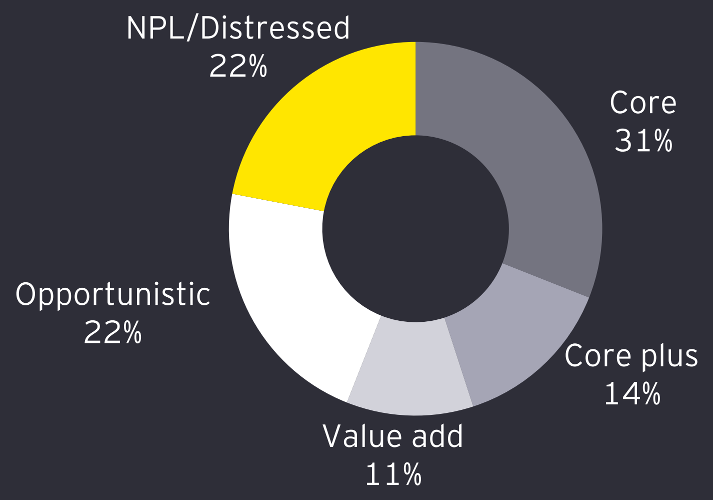


Over 90% of companies are expecting the rate cutting cycle commenced by the ECB in June to continue over the coming 12 months, with 43% anticipating a decrease of between 25bps -75bps and 48% expecting a decrease of over 75bps.

> The ECB's initial rate cut in June and subsequent cut in September has sent a positive signal to the real estate market.
>
> The benefit will be twofold as the cost of capital lowers in line with a reduced Euribor coupled with yield and valuations stabilising, subject to the sector and asset.

David Martin
Partner, Head of Capital & Debt Advisory

Q9. Please rank the following investor strategies in terms of expected activity over the next 12 months?



Grade A assets with long term quality leases is the investment strategy expected to attract the greatest inflow of capital over the coming 12 months. Opportunistic and distressed investment strategies account for a combined 44% of expected investment activity in the period.

“We are not seeing significant distress in the Irish corporate sector, except for sub-sectors with particular market dynamics. As indicated in our survey, there is capital available in distressed scenarios. If borrowers are under financial stress our recommendation is early engagement with advisors and lenders. Given the market disruption over the past number of years turnaround teams are increasingly implementing reorganisation plans, thereby preserving value for a company and its stakeholders.

Luke Charleton
Partner, Turnaround and Restructuring Strategy

“There are increasing signs of an uptick in transactional activity across different sectors of the real estate market through the second and third quarters of 2024 as international institutional investors look for liquidity, or an exit at the end of fund investment cycles, and new investors are more willing to take view on valuations, playing into a more dynamic funding environment.

Cian O’Donovan
Partner, Tax

Q10. Respondents to our survey have provided the following insights on Government initiatives in the residential market

- Too much intervention tends to discourage long-term investment (e.g. rent caps) due to lack of certainty
- Strong capital commitment but questionable speed of deployment
- Limitations around planning and necessary infrastructure require greater attention
- Speed of planning process and lack of zoned land are key challenges to ramping up delivery
- Levy waivers welcomed
- Positive steps, need to be maintained
- Making progress but more to do
- The majority of Government understand certainty and predictability on policy and regulation are critical to sustain investment from mobile international capital

Conclusion

An improving macro-economic environment and the ECB's rate cuts are paving the way to a more supportive growth environment for the real estate market. Despite this, financing and structural challenges persist across all sectors but are more pronounced in some.

Residential development is the most attractive asset in the real estate financing market with strong fundamentals and potentially big opportunities likely to arise for supportive Equity Investors. The notable drop off in apartment development is unlikely to recover, from a financing perspective, until Institutional Equity re-emerges in the market, which will likely happen with greater certainty on interest rates and government policy. The Office sector continues to be a difficult asset class for both our domestic and international clients, with most of the capital chasing Grade A office stock.

In summary, the general themes of our survey show a more positive outlook on the Real Estate sector in comparison to 12 months ago. There is little doubt that this optimism is driven by demand requirements in Housing & Student Accomodation in particular, aswell as a positive movement and outlook in the interest rate environment.

Whether you are approaching domestic or international capital, having a well thought-out funding strategy is key to achieving the best terms and conditions for your business and its objectives.

David Martin
Partner
Head of Capital & Debt Advisory

Michael Armstrong
Director
Capital & Debt Advisory

EY Real Estate Capital & Debt Advisory Contacts

David Martin
Partner
Capital and Debt Advisory
david.martin1@ie.ey.com
086 839 2658

Michael Armstrong
Director
Capital and Debt Advisory
michael.armstrong1@ie.ey.com
086 222 0622

Dan Murphy
Director
Capital and Debt Advisory
dan.murphy@ie.ey.com
087 934 9366

Donal Crotty
Associate Director
Capital and Debt Advisory
donal.crotty@ie.ey.com
086 813 8615

Rebekah Mulryan
Manager
Capital and Debt Advisory
rebekah.mulryan@ie.ey.com
085 736 5431

EY Real Estate Contacts

Cian O'Donovan
Partner
Real Estate Taxation
cian.odonovan@ie.ey.com

Alan Murphy
Partner
Head of Law
alan.murphy1@ie.ey.com

Annette Hughes
Director
Economic Advisory Services
annette.hughes@ie.ey.com

Luke Charleton
Partner
Turnaround & Restructuring Services
luke.charleton@ie.ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

ey.com