EY Real Estate Borrowers Outlook Survey 2023

September 2023

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Contents

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Executive summary

In an era marked by dynamic economic shifts the Real Estate Sector is grappling with multiple macro-economic headwinds including inflation, interest rate, and environment and geo-political unrest. However, despite the global challenges, economic outlook remains positive, with both Gross Domestic Product (GDP) and modified domestic demand (MDD) forecast set to grow this year and next.

In the midst of this backdrop, EY's Capital & Debt Advisory teams recent Real Estate Borrowers Outlook Survey sought to establish key industry players view of the debt markets over the next 12 months. Below is a synopsis of the key themes running through the responses.

Cautiously Optimistic

Despite the perceived challenges more than three-quarters of companies intend to raise or refinance debt over the next 12 months. While the challenges are acknowledged, the sector is proactively moving forward and taking steps to mitigate risks through measures such as hedging policies, implementing sustainability strategies and early pro-active engagement with lenders in advance of issues arising. Further to this, over 50% of companies see a potential buying opportunity for distressed assets over the next 12 months.

Given the economic headwinds, having a well thought out debt plan is paramount to achieving a successful debt raise in the current environment.

International & Alternative Funding Solutions

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 debt funds from both a domestic and international base. The lender universe continues to change on an almost monthly basis with new capital providers attracted to the market given the strength of the Irish economy.

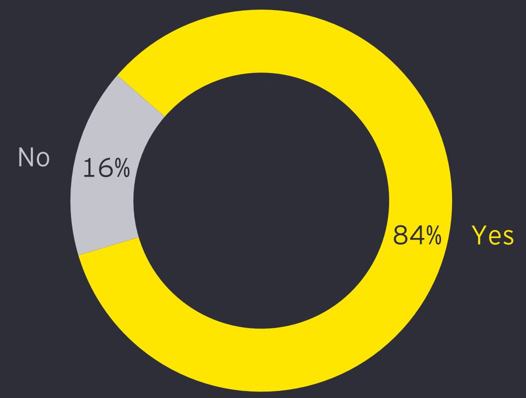
Despite the diversity of the debt pool, domestic bank debt remains the most popular source of funds, followed by international debt funds. It is no surprise in a period of increasing interest rates that margin was the primary consideration for those intending to borrow over the next 12 months.

Sustainability

The increasing prominence of sustainability is changing attitudes to real estate. While it has long been a discussion point, it is now at the forefront of lenders (and other key stakeholders) minds when assessing funding opportunities for both new and older assets. Positively, almost 60% of respondents have a sustainability plan in place and as a result may benefit from improved access to capital and enhanced terms and conditions on facilities.

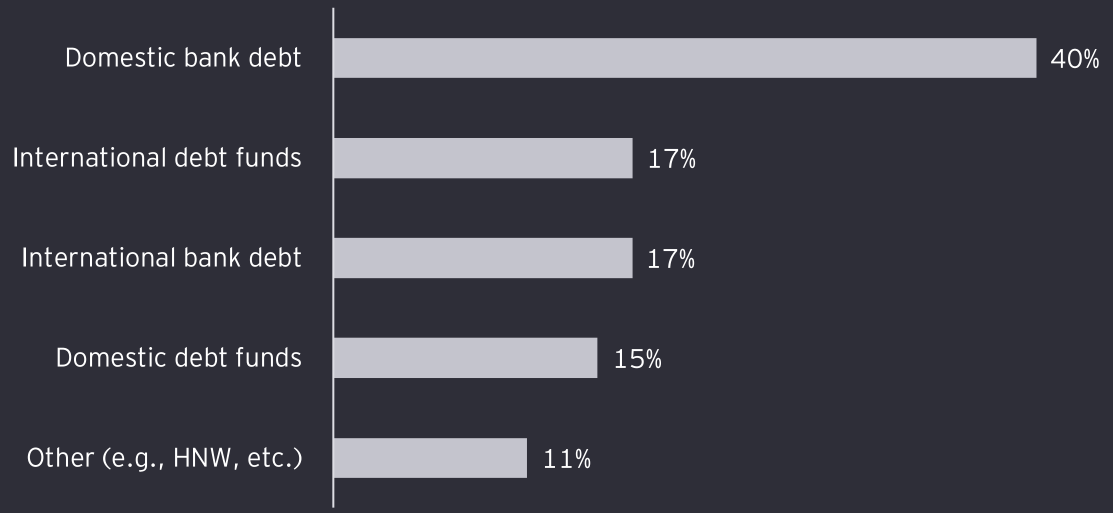
Knowing what information lenders will look for and assess when preparing to raise finance can be the difference between a successful and unsuccessful debt raise.

Q1. Do you intend to raise finance or refinance over the next 12 months?



Despite the perceived headwinds, there was a strong appetite across all RE subsectors to raise new or refinance existing debt over the next 12 months with 84% of respondents planning to initiate financing processes.

Q2. What will be the primary source of your debt in the next 12 months?

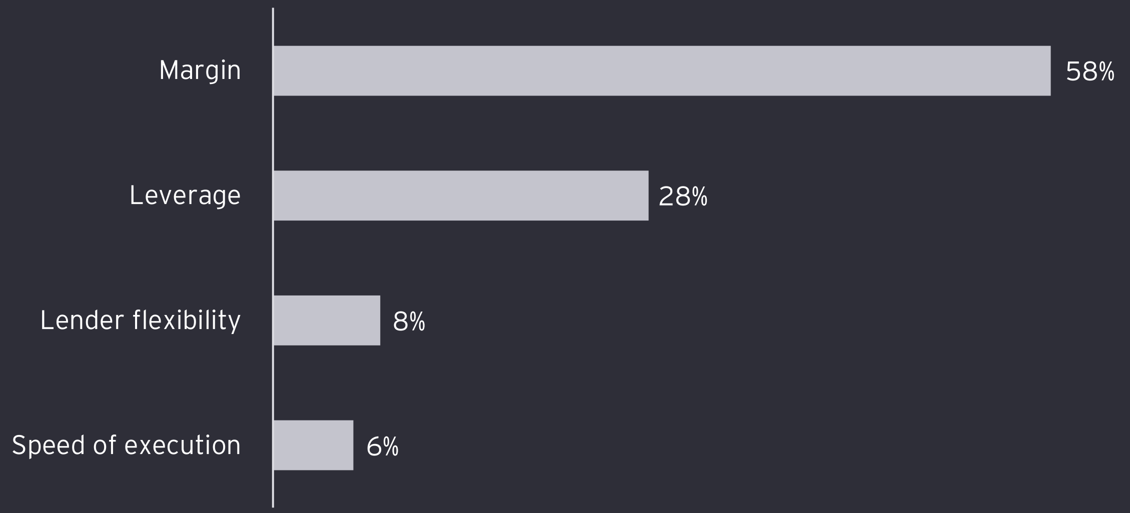


It is positive to see the acknowledgment of Borrowers of the ever-changing debt funding landscape. Despite a tightening credit market, the preferred source of funding remains domestic bank debt with 40% of respondents planning to access capital through this source in the next 12 months.

> While domestic banks remain the primary source of capital for borrowers, debt funds are closing the gap and playing an important role in bringing additional liquidity to the Irish funding market.

Michael Armstrong
Director, EY Ireland

Q3. Please rank in order of importance the following considerations when raising or refinancing debt over the next 12 months

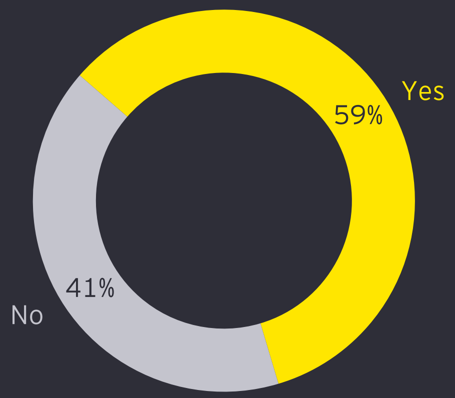


58% of respondents ranked margin as the most importance consideration when raising or refinancing debt over the next 12 months. Leverage is the second most important consideration for borrowers with 28% of respondents ranking it as their primary consideration.

> Given the inflationary environment and pressure on returns borrowers are increasingly price sensitive.

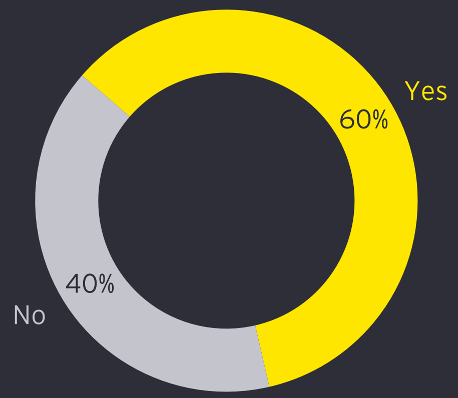
David Martin
Partner, EY Ireland

Q4. Do you hedge existing borrowings or intend to hedge future borrowings?



With the European Central Bank (ECB) steadily increasing interest rates since July 2022 hedging strategy has become increasingly important to borrowers seeking certainty on future cost of funds, as evidenced by almost 60% of respondents having a hedging policy in place.

Q5. Do you have a sustainable financing framework/plan in place?



As the awareness of global sustainability challenges increase it is positive to that over 60% of respondents surveyed have a sustainable financing framework or plan in place.

> Simple hedging products can create a bespoke and tailored hedging solution that meets borrower needs providing certainty on future cost of funding.

David Martin

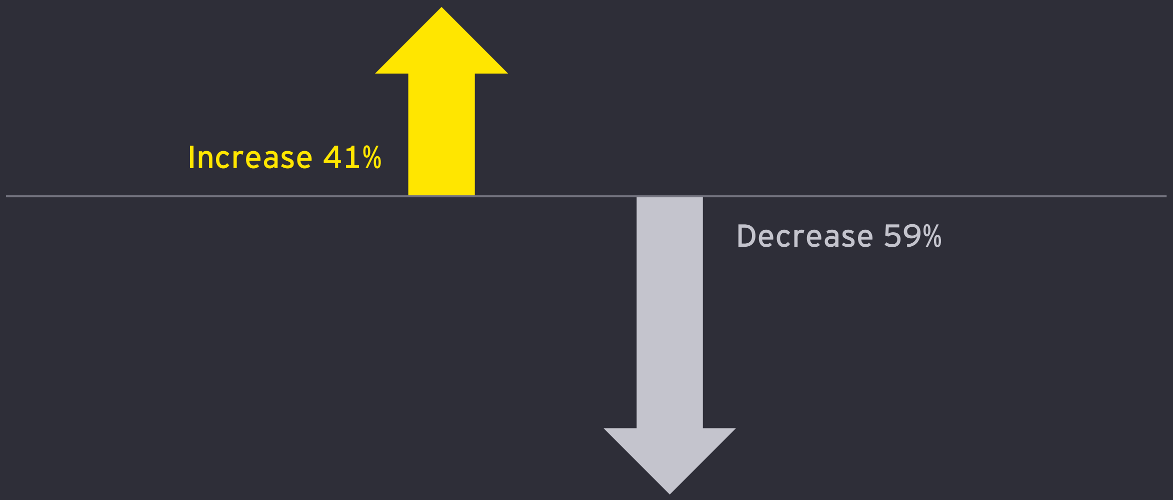
Partner, EY Ireland

> The focus on ESG issues in the lending sphere continues to grow, with many lenders integrating 'sustainability' into lending practices. Borrowers that engage meaningfully and embed sustainability in their funding applications can expect more positive attention when raising new or refinancing existing facilities.

Michael Armstrong

Director, EY Ireland

Q6. Do you expect the asset values of your sector to increase or decrease in the next 12 months?



The impact of **(1)** higher interest rates, **(2)** enhanced ESG requirements, and **(3)** a slowed transaction market appears to be weighing on sentiment as 59% of companies expect real estate asset values to decrease over the next 12 months.

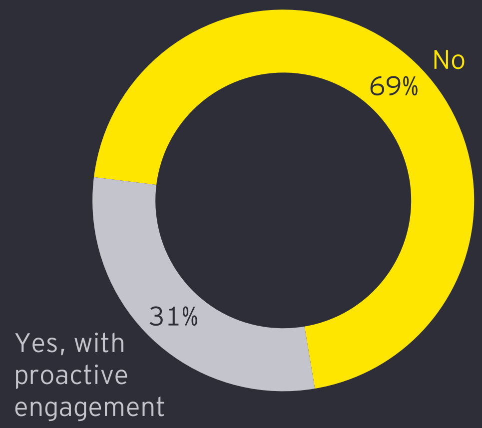
The greatest concern is for offices with 75% of companies expecting a decrease in values. Hospitality & logistics asset owners have a more positive outlook with over 65% expecting an increase in asset values.

> “While decreasing asset values may cause a degree of stress for some owners in terms of covenants pressures and challenges in refinancing, others see it as an opportunity with 50% of companies planning to invest in distressed assets.

David Martin

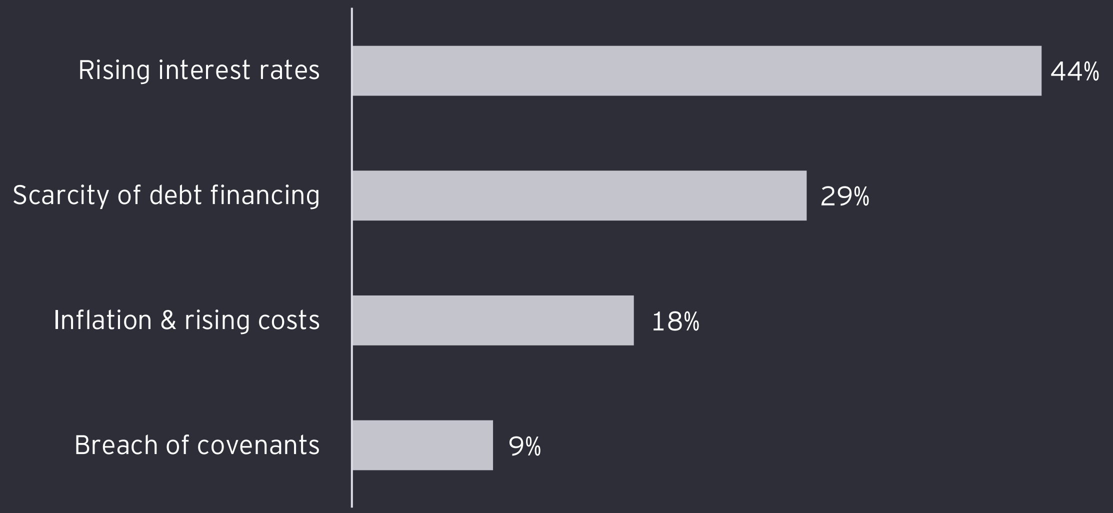
Partner, EY Ireland

Q7. Are you concerned about breaching financial covenants in the next 12 months?



Despite the perceived challenges in the market 69% of respondents are confident they will remain compliant with their financial covenants. It is positive to see that 31% are proactively engaging with lenders.

Q8. Which of the following represent the greatest concerns for your sector in the next 12 months?

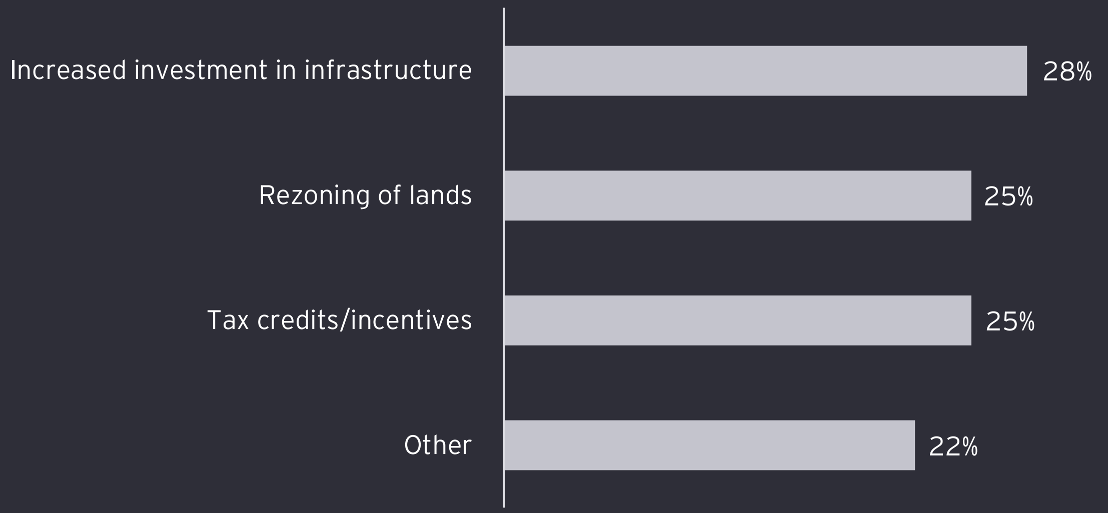


44% of respondents say that rising interest rates represents the greatest concerns for their sector in the next 12 months followed by the scarcity of debt financing at 29%.

> Given the view on asset valuations declining over the next 12 months there may be further pressure on financial covenants however continued early engagement with advisors and lenders is the best approach to arriving at a resolution.

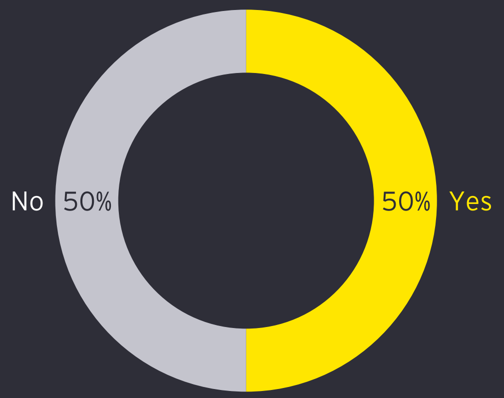
Michael Armstrong
Director, EY Ireland

Q9. What government policy would facilitate the biggest increase in real estate development ?



Views on the government policy which would have the biggest increase in development were evenly spread. The predominant specific feedback was from the residential sector and related to the need to improve & streamline the planning system and improve efficiencies in utilities.

Q10. Do you anticipate investing in distressed debt assets in 2023?



There was a 50/50 split amongst respondents when asked if they intended to invest in distressed assets over the next 12 months.

Conclusion

The respondents from the office sector were particularly concerned about valuation erosion, primarily driven by interest rate rises and sustainability requirements. This is causing real concern in raising new debt, refinancing existing facilities and in some cases leading to breaching of financial covenants. In all of these events early engagement with your advisors and lenders is paramount in order to achieve appropriate terms and conditions.

Residential developers have welcomed the role played by the Land Development Agency ("LDA") and Approved Housing Bodies ("AHB"s) but continue to express concern with the planning process and want improved efficiencies on utilities.

Given current market conditions, the need for a hedging policy and sustainability plan are key components for any debt raise, refinance or restructure in the Real Estate Sector.

Capital & Debt Advisory contact details

As a globally integrated firm with circa 20,000 Real Estate, Hospitality and Construction professionals, EY can access a network with global experience to provide key insights on residential housing transactions from other jurisdictions. EY's Core Senior Real Estate team has strong relationships with active Global Institutional Investors, Approved Housing Bodies, the Land Development Agency and Local Authorities in the Irish market, as well as an extensive understanding of each of their investment appetites.

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If you have any queries about the findings of this report, and their implications for your business, please contact, please contact me or a member of the EY Real Estate Sector Team.

EY Real Estate contact details

We have a wealth of experience advising clients across a range of sectors. Our EY Real Estate team operates as one single team with our various service lines coming together to provide a holistic service offering to our clients in the real estate space.

We specialise in areas across Tax, Law, Strategy and Transactions, Restructuring, Consulting, Debt Advisory and Economics. Our sector approach to real estate allows us to work in an integrated, seamless, and streamlined manner, ensuring that clients experience a true end-to-end service offering when engaging in real estate transactions in Ireland.

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