Market update March 2019

AIB Real Estate Finance

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Irish market continues to perform well

The Irish economy continued to see strong growth in the final quarter of 2018, which in turn supports the Irish residential and commercial property markets. According to the CSO, the monthly unemployment rate for January 2019 was 5.3%, compared with 6.0% in January 2018 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 in Q4 2018 reached €1.1bn across 66 transactions according to JLL, marking a 77% increase on Q3 volumes and an 11% increase on the corresponding period in 2017. The total volumes for 2018 reached €3.6bn, a significant increase on the €2.3bn traded in 2017.

Irish CRE market still seeing positive rental and capital value growth

The MSCI all property total return index increased slightly from the 6.3% seen at the end of Q3, recording an annual increase of 9.1% in the 12 months to December 2018, leaving the index 26% above previous peak levels. However, the composition of growth is very different from the period leading up to 2008, when the total returns was driven by capital growth, compared to today where the driver of returns are more evenly spread between capital, income and rental growth.

Gains in capital and rental values have remained relatively strong, at 4.1 and 2.0 per cent respectively in Q4 on an annualised basis. Irish commercial property capital values have risen by 75% since the bottom of the market in Mid-2013.

Industrial rents seeing a significant slowdown

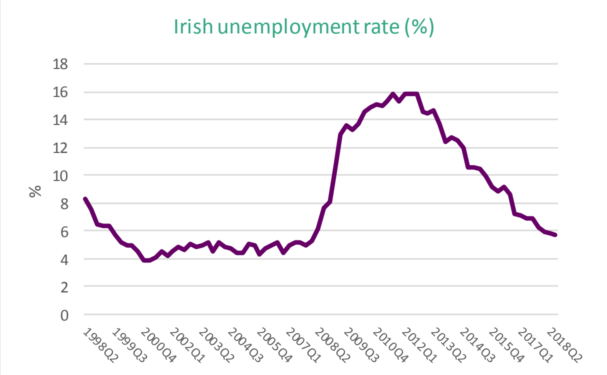
According to CBRE, office take-up in Dublin reached 143,840 sq.m. during Q4 2018, bringing total take-up in the capital in 2018 to a new annual record of 364,057 sq.m. The overall rate of vacancy at the end of Q4 was 6.09%, compared with 7.32% in the previous quarter.

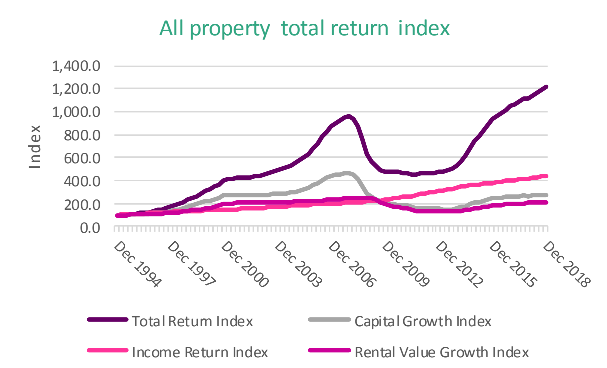
Prime Dublin City centre rents remain at €700 per sq.m, and given the increased level of supply, rents should moderate. In the absence of a large scale influx of investment banks into Ireland due to Brexit, prime rents are expected to peak in 2019 / 2020 at around €70 sq.ft.

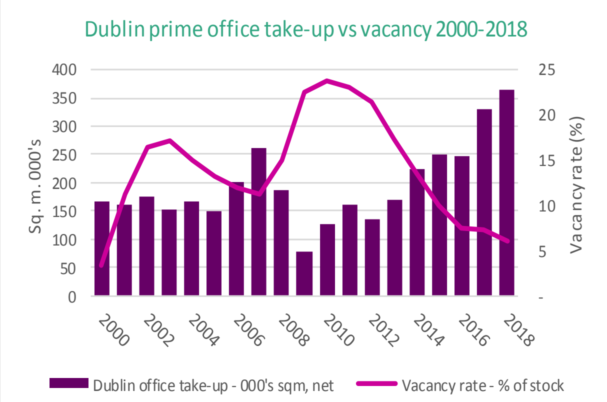
Retail and industrial rents grew by 1.6% and 1.9% respectively in 2018, although there is a notable slowdown particularly in industrial rental growth, which saw an increase of 8.2% in 2017, and 10.6% in 2016.

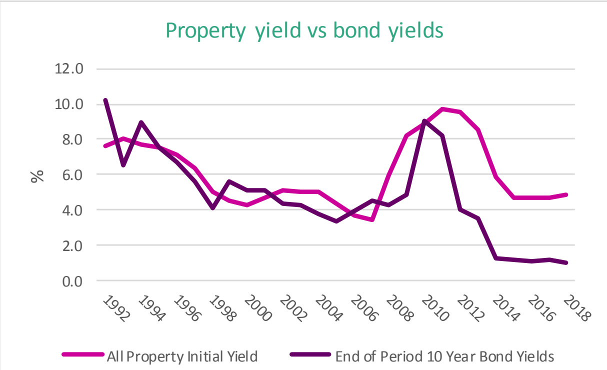
Yields—Substantial spread provides buffer for property values

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.









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Sources: CBRE, CSO, JLL, MSCI, PMA

Retail market – volume of sales still strong, while earnings and consumption continue to grow

The KBC Bank/ESRI Irish consumer sentiment index improved slightly in January as a seasonal Christmas effect and positive job news offset concerns around the increasing possibility of the UK leaving the European Union without a deal. While the index rose to 98.8% from 96.5% in December, it is still well below the 2018 average of 102.5%.

Despite this, retail sales in Ireland have continued to be strong, with the seasonally adjusted volume of retail sales increasing by 3.7% in the year to December, while sales grew in value by 2.3%. In addition, expenditure on personal consumption increased by 2.9% in year on year terms in the third quarter of 2018, although lower than 4.8% in the previous quarter. This is supported by an increase in average earnings, which rose by 3.2% in the year to the end of Q3, and leaves retail in a positive position heading into a year of uncertainty.

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.

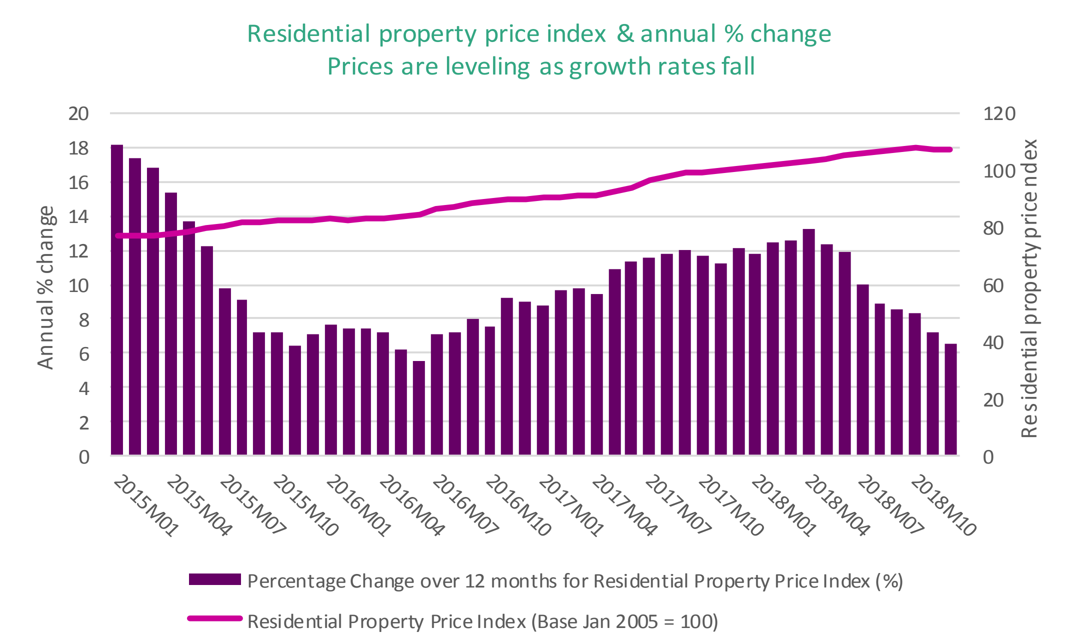
In terms of retail rents, there was an annual increase of 1.6% in Q4 2018 according to MSCI, slightly slower growth than both the office (+1.8%) and industrial (1.9%) sectors. Prime Dublin high street yields stood at 3.15% in Q4, while prime Cork yields remained at 5.00%.

The rate of house price growth has fallen for 8 consecutive months

While house prices nationally are now over 80% above their lowest point, the rate of increase has moderated, with the growth rate falling for eight consecutive months, a result of increasing supply as well as the Central Bank's macroprudential rules. Between May 2017 and July 2018, annual house price inflation was in double figures, peaking at 13.3% in April 2018. Prior to this, house price growth reached 20.4% in late 2014. Since this peak, the rate of house price growth has fallen in each month, with the rate standing at 6.5% in December 2018, the smallest increase since mid-2016.

According to the CSO, there were 18,072 new dwellings completed in 2018, an increase of 25.1% on the 14,446 built in 2017. Scheme houses accounted for 61% of new completions in 2018, while apartments accounted for just 13%. The remaining 26% was made up of one off houses.

There were 12,112 mortgage drawdowns in Q4 2018, valued at €2,635m. This represents an increase of 11.5% in year-on-year terms, bringing the size of the mortgage market to €8.7bn in Q4 2018. Mortgage approvals totalled €10bn in the 12 months of 2018, with a 5.9% volume increase in the year to December.



Future supply

Planning permission was granted for 8,018 housing units in Q3 of 2018, an annual increase of 69% from 6,934 in the same period of 2017. Of these, houses accounted for 60%, while the remaining 40% was made up of planned apartment units.

Increasing supply, along with affordability constraints, should result in a further slowdown in house price growth in 2019.