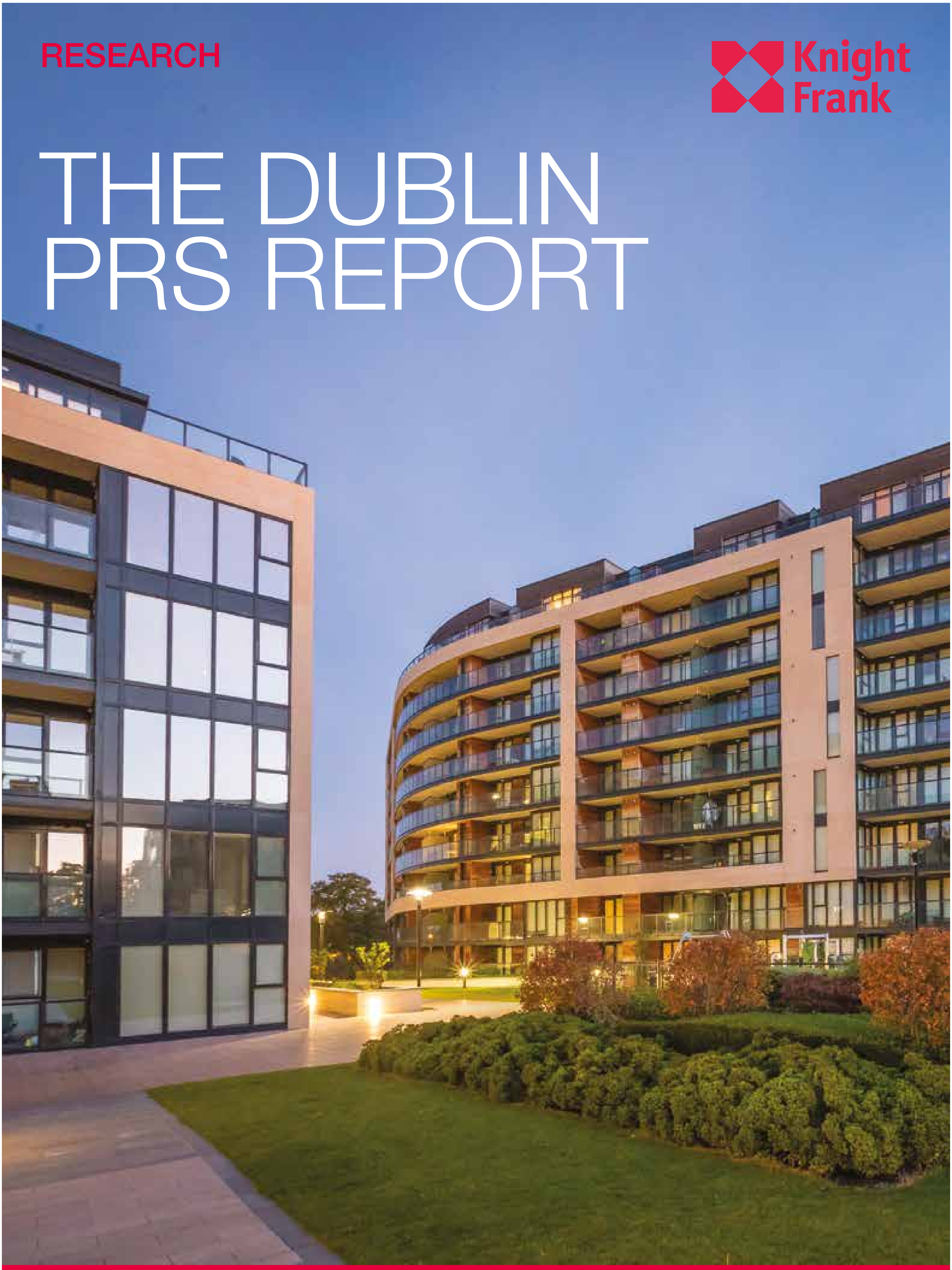
RESEARCH

THE DUBLIN PRS REPORT



TRENDS | ANALYSIS | OUTLOOK

SUMMARY

1. Dublin is witnessing a large increase in investment in the Private Rented Sector

2. The next wave of investment activity will concentrate on Build-to-Rent opportunities

3. There has been a move away from home ownership to PRS, with 60% of under 35's now renting in Dublin

4. Ireland compares very favourably with other European nations regarding PRS market fundamentals

5. New design standards introduced by the Government will help increase the viability of the Build-To-Rent model in Ireland

INTRODUCTION

Investor sentiment towards the Private Rented Sector (PRS) is increasingly positive internationally, with Dublin well-positioned to capitalise on this trend.

The internationalisation of real estate coupled with its segmentation into alternative investment specialisations – student housing, retirement living and PRS – means there is a supply of specialist global capital to deploy to the right markets. The interest in PRS has primarily been driven by pension funds, who are looking to take advantage of the fact that real wages and residential rents are highly correlated – a relationship they use to offset future liabilities. More generally, a wide spectrum of investors are attracted to having an element of PRS in their portfolio as it exhibits unique risk-return characteristics thus offering portfolio diversification benefits. This demand has seen PRS become the second largest asset class in Dublin, with €926.7 million deployed last year. However, the real potential of PRS lies in the Built-to-Rent model. This is where investors fund the developments and hold for the long-term, with an estimated weight of capital of between three to five billion euros chasing these opportunities in Dublin.

The transition from a buy-to-rent to a Build-to-Rent market will be driven by the drying-up of standing investment opportunities coupled with the positive market fundamentals that BTR investors seek. For starters, Dublin is undergoing a population boom, with the population set to increase by 292,400 – or 21.7% – between 2016 and 2040 according to the Economic and Social Research Institute (ESRI).

Furthermore, tighter mortgage underwriting standards has seen bank lending fall to a fifth of the peak in 2006, resulting in a growing cohort of lifetime renters. Finally, there has been a cultural shift in attitudes towards renting in recognition of the flexibility it offers, with this demand particularly strong from the young, internationally mobile professionals working in the tech and finance sectors.

That is not to say that the sector is without its challenges. Despite rents reaching record levels, the costs of construction remain high relative to other European markets, although the Government has recently implemented new design standards to address these challenges.

Furthermore, there is limited public data in relation to management/operational costs on which new entrants to the market can base investment decisions. However, with increased interest and confidence in this space, we see PRS continuing to grow in importance and looks set to play a crucial role in relieving the lack of residential supply that has emerged over the last number of years.

INVESTMENT MARKET ACTIVITY

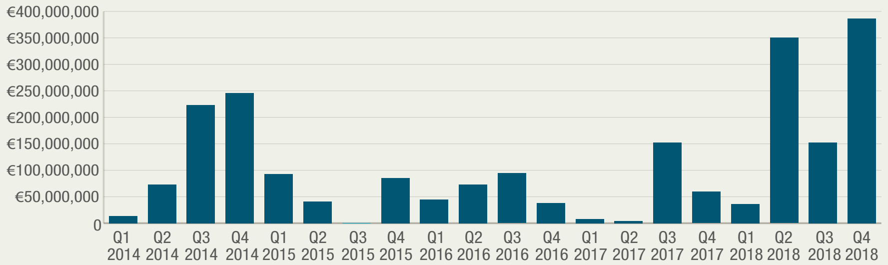
The PRS investment market has got off to a strong start in 2019 with Greystar going sale agreed on 268 apartments at Dublin Landings for €175.5 million.

Activity in 2018 was dominated by schemes that were already under construction such as the purchase of 6 Hanover Quay by Carysfort Capital from Cairn Homes and Irish Life's acquisition of Fernbank in Churchtown from Park Developments. Similarly, Patrizia bought Honeypark from Cosgrave's in Q3 2017 during the construction phase. Interestingly, each of these developments were originally intended for sale on a break-up basis to individual owner-occupiers / investors before being converted to a PRS model.

The sale of The Grange in Stillorgan represented one of the last major disposals by NAMA of its standing residential portfolio. The next stage in the market will see these investors forward commit and forward fund developments directly on a BTR basis.

FIGURE 1

Dublin PRS investment volumes



Source: Knight Frank Research

Selection of recent transactions (arranged by price psf)

Date	Property	Type	Buyer	Units (1-bed/ 2-bed/ 3-bed)	Average price psf	Average price/unit	Est. price €m	Est. net initial yield
Q2 2018	6 Hanover Quay, Dublin 2	New Build	Carysfort Capital	120 (24/74/22)	€807	€841,667	€101	4.00%
Q1 2019	Dublin Landings, Dublin 1	New Build	Greystar	268 (82,146,40)	€740	€654,851	€ 175.5	N/A
Q2 2018	Fernbank, Dundrum, Dublin 14	New Build	Irish Life	261* (56/188/17)	€596*	€523,946*	€138.5	5.00%
Q3 2018	The Grange, Stillorgan, Co Dublin	Existing Stock	Kennedy Wilson	274 (74/175/25)	€539	€459,854	€126	4.37%
Q3 2017	Honeypark, Dún Laoghaire, Co Dublin	New Build	Patrizia	319 (61/197/61)	€449	€413,793	€132	5.44%

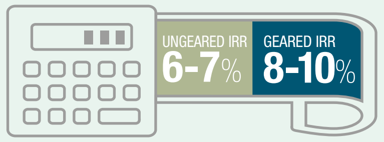
Source: Knight Frank Research

*261 apartments, excluding one listed building on site that must be retained as a single-use dwelling. Estimated valuation adjusted for this.

BUILD-TO-RENT DEAL STRUCTURING

Investor

- PRS investors implement forward funding and forward commitment structures with developers and illustrate a willingness to pay a premium when transacting with well-funded developers
- Funding new BTR stock rather than purchasing existing apartment stock allows greater scope for maximising operational efficiencies as well as future proofing assets
- Net prime entry yields range between 4.00% and 5.00%, with expected returns over a 15 year horizon given below:



Developer

Forward funding

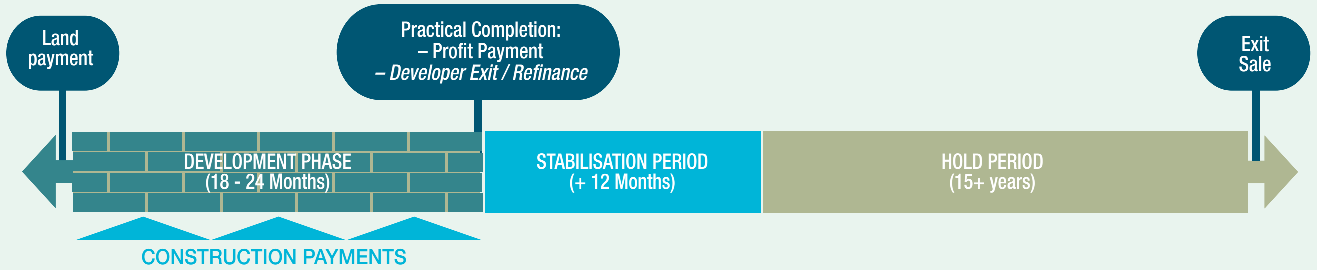
- 100% funding solution with payments staggered as milestones of project reached and covenants satisfied
- Improves Return on Capital Employed (ROCE)
- Stamp Duty savings are possible
- Buyers are institutional investors

Forward commitment

- No up-front funding, fixed price agreed to be paid on practical completion
- De-risked disposal at practical completion
- Stamp Duty on full cost
- Less risky, wider opportunity set of capital available

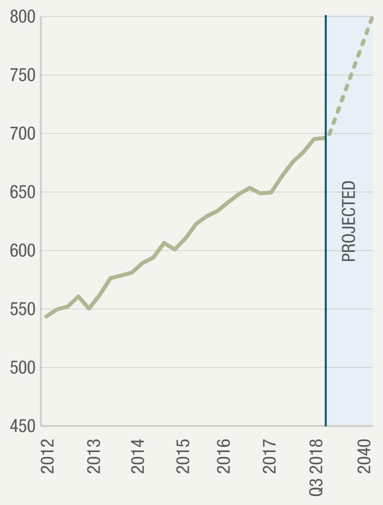
Scheme requirements

- Investment value of between €450 to €800 psf
- Need for scale, ideally with 150 plus units and €50 million plus ticket deal size
- Prime locations or those near good transport links



FUNDAMENTAL DRIVERS

FIGURE 2
Employment Dublin 000's



Source: CSO, ESRI

Economy

According to the ESRI, the Irish economy is expected to have grown by 8.2% in 2018. Growth of this magnitude would make it the fastest growing economy in Europe for a fifth consecutive year. Dublin is the main engine of economic growth and has seen office take-up expand for six consecutive years to set a new record in 2018 with 3.9 million sq ft transacting. The tech sector is the main driver of the market, accounting for 52% of activity in 2018. In fact, Google, Amazon, Facebook, LinkedIn and Microsoft now occupy over 2.2 million sq ft in Dublin and continue to expand at a rapid pace. This growth has led to employment surpassing its pre-crisis peak with 696,200 people employed as of Q3 2018 according to the Central Statistics Office (CSO).
In total, Dublin represents 31% of the national workforce.

Looking ahead, The ESRI is forecasting that 100,000 more jobs will be created in Dublin by 2040, growing employment to 795,900 over the period. In the shorter-term, Brexit adds the potential for job relocations from London with Barclays and JP Morgan among the companies believed to be ramping-up their operations in Dublin.

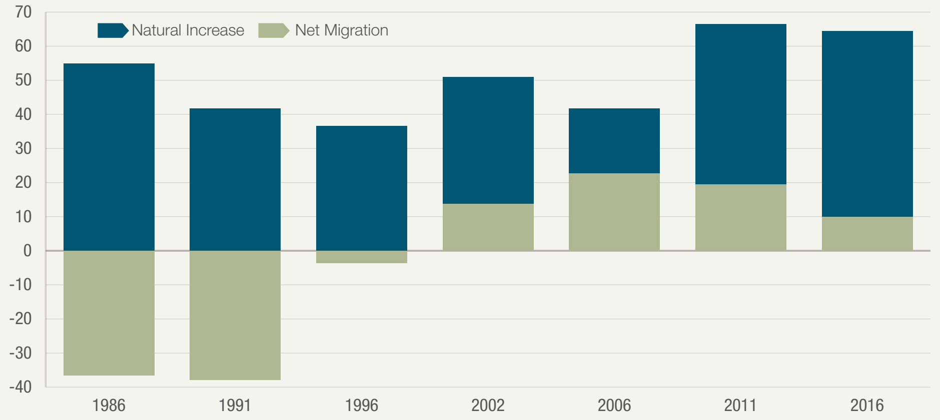
Population

Ireland is experiencing a population boom, providing a natural long-term source of demand for housing. Over the period 1991-2016, the population grew by 35% compared to a growth rate of 7% for the EU as a whole. A high fertility rate in conjunction with low mortality rates has resulted in Ireland's natural population growth being the highest in Europe at 6.6% in 2017, far ahead of the second highest of Cyprus which had an increase of 3.8%.

The high growth rate is set to continue with Eurostat projecting that the population of Ireland will increase by 28.2% to 2080, compared to just 0.6% for the EU-28.

Due to trends in urbanisation, Dublin is set to benefit most from this population growth. According to the UN, 80% of people in Ireland will live in urban areas by 2050, up from 62.7% in 2016. According to the CSO, over 40% of population growth in the coming years will be concentrated in Dublin. Furthermore, the counties surrounding Dublin in the Mid-East region (Meath, Kildare and Wicklow) have the next highest potential accounting for approximately 25% of projected growth. Clearly then, Dublin will be the focal point of future population growth which will underpin long-term demand for housing.

FIGURE 3
Components of Dublin's population change by Census year (in thousands)



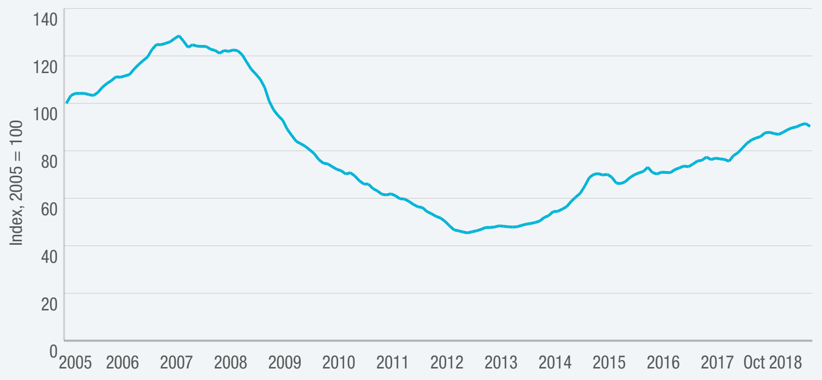
Source: CSO

KEY MARKET INDICATORS

Dublin apartment prices

Apartment prices in Dublin have almost doubled since the bottom of the market in 2012. The latest data also shows that prices grew by 5.7% in the year to October 2018.

FIGURE 4

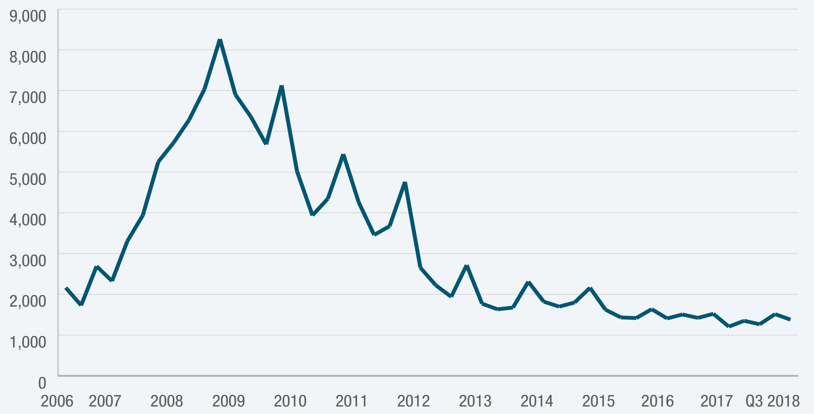


Source: CSO

Dublin properties to rent

Just 1,379 properties were listed as available for rent on Daft.ie at the end of Q3 2018, less than a fifth of the peak of 8,264 recorded in Q2 2009.

FIGURE 5



Source: Daft.ie

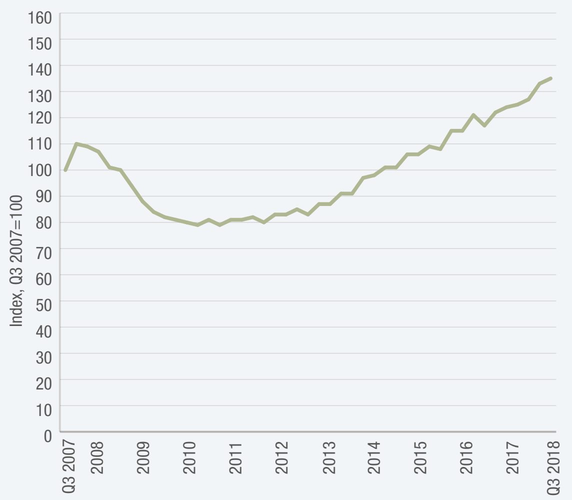
6,632

new units were delivered in the 12 months to Q3 2018

Dublin apartment rents

Dublin rents in Q3 hit their highest level since records began in 2007 and have now increased by 71% since their low point in Q1 2011. Rents have been more stable than prices having fallen by 28% in the aftermath of the financial crisis compared to 65% for prices.

FIGURE 6

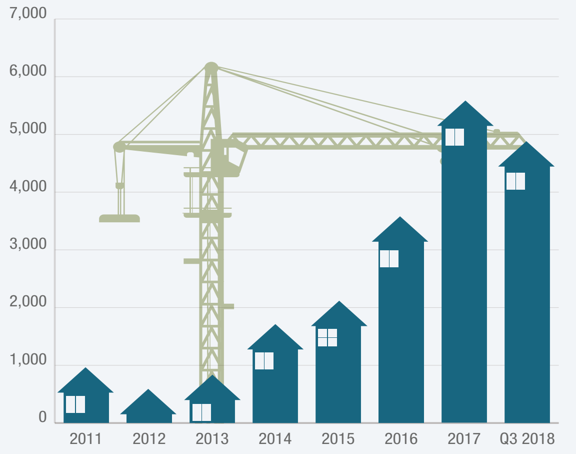


Source: RTB

Dublin new residential delivery

Just 6,632 new residential units have been delivered in Dublin in the 12 months to Q3 2018, representing just over half of the estimated demand. Furthermore, we estimate an immediate need for approximately 33,000 units to account for pent-up demand.

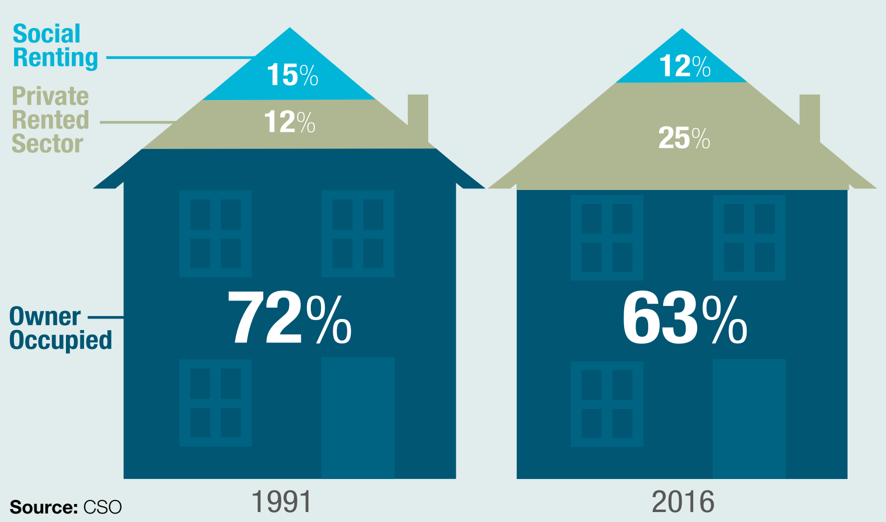
FIGURE 7



Source: CSO

TENURE AND THE AFFORDABILITY GAP

FIGURE 8



Source: CSO

Tenure

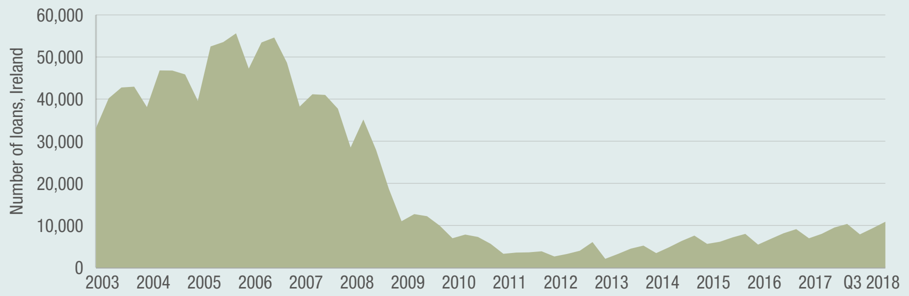
In Ireland, home ownership has traditionally been the aspiration for most people. Increasingly, however, there is an ongoing shift towards renting with 25% doing so in Dublin according to the 2016 Census, over double the 12% recorded in 1991.

Private renting is the most frequent tenure of households under 35 years of age – 60% of this cohort privately rent, while only 14% of over 35's privately rent. However, it should be noted that in absolute numbers these are of similar sizes – there are almost 60,000 who privately rent aged under 35 and there are almost 55,000 households who privately rent aged over 35 years old.

Mortgage drawdowns

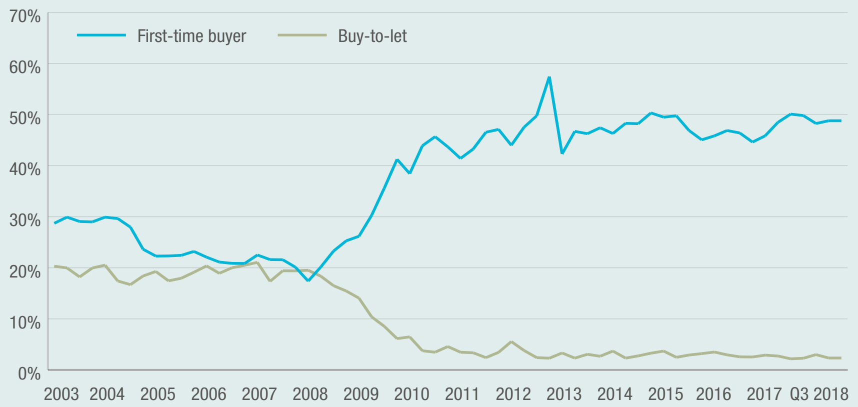
A lack of mortgage financing is channeling households into PRS across all household ages in Dublin. For example, while the number of PRS households in the over 35 age group grew at a rate of 4% per year, the number of outright owners grew at half this rate at only 2%. The number of households who own with a mortgage grew at an even slower rate of 0.4% per annum, illustrating the lack of mortgage financing in the market.

FIGURE 9



Source: BPFI

FIGURE 10



Source: BPFI

Share of mortgage market

Non-professional individual buy-to-let investors have traditionally been the providers of rental accommodation in Ireland. In fact, at one stage during 2008, the BTL share of the mortgage market exceeded the FTB share, which was an indication of the unsustainable credit boom that fuelled the market at the time.

However, these individual investors have been exiting the market due to the onerous tax burden of approximately 50% on rental income. Their exit is an opportunity for professional PRS investors to fill.

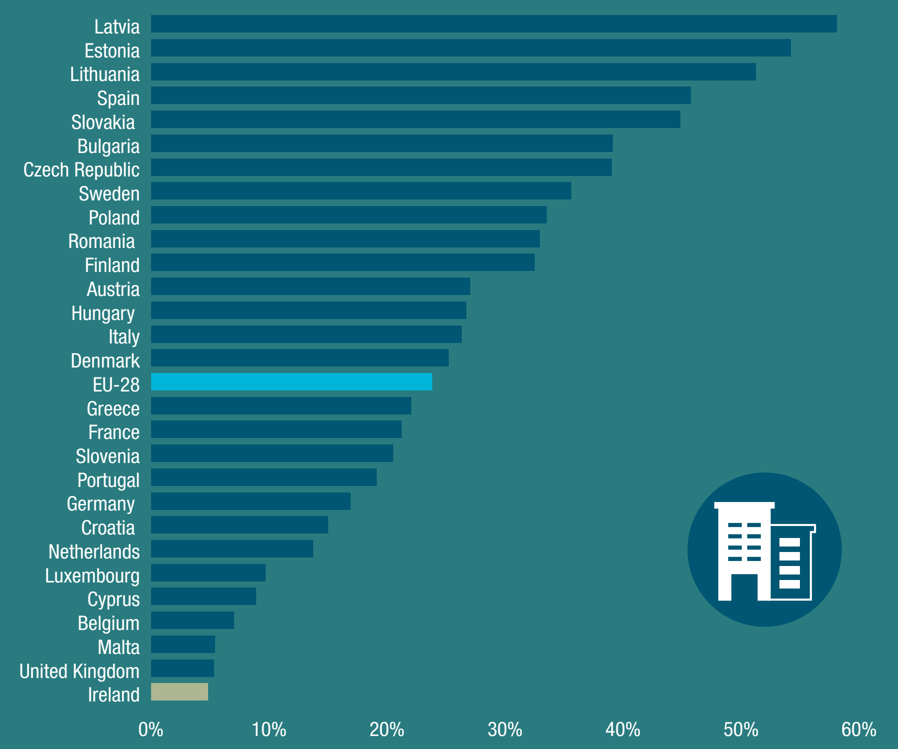
PRS MARKET FUNDAMENTALS:

IRELAND IN A EUROPEAN CONTEXT

	LIVING IN APARTMENTS	RENTING FROM A PRIVATE LANDLORD	PAYING OVERBURDENED RENTAL LEVEL	AVERAGE HOUSEHOLD SIZE	ANNUAL NATURAL POPULATION CHANGE	POPULATION INCREASE TO 2080
IRELAND	4.8%	13.2%	19.6%	2.7	6.6%	28.2%
EU-28	23.8%	19.9%	28.0%	2.3	-0.4%	0.6%

FIGURE 11

Population living in apartments

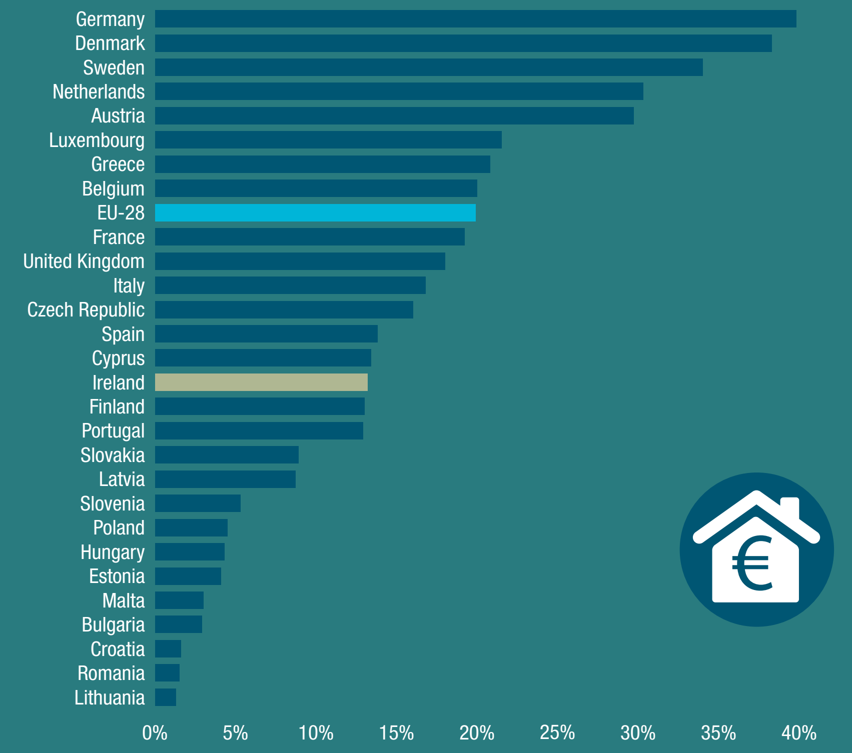


Source: Eurostat, data relating to 2016

Note: Percentage of the population living in a flat in a building with ten or more dwellings

FIGURE 12

Population renting from a private landlord

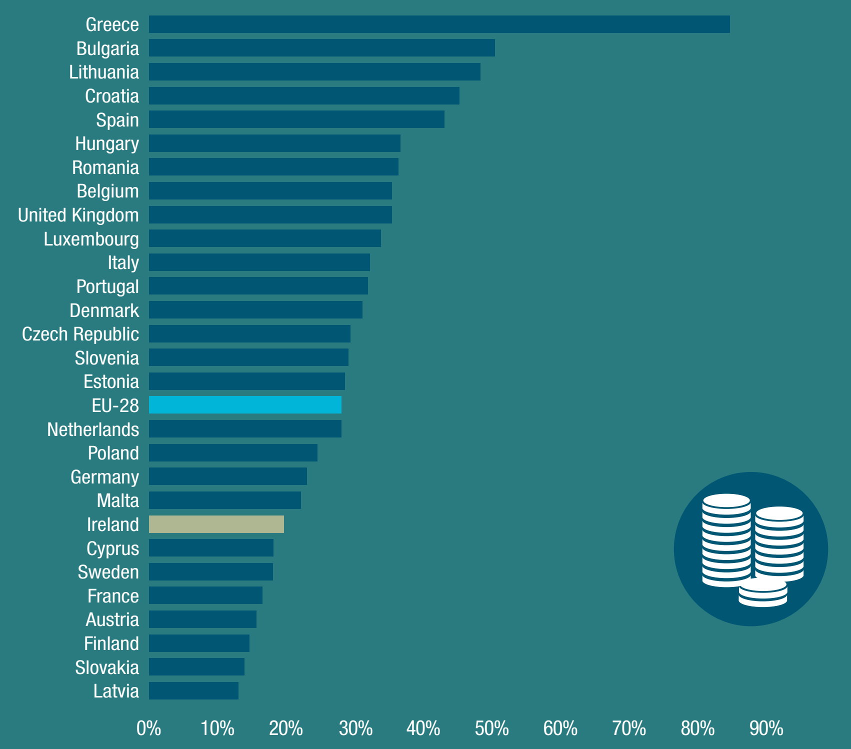


Source: Eurostat, data relating to 2016

Note: Percentage of the population renting at market prices

FIGURE 13

Renting population paying overburdened rental level



Source: Eurostat, data relating to 2016

Note: Percentage of the population living in households spending 40% or more of their equivalised disposable income on housing

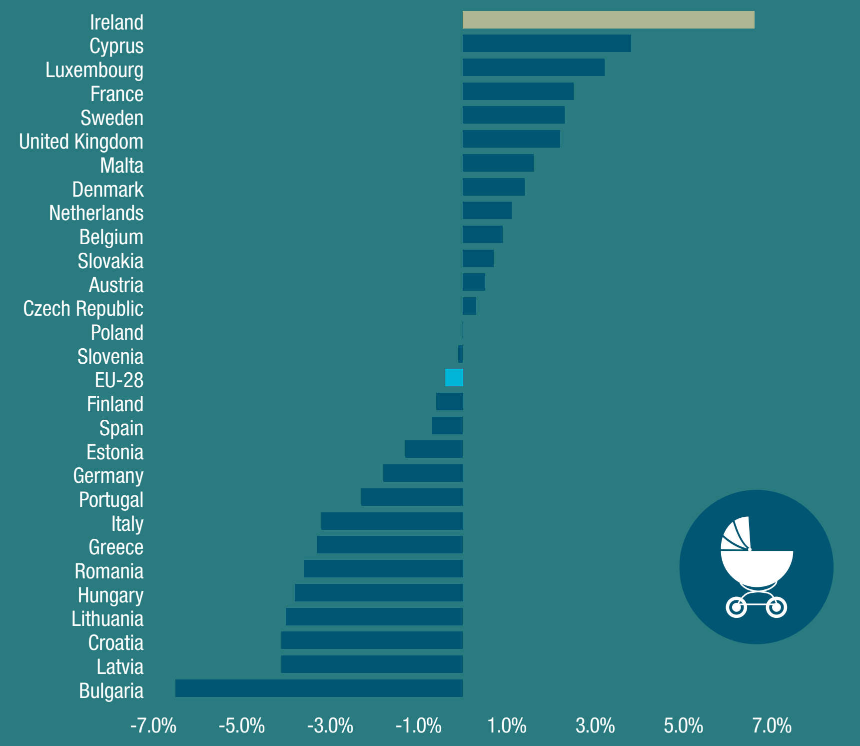
FIGURE 14

Average household size

Source: Eurostat, data relating to 2016

FIGURE 15

Natural population growth

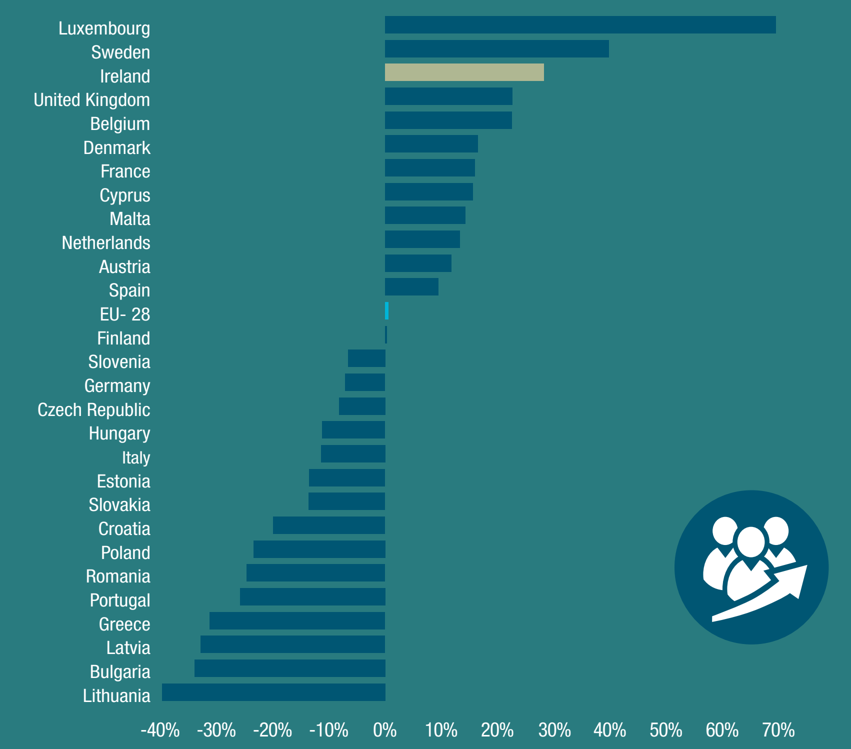


Source: Eurostat, data relating to 2017

Note: The crude rate of natural change is the ratio of the natural change during the year (live births minus deaths) to the average population in that year.

FIGURE 16

Forecast population growth 2020–2080



Source: Eurostat, 2018

NEW DESIGN STANDARDS

The Irish Government introduced a new set of apartment design guidelines – ‘Design Standards for New Apartments – Guidelines for Planning Authorities’ – in 2018 which included measures aimed at boosting construction and investment in PRS as summarised below.

Asset class designation

BTR is now a specific asset class. In order to be classed as BTR, certain covenants must be satisfied such as providing communal and recreational facilities. Perhaps most importantly are the stipulations regarding the holding and disposal of the asset in order to be designated as BTR: ‘the development remains owned and operated by an institutional entity and that this status will continue to apply for a minimum period of not less than 15 years and that similarly no individual residential units are sold or rented separately for that period’.

However, this does not prohibit the selling of the entire scheme to another institutional investor during this time.

Dwelling mix

There is no dwelling mix requirement for a BTR scheme under the new guidelines. This means that an entire scheme could theoretically be comprised of studios or one-bed units, although operators would generally prefer some mix of unit sizes.

Unit sizes

Studios are included at a minimum size of 37 sq m. In addition, a new category of 2-bedroom apartment has been introduced. While previously 2-bedroom apartments could only be designed for four people habitation with a minimum size of 73 sq m, the new standards introduce a 2-bed standard for three people at a reduced size of 63 sq m. Also, the requirement that the majority of all apartments in a proposed scheme exceed the minimum floor area standards by a minimum of 10% does not apply to BTR schemes.

Shared Accommodation is now permissible with minimum floor areas of 12 sq m for single rooms and 18 sq m for double or twin rooms.

Dual aspect ratios

The dual aspect requirement for centrally located schemes has been reduced to 33% from 50%, with the 50% requirement remaining for intermediate and peripheral locations.

Floor-to-ceiling heights

Minimum floor to ceiling heights remain at 2.4m (2.7m at ground) but a floor to ceiling height of 2.7m throughout is encouraged in locations where greater height is appropriate. There is no maximum number of permissible units per floor per core for BTR schemes.

Car parking

BTR schemes have a default of ‘minimal or significantly reduced car parking provision on the basis that BTR development is centrally located and/or close to public transport services.’

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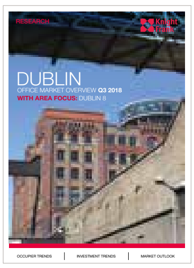

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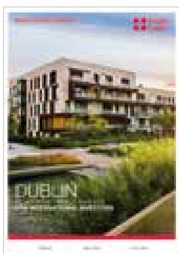

Dublin Residential Market Analysis for International Investors

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