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. Design standards introduced by the Government in 2018 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. 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 United Nation's forecasting that it will be the fastest growing of any of the 162 cites in Europe with a population greater than 300,000 people between now and 2035, undergoing an expected expansion of 18% over the period.

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 introduced a set of 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.

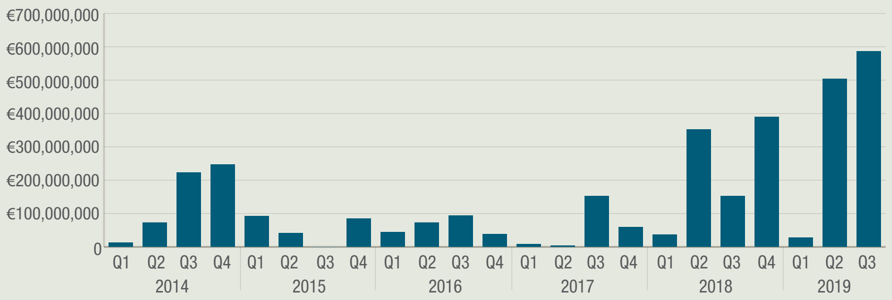
INVESTMENT MARKET ACTIVITY

Institutional investment in Dublin's PRS market is growing rapidly with allocations to the sector expected to reach €1.5 billion in 2019, which would represent an increase of 61% on 2018 and 570% compared to 2017.

There is a wide variety of capital sources active in the market, with Irish, European and United States funds all competing for acquisitions. German fund Patrizia have been particularly active, purchasing both The Benson Building and Mount Argus for €52.5 million and €93.0 million respectively. Meanwhile, Greystar bought Dublin Landings for €175.5 million, which represented the largest single asset transaction witnessed thus far in the PRS market.

Prime yields have been firmly established at 4.00% with a number of transactions providing evidence at this level, although we may see further tightening as the ECB embarks on another round of quantitative easing which will put further downward pressure on yields.

FIGURE 1
Dublin PRS investment volumes



Source: Knight Frank Research

Selection of recent transactions (arranged by price psf)

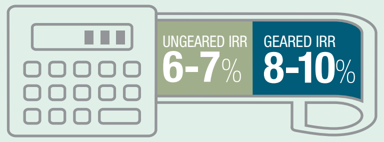
Date	Property	Type	Buyer	Units (1-bed/2-bed /3-bed)	Average price psf	Average price/unit	Est. price millions	Est. net yield
Q3 2019	The Benson Building, Dublin 2	New Build	Patrizia	72 (14/43/15)	€€821	€€729,167	€52.50	3.95%
Q2 2018	6 Hanover Quay, Dublin 2	New Build	Carysfort Capital	120 (24/74/22)	€€807	€€841,667	€€101.00	4.00%
Q3 2019	Dublin Landings, Dublin 1	New Build	Greystar	268 (82/146/40)	€€740	€€654,851	€€175.50	4.00%
Q2 2018	Fernbank, Dundrum, Dublin 14	New Build	Irish Life	261* (56/188/17)	€€596	€€523,946	€€138.50	4.00%
Q3 2019	Mount Argus, Harold's Cross, Dublin 6	New Build	Patrizia	179 (25/128/26)	N/A	€€519,553	€€93.00	4.00%
Q3 2018	The Grange, Stillorgan, Co. Dublin	Existing Stock	Kennedy Wilson	274 (74/175/25)	€€539	€€459,854	€€126.00	3.70%

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

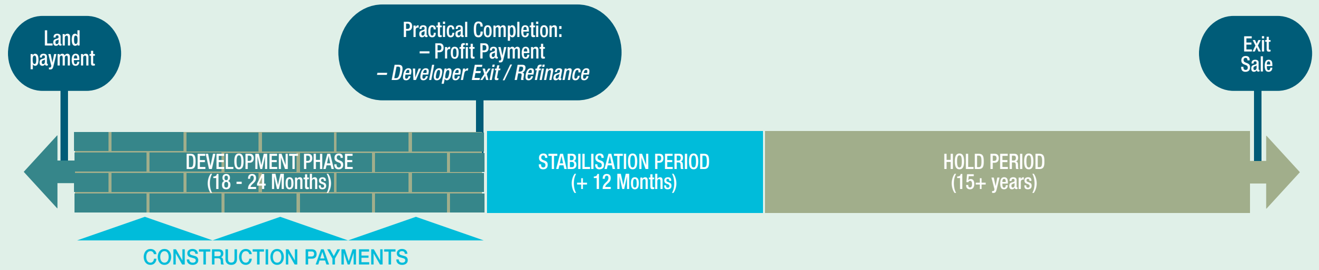
- 100% funding solution with payments staggered as milestones of project reached and covenants satisfied
- Improves Return on Capital Employed (ROCE)
- Stamp Duty savings are possible
- Buyers are institutional investors

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

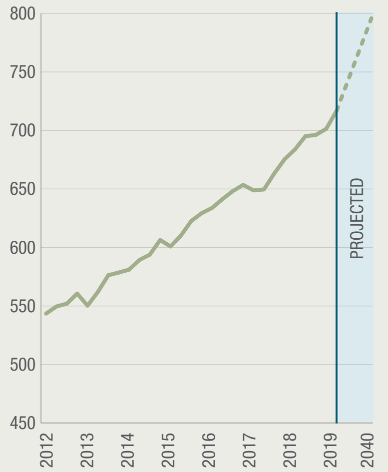
Scheme requirements

- 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 in Dublin 000's



Source: CSO, ESRI

Economy

The Irish economy has been the fastest growing economy in Europe for the last five years. 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. Though it may not quite reach these heights, 2019 is on course to be another very strong year for the Dublin office market. The tech sector is the main driver of the market, accounting for 46% of activity over the last five years. In fact, Google, Amazon, Facebook, LinkedIn and Microsoft have a total office footprint of 2.3 million sq ft in Dublin, ahead of the 2.2 million sq ft these companies collectively occupy in London.

This growth has led to employment surpassing its pre-crisis peak with 716,700 people now employed in Dublin according to the Central Statistics Office (CSO), a figure which is expected to rise to 795,900 by 2040 according to the ESRI. In addition, Dublin is well-hedged against Brexit, with our research showing that Dublin is the leading European city for Brexit-related office moves having received 86 announcements, ahead of Luxembourg (55), Paris (47), Amsterdam (47) and Frankfurt (41).

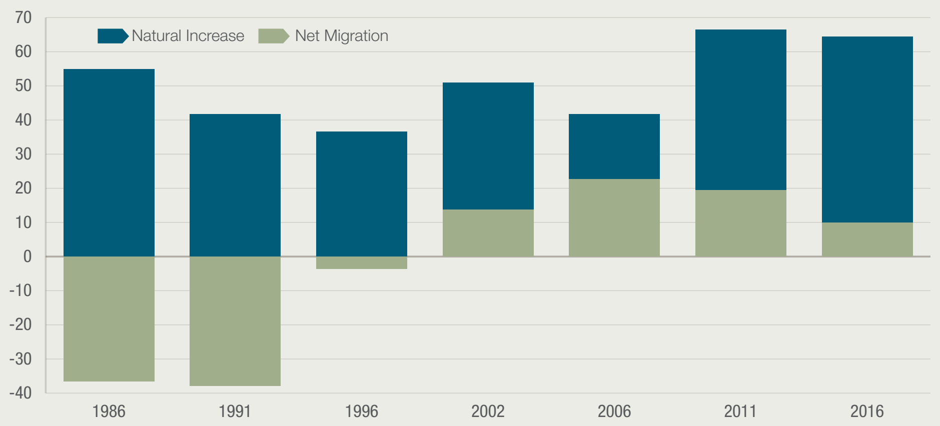
Population

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 6.1% in 2018, far ahead of the next highest of Cyprus which had an increase of 4.1%.

The high growth rate is set to continue with Eurostat forecasting that the population of Ireland will increase by 25.8% between 2020 and 2080, which compares with a -2.0% projection for the EU-28.

Due to trends in urbanisation, Dublin is set to benefit most from this population growth. According to the United Nations, 75% of people in Ireland will live in urban areas by 2050, up from just over 60% currently. Taking an average of population distribution scenarios produced by the CSO, 38% of growth will be concentrated in Dublin in the coming years. Furthermore, the commuter belt counties comprising the Mid-East region (Meath, Kildare, Wicklow) have the next highest potential accounting for 26% 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)



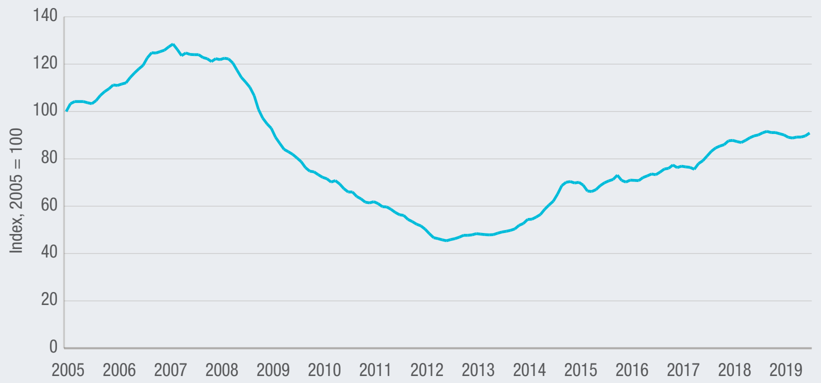
Source: CSO

KEY MARKET INDICATORS

Dublin apartment prices

Dublin apartment prices have doubled since the bottom of the market in 2012, however they remain 29% below their previous peak.

FIGURE 4

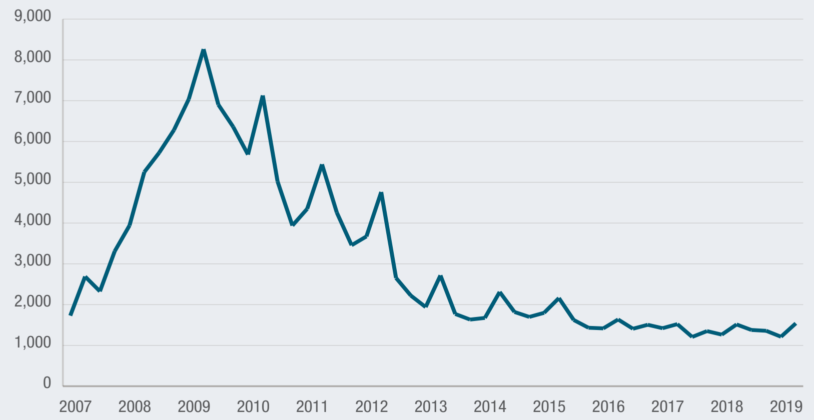


Source: CSO

Dublin properties to rent

The number of properties listed as available for rent on Daft.ie is less than a fifth of the peak of 8,264 recorded in Q2 2009.

FIGURE 5



Source: Daft.ie

8,000

new units will be delivered in Dublin in 2019

Dublin apartment rents

Apartment rents in Dublin have hit their highest level since records began in 2007. Rents have been more stable than prices having fallen by 28% in the aftermath of the financial crisis compared to 65% for prices.

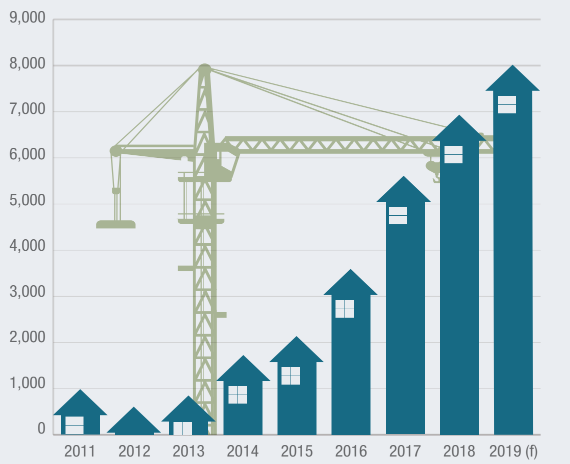
FIGURE 6

Source: RTB

Dublin new residential delivery

Although output has been rising in Dublin during the last number of years – growing from 964 units at the bottom of the market in 2011 to a forecast 8,000 units for 2019 – completion levels have remained consistently below the required annual demand of 11,000 units as identified by our research.

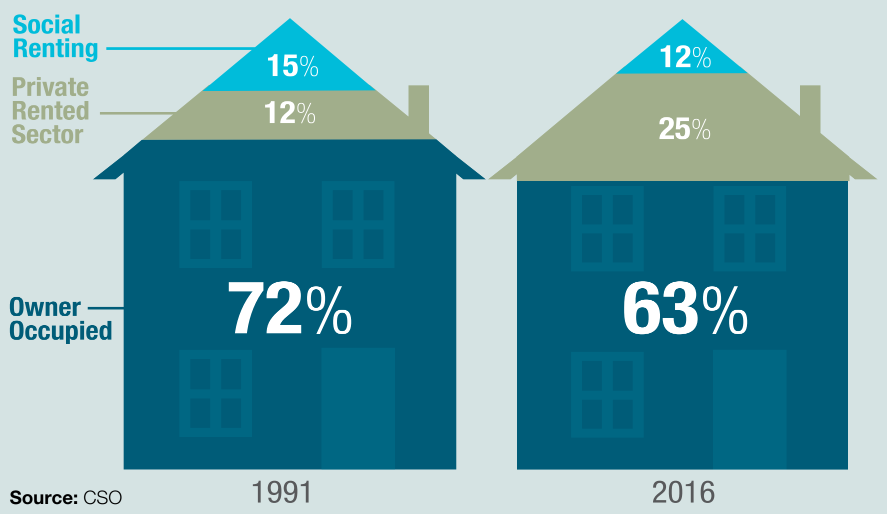
FIGURE 7



Source: CSO

TENURE AND THE AFFORDABILITY GAP

FIGURE 8



Source: CSO

Tenure

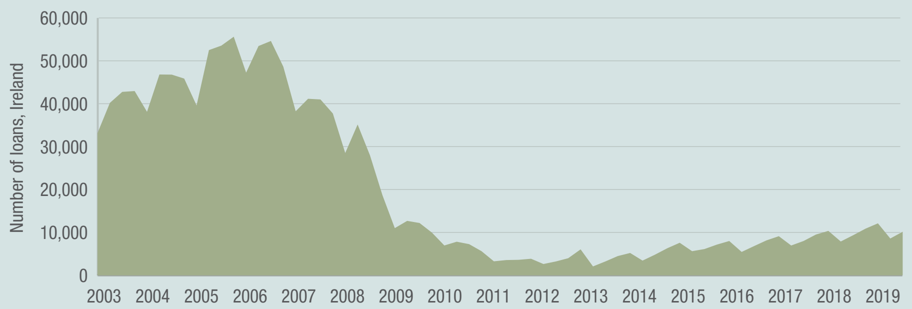
In Ireland, home ownership has traditionally been the aspiration for most people. Increasingly, however, there is an ongoing shift towards renting with 25% doing so in Dublin according to the 2016 Census, over double the 12% recorded in 1991.

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

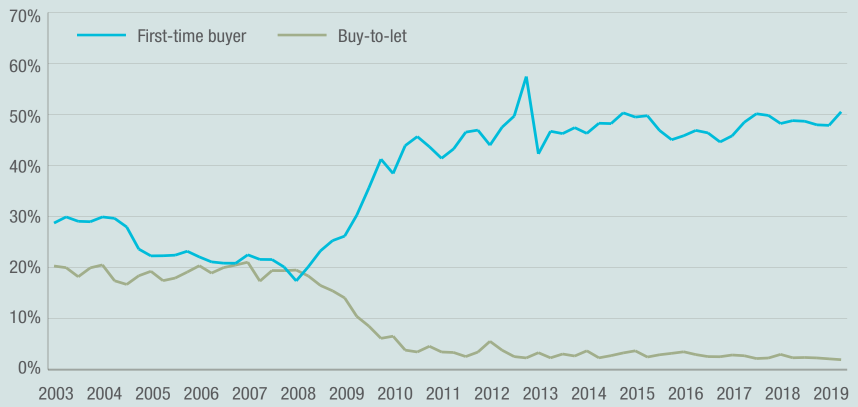
A lack of mortgage financing is channeling households into PRS across all household ages in Dublin. For example, the number of PRS households in the over 35 age group grew at a rate of 4% per year, the number of outright owners grew at half this rate at only 2%. The number of households who own with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

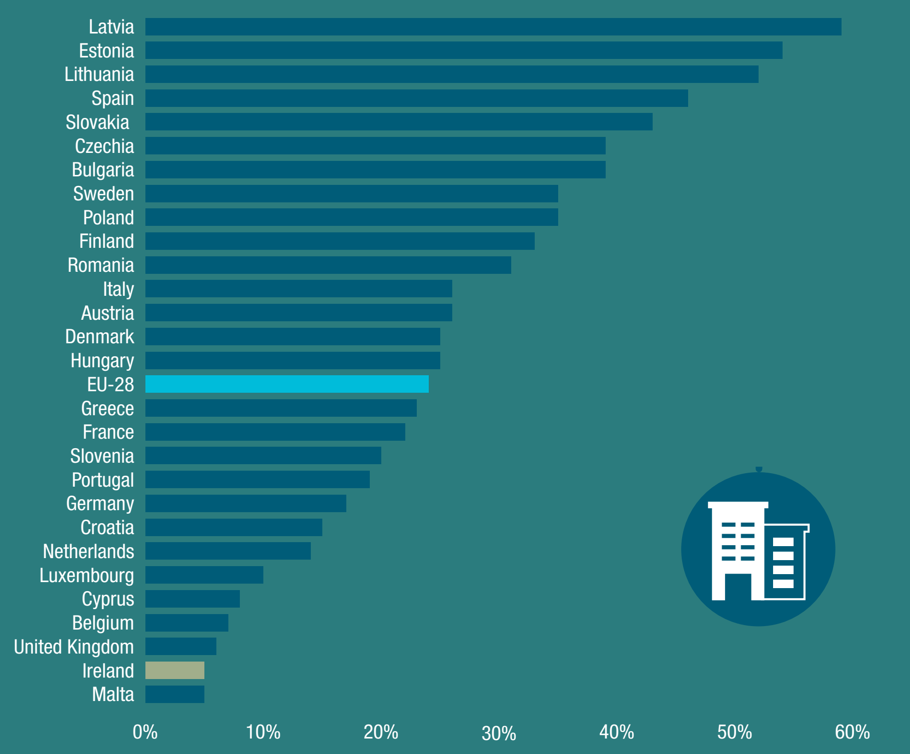
However, these individual investors have been exiting the market due to the onerous tax burden of approximately 50% on rental income. Their exit is an opportunity for professional PRS investors to fill.

PRS MARKET FUNDAMENTALS:
IRELAND IN A EUROPEAN CONTEXT

IRELAND

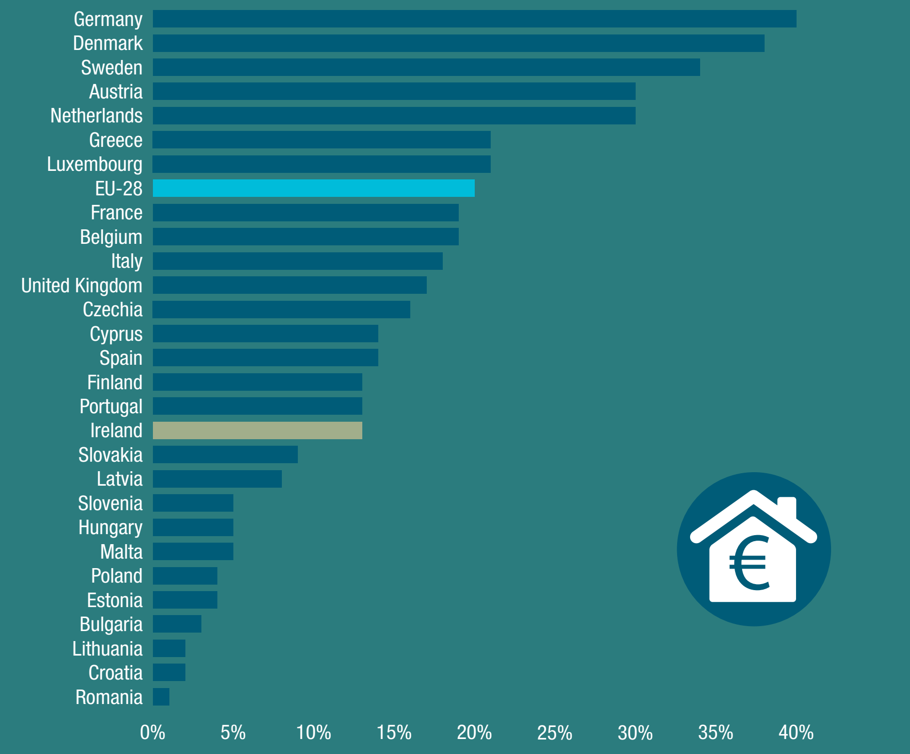
	LIVING IN APARTMENTS	RENTING FROM A PRIVATE LANDLORD	PAYING OVERBURDENED RENTAL LEVEL	AVERAGE HOUSEHOLD SIZE	ANNUAL NATURAL POPULATION CHANGE	POPULATION INCREASE TO 2080
IRELAND	5.4%	12.5%	21.5%	2.6	6.1%	25.8%
EU-28	23.9%	20.0%	26.3%	2.3	-0.7%	-2.0%

FIGURE 11
Population living in apartments



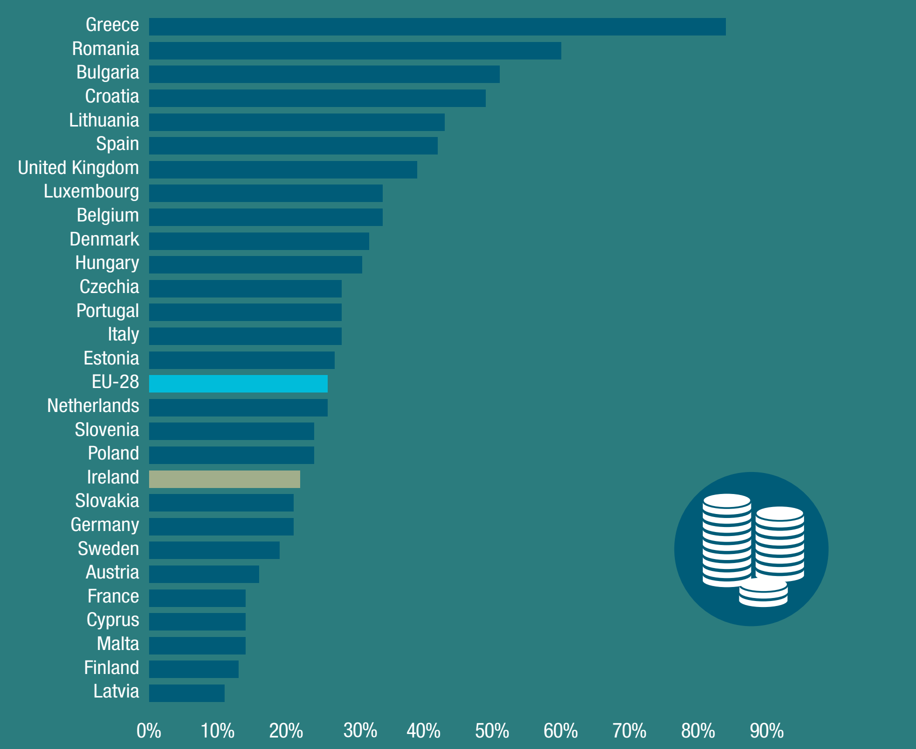
Source: Eurostat, data relating to 2017
Note: Percentage of the population living in a flat in a building with ten or more dwellings

FIGURE 12
Population renting from a private landlord



Source: Eurostat, data relating to 2017
Note: Percentage of the population renting at market prices

FIGURE 13
Renting population paying overburdened rental level

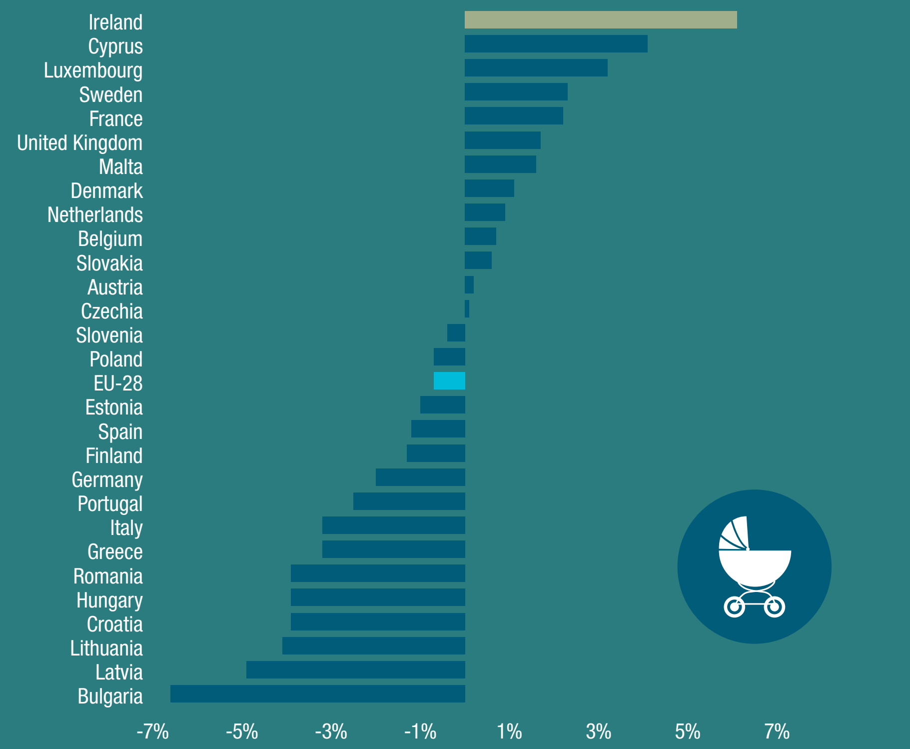


Source: Eurostat, data relating to 2017
Note: Percentage of the population living in households spending 40% or more of their equivalised disposable income on housing

FIGURE 14
Average household size

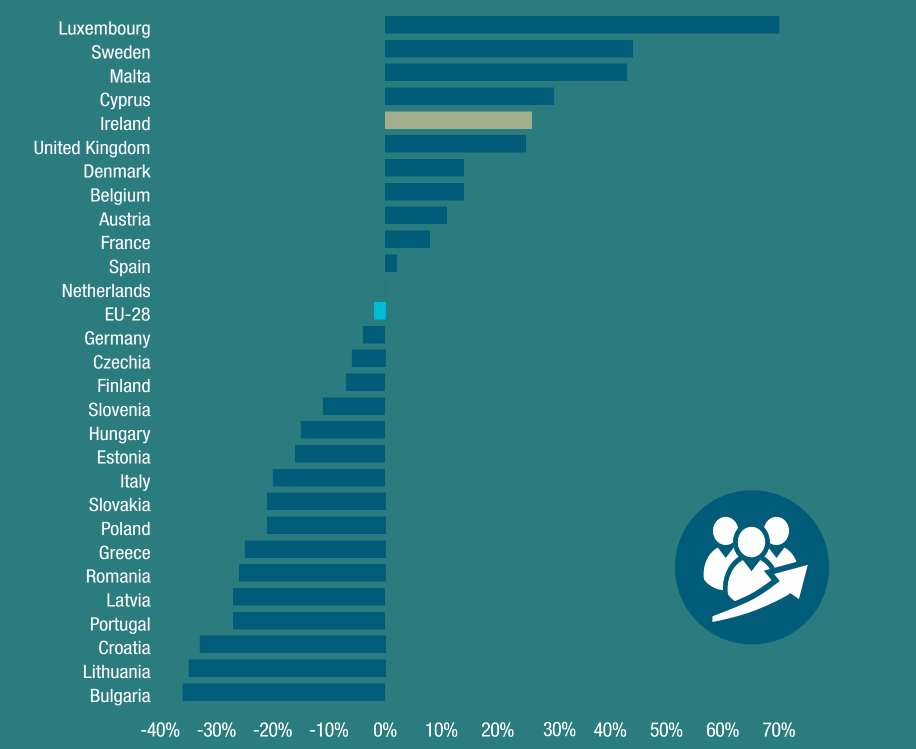
Source: Eurostat, data relating to 2018

FIGURE 15
Natural population growth



Source: Eurostat, data relating to 2018
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, 2019

DESIGN STANDARDS

The Irish Government introduced a 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.

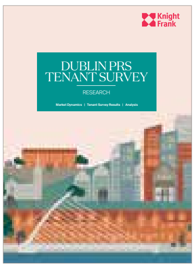
Floor-to-ceiling heights

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.

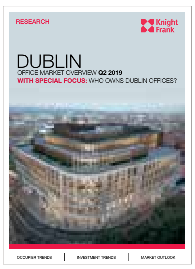
Car parking

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.'

RECENT MARKET-LEADING RESEARCH PUBLICATIONS



Dublin PRS Tenant Survey



Dublin Office Market Overview

Dublin Residential Market Analysis for International Investors

Under Pressure #2

Knight Frank Research Reports are available at **KnightFrank.com/Research**

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