KPMG

Irish Real Estate Lending Survey

August 2023

Introduction

We are pleased to present the KPMG Ireland 2023 Real Estate Lending Survey. This report provides insights on the Irish real estate lending market, including:

- Sentiment for financing in the real estate sector in Ireland;
- Respondents' lending preferences;
- Market metrics; and
- Respondents' expectations for Irish real estate lending.

The survey was carried out through April and May 2023, nine months into the ECB rate rising programme. Across the euro area, inflation is now at 6.1 per cent, down from a peak of 10.6 per cent in October 2022. According to a flash estimate by the CSO in May 2023, Ireland's inflation is now down to 5.4 per cent, down from 9.6 per cent last summer. Wholesale prices for construction products peaked in 2022 with a 15.5 per cent increase the 12 months to January 2023. Price inflation for wholesale construction products has now begun to decline, reported at 9.1 per cent in the 12 months since May 2022.

Lenders and borrowers continue to negotiate the challenges of market volatility, rising inflation, interest rate rises and upward yield pressure. In spite of these challenges, lenders remain positive about the Irish real estate sector with all survey participants expecting their real estate lending exposure to either grow or at the very least remain the same. In particular, and against a backdrop of pent-up demand in the housing market, appetite continues to be strongest for residential development in Dublin and surrounding counties.

The Irish real estate lending market has experienced significant fluctuations in recent years, shaping its landscape. As we progress through 2023, the market presents new opportunities and challenges for both lenders and borrowers. This report aims to provide an analysis of the current state of real estate lending in Ireland, shedding light on the prevailing trends and identifying the key challenges. We would like to take this opportunity to thank all of those who participated in this survey. Their cooperation was key to the success of this report.

Hazel Cryan
Partner, Corporate Finance

T: +353 87 050 4440
E: hazel.cryan@kpmg.ie

Contents

This report provides insights on the Irish Real Estate Lending Landscape across the following subsections:

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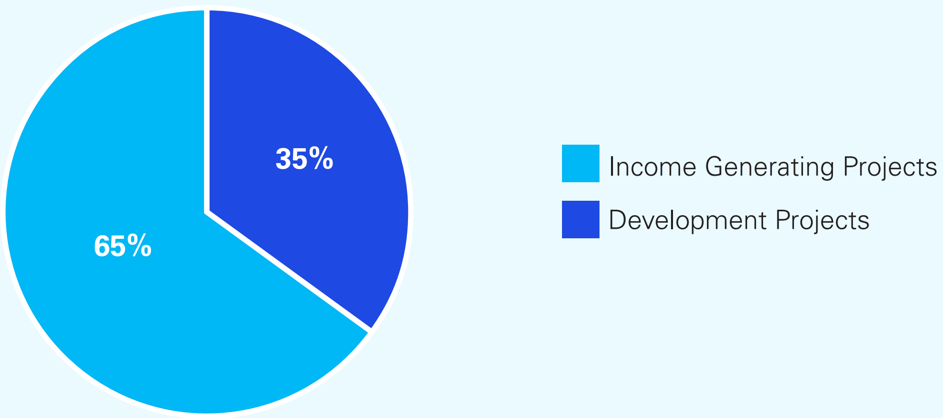
Lending Appetite

How would you divide the total volume of real estate loans provided by your financial institution during the **last 12-18 months** between the following two categories?

Volume of Real Estate Lending in Ireland over the last 12 -18 months



In order of preference what priority would you give to the following real estate projects in the **next 12-18 months?**

Real Estate Asset Class Preference

1. Residential
2. Industrial/ Logistics
3. Hotel/Resort
4. Office
5. Retail
6. Other

02

Development Lending

Lenders provided their view on leverage appetite and other credit metrics in the context of development lending.

Loan to Cost

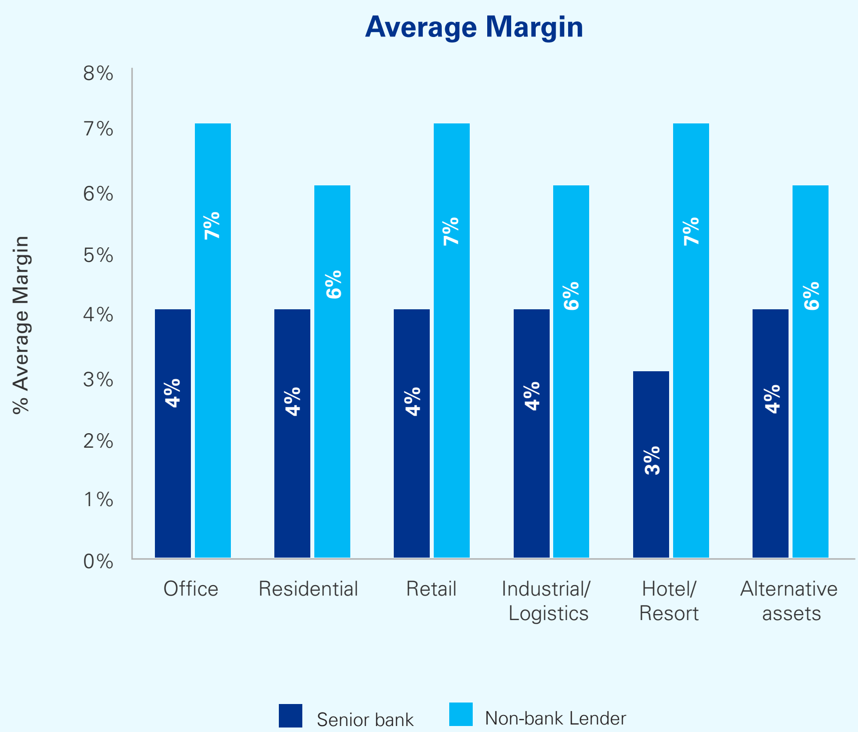
The below table reflects a consistency in credit appetite for asset classes considered to carry less risk in the current macroeconomic climate whilst also highlighting the diverging credit appetite for those asset classes more exposed to current market volatility.

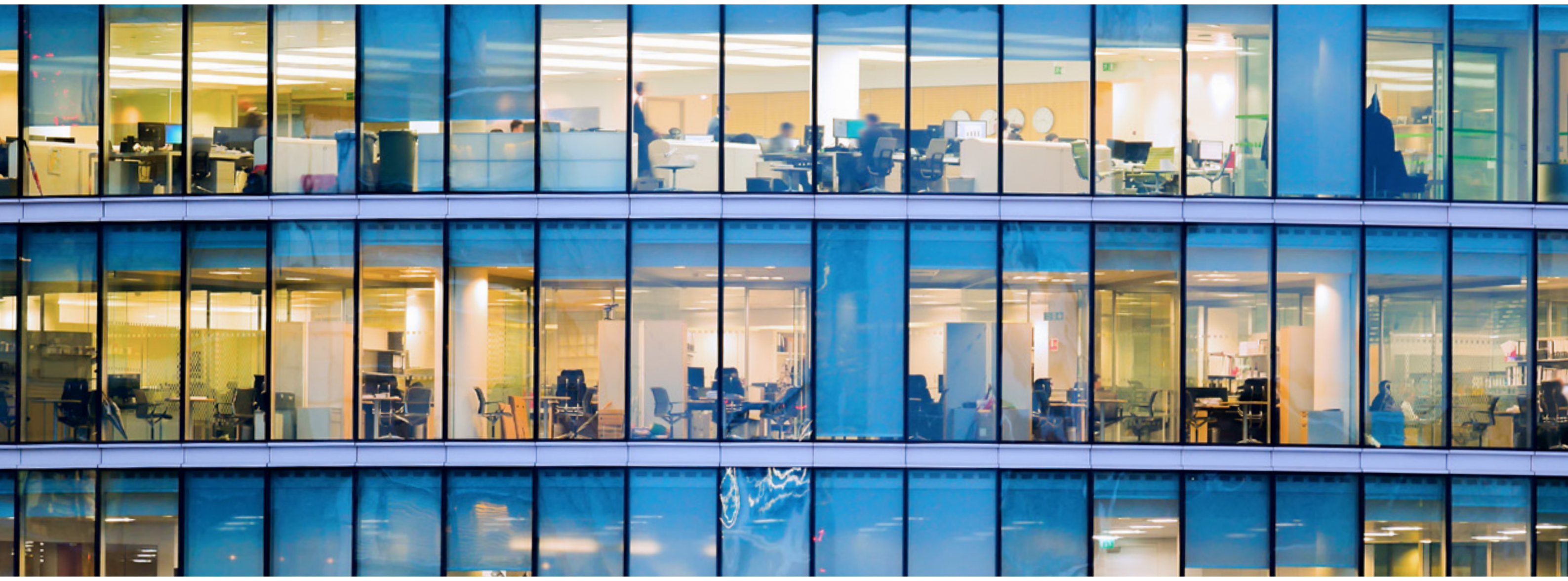
Asset Class	Senior Bank		Non-bank Lender	
	% of Responses	Loan to Cost	% of Responses	Loan to Cost
Office	100%	Up to 49%	37% 9% 9% 36% 9%	Would not finance Below 40% Up to 59% Up to 69% Up to 79%
Residential	50% 50%	Up to 59% Up to 69%	9% 9% 18% 55% 9%	Would not finance Up to 59% Up to 69% Up to 79% Over 80%
Retail	25% 25% 50%	Would not finance Up to 49% Up to 59%	64% 18% 9% 9%	Would not finance Up to 49% Up to 59% Up to 79%
Industrial/ Logistics	25% 25% 50%	Up to 49% Up to 59% Up to 69%	37% 18% 27% 18%	Would not finance Up to 59% Up to 69% Up to 79%
Hotel/ Resort	25% 75%	Would not finance Up to 59%	37% 9% 18% 27% 9%	Would not finance Up to 49% Up to 59% Up to 69% Up to 79%
Alternative assets	50% 50%	Up to 59% Up to 69%	19% 9% 36% 36%	Would not finance Up to 59% Up to 69% Up to 79%

02

Development Finance Pricing

Based on the foregoing LTCs and pre-lets the below graph represents average pricing (above a 3-month Euribor) for each of the asset classes across the lender categories.

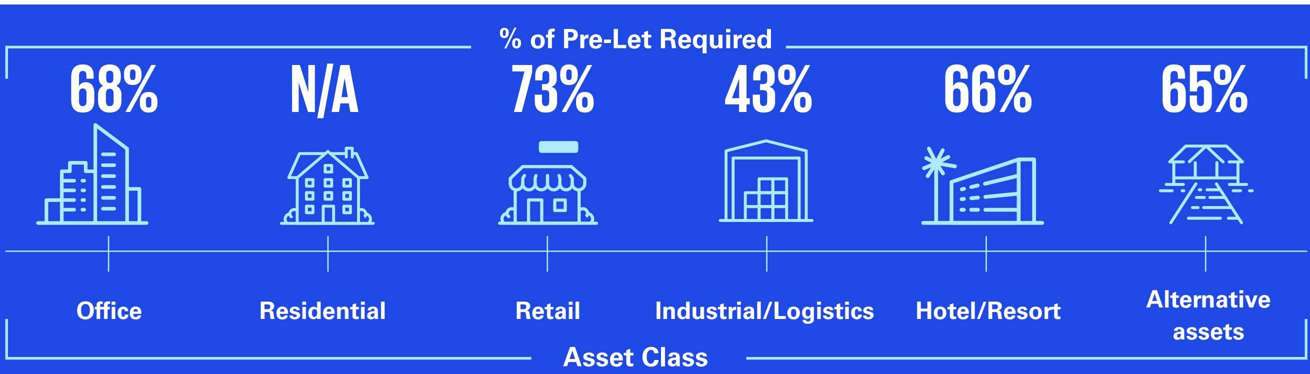




02

Pre-Let

When deploying development finance in a non-residential context, lenders, typically have a preference for a level of pre-let. The survey shows pre-lets increasing in line with the heightened cash flow risk associated with asset classes in the current environment.

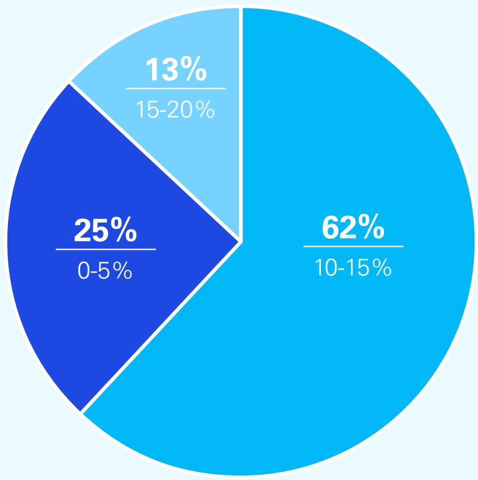


Cost Over-Run Facility

Lenders and borrowers surveyed where asked, what level of recourse guarantee (as a percentage of the development budget) would they expect to form part of the facility agreement covering cost overruns.

The level of cost over-run facilities required by lenders varied across lenders, with the majority requiring **greater than 10%.**

Level of Cost Over-Run Facility

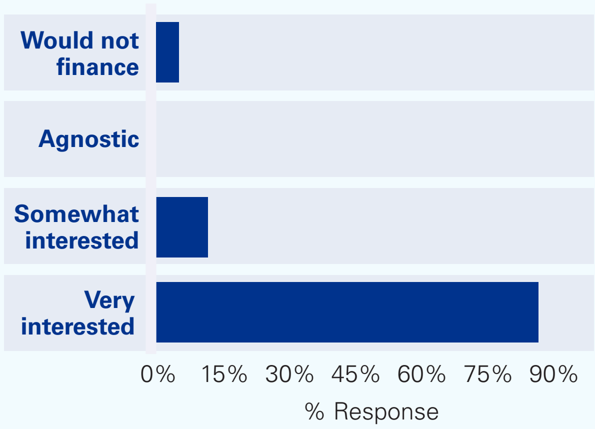


Lender appetite by location type

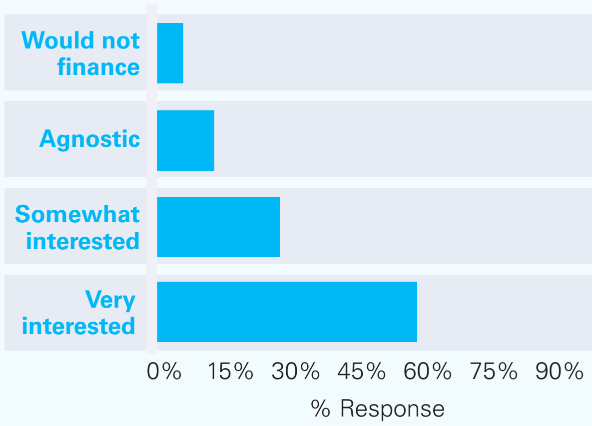
Lenders indicated a strong appetite for residential development lending, particularly in Dublin, surrounding areas and regional cities.

Residential

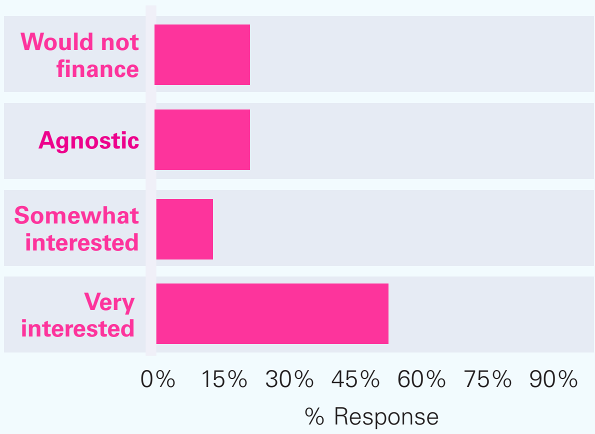
Residential Development - Dublin Prime



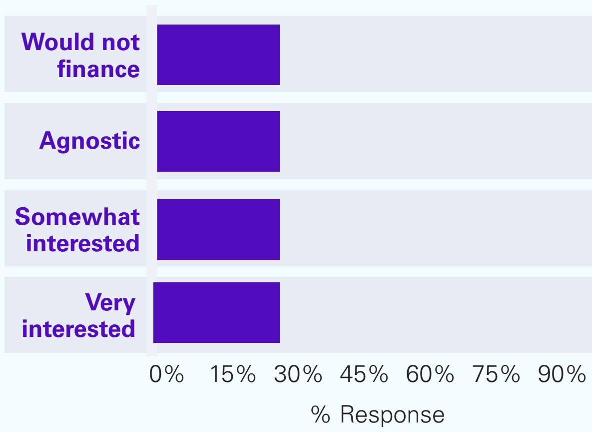
Residential Development - Dublin Other



Residential Development - Regional Cities

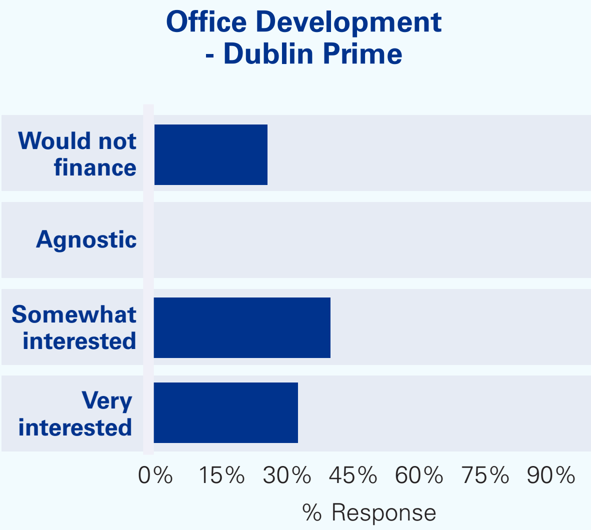


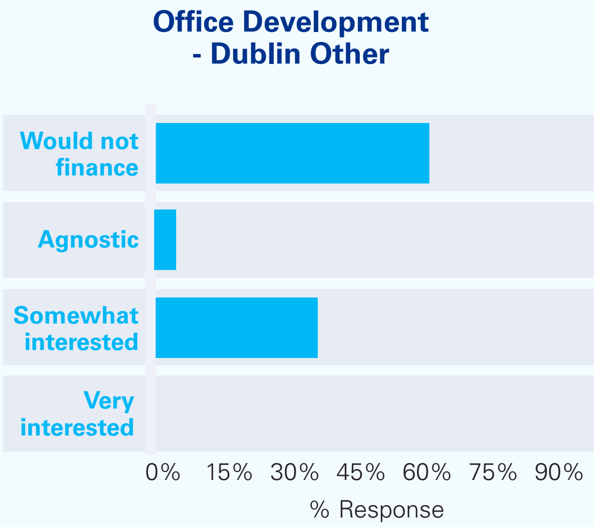
Residential Development - Tertiary Centres

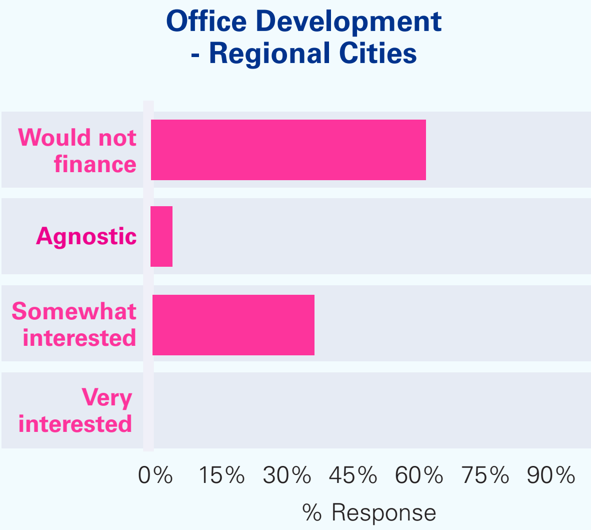


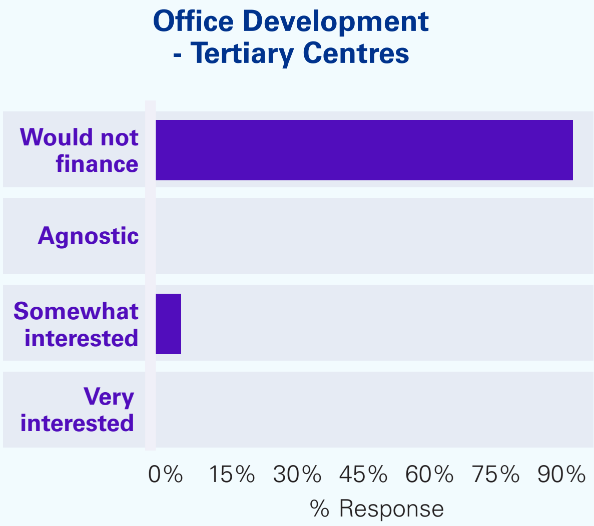
Lenders exhibited reluctance to provide funding for office development, particularly in locations outside of Dublin, with a large majority of respondents indicating they would not finance office developments in regional cities and tertiary centres.

Office







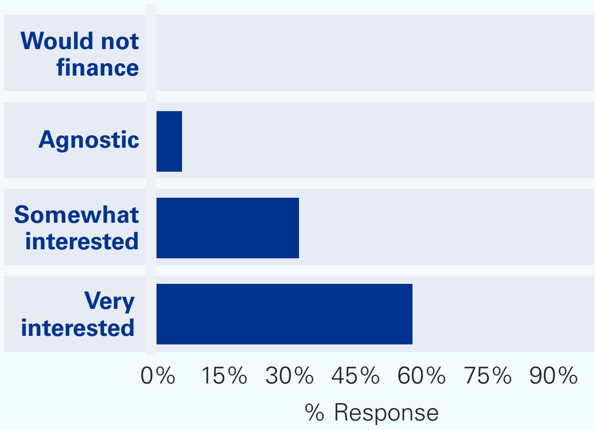


02

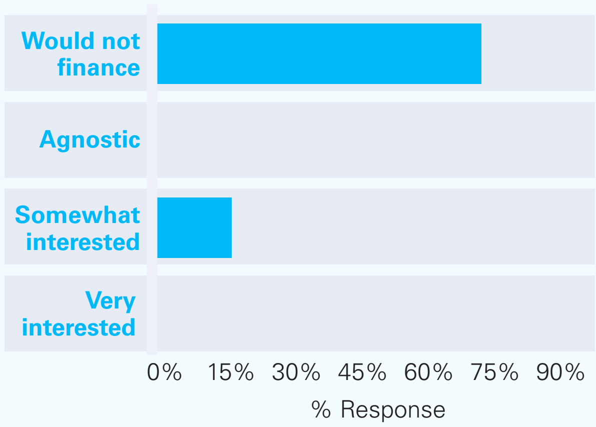
Lenders exhibited a limited appetite to fund retail development initiatives outside the Dublin Prime region.

Retail

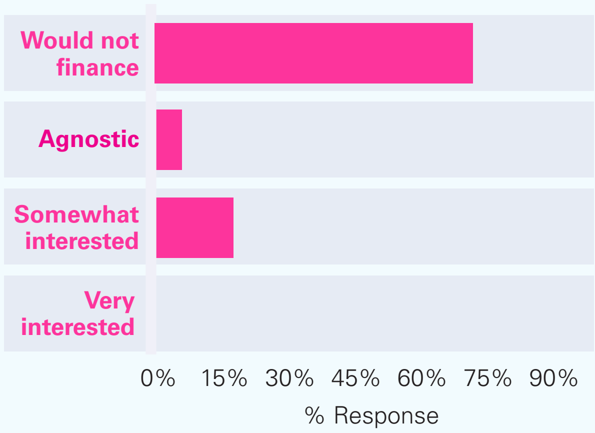
Retail Development - Dublin Prime



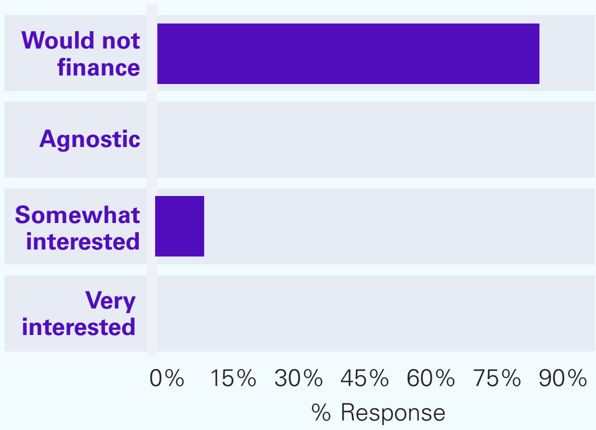
Retail Development - Dublin Other



Retail Development - Regional Cities



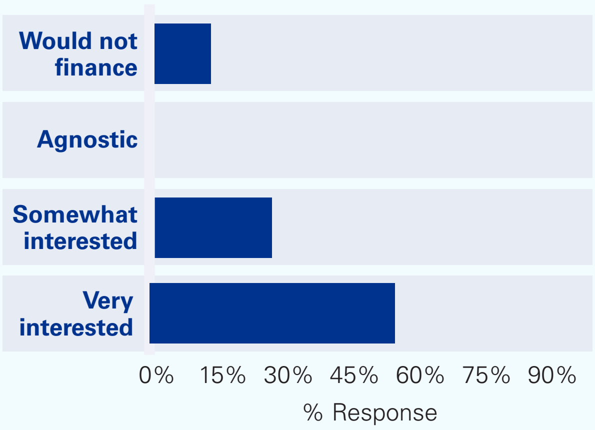
Retail Development - Tertiary Centres



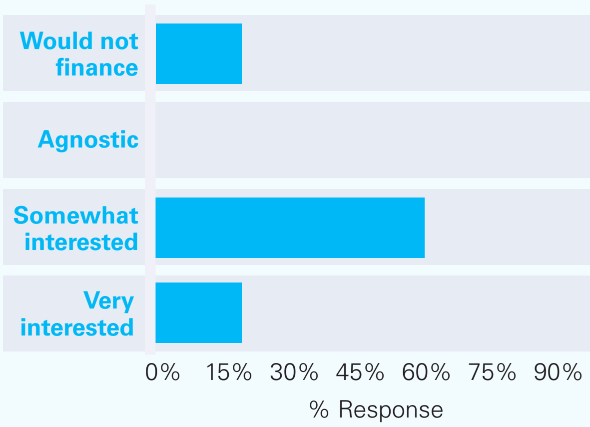
Outside of Dublin, lenders have a varied appetite for industrial/logistics development lending.

Industrial/Logistics

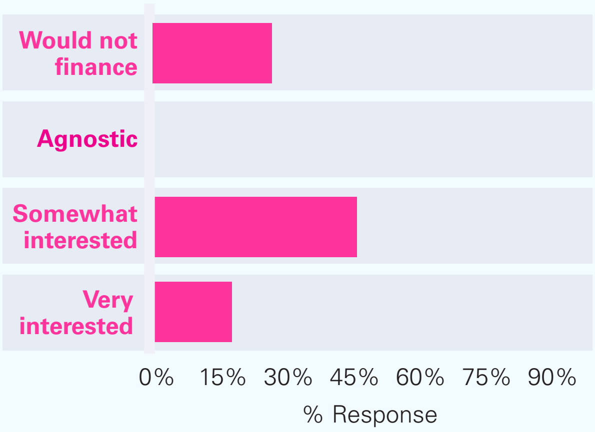
Industrial Development - Dublin Prime



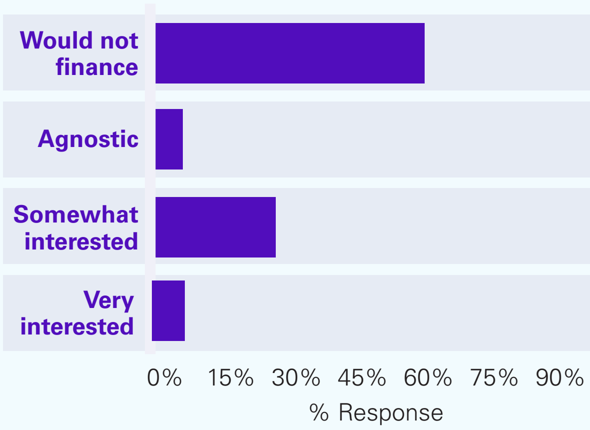
Industrial Development - Dublin Other



Industrial Development - Regional Cities

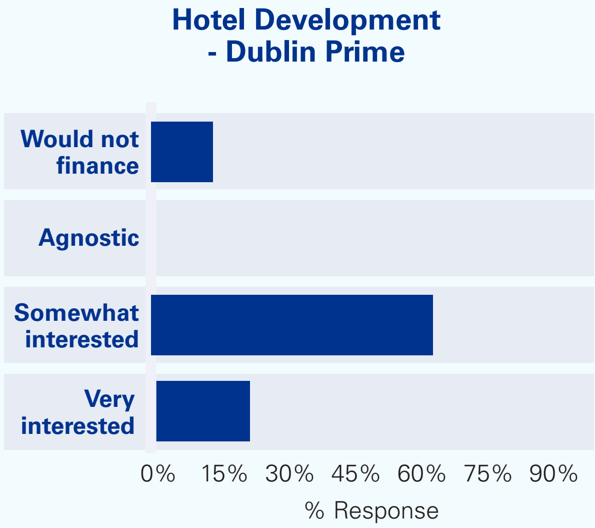


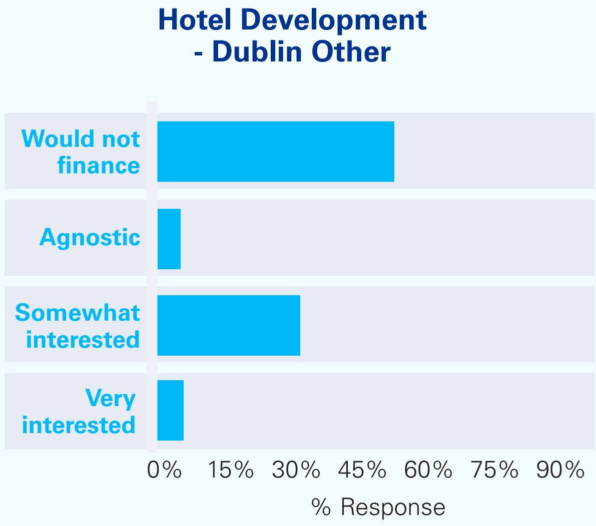
Industrial Development - Tertiary Centres

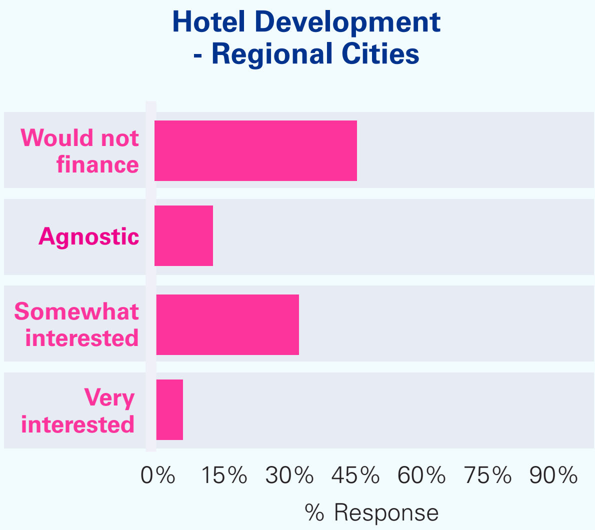


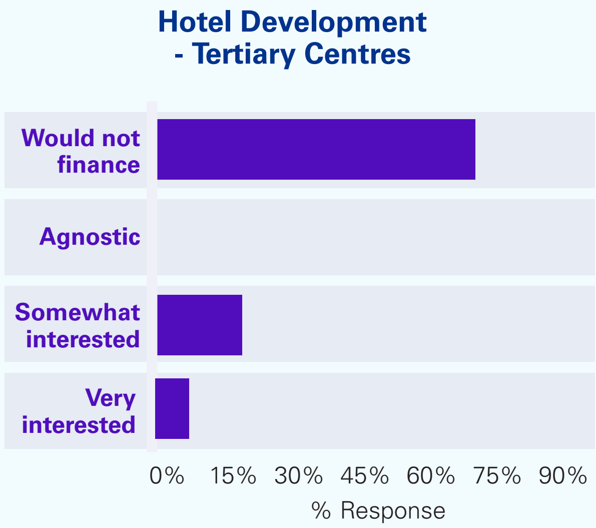
Lenders have indicated varying appetite levels when funding hotel development projects.

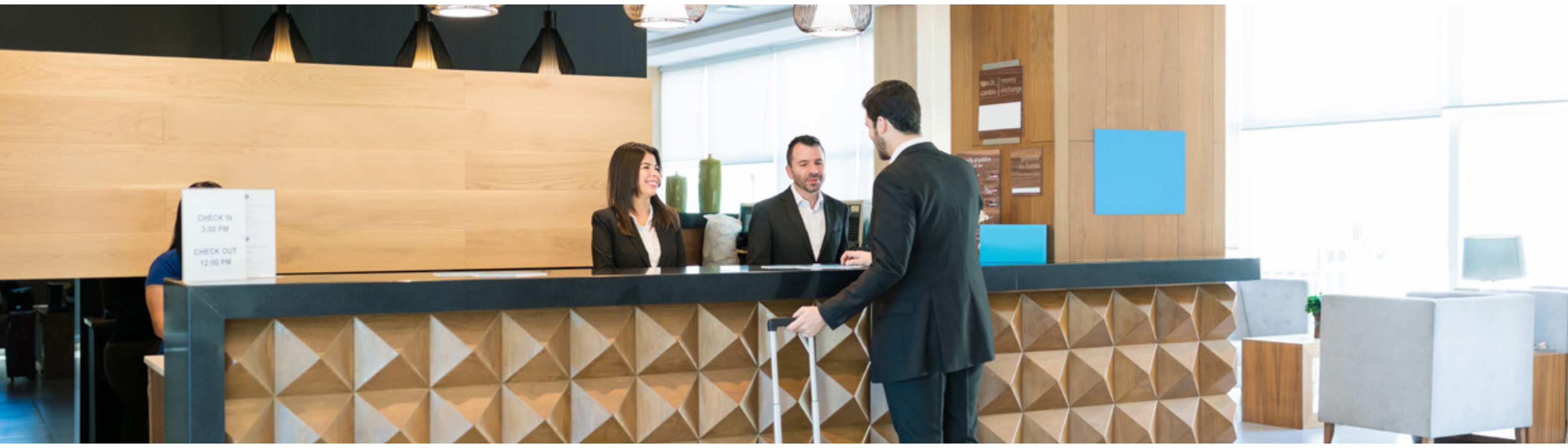
Hotel/Resort





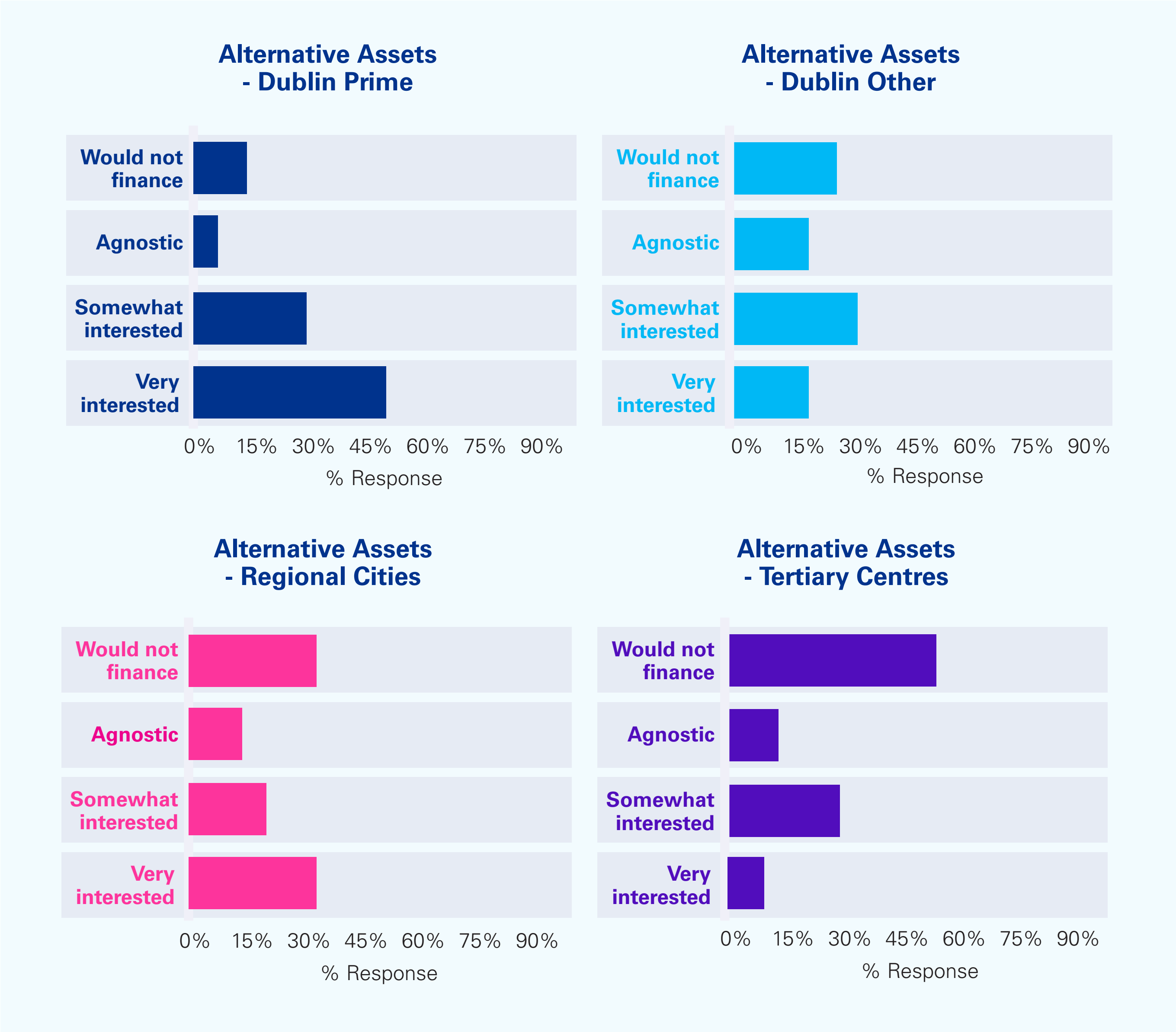






Lender appetite to fund alternative asset development is strongest for Dublin Prime assets.

Alternative Assets



03

Investment Lending

Lenders provided their view on leverage appetite and other credit metrics in the context of investment lending.

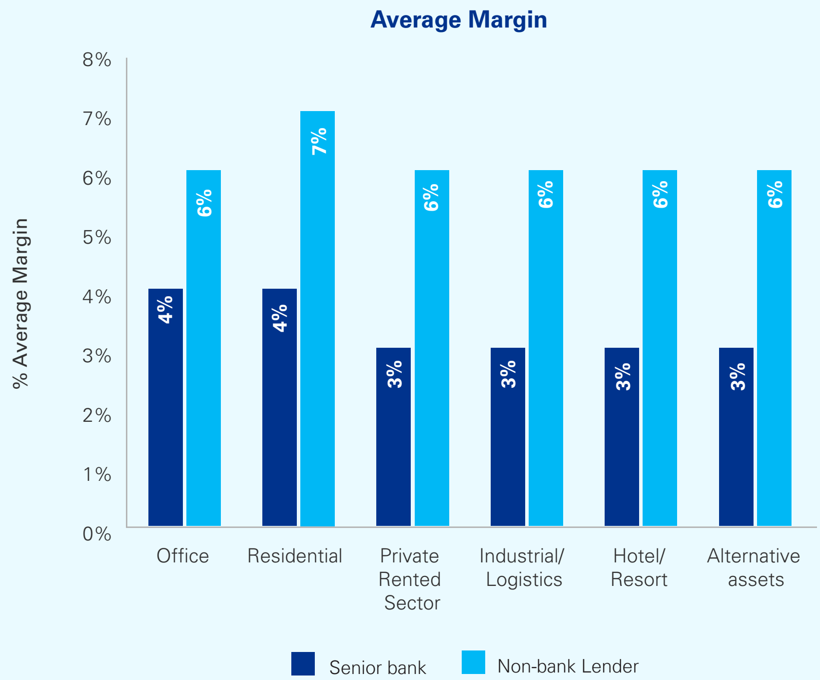
Loan to Value

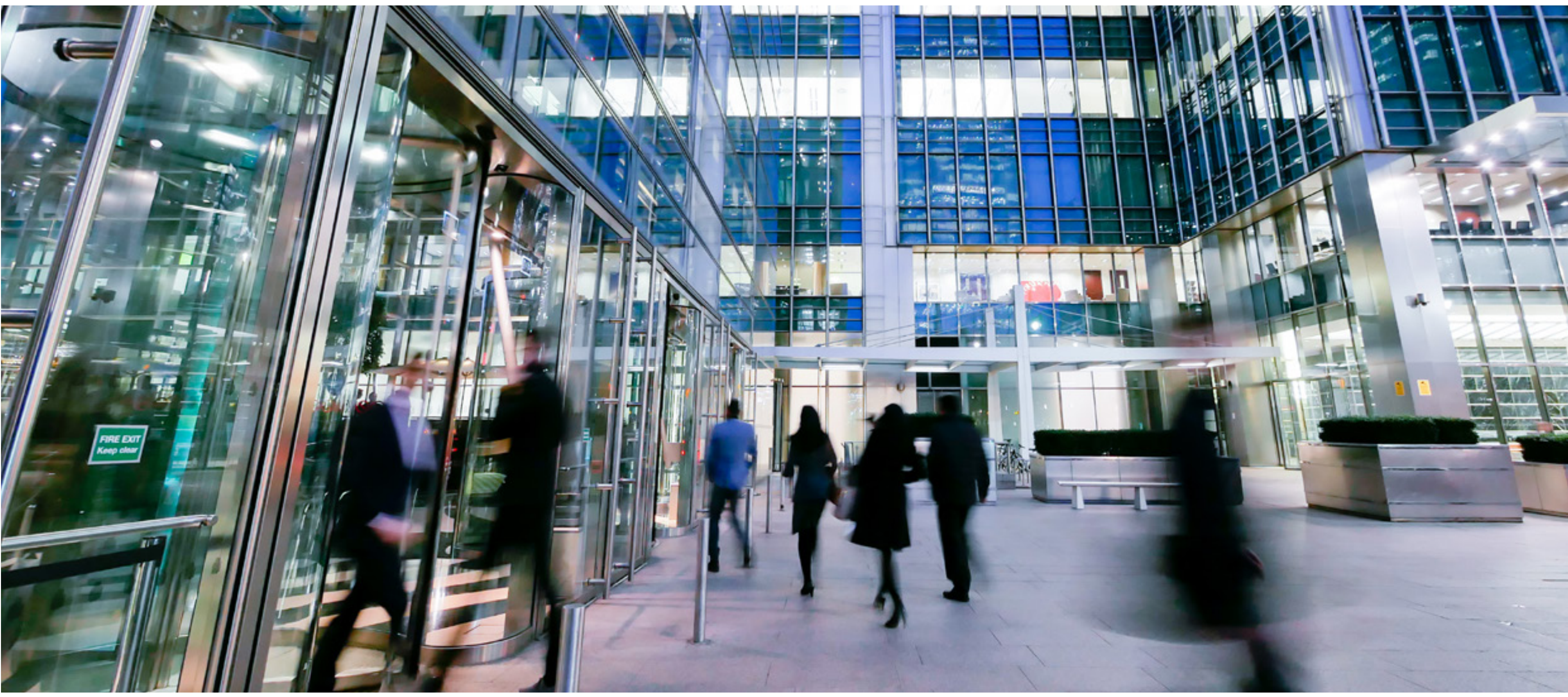
Similar to development lending, the lenders' appetite for investment lending deviates from majority responses for asset classes most exposed to macroeconomic threats.

Asset Class	Senior Bank		Non-bank Lender	
	No. of Responses	Loan to Value	No. of Responses	Loan to Value
Office	50% 50%	Up to 59% Up to 69%	7% 8% 8% 33% 44%	Would not finance Below 40% Up to 59% Up to 69% Up to 79%
Residential	75% 25%	Up to 59% Up to 69%	8% 17% 75%	Up to 59% Up to 69% Up to 79%
Retail	25% 25% 50%	Below 40% Up to 49% Up to 59%	25% 8% 9% 33% 25%	Would not finance Up to 49% Up to 59% Up to 69% Up to 79%
Industrial/Logistics	25% 50% 25%	Up to 49% Up to 59% Up to 69%	9% 8% 25% 58%	Would not finance Up to 59% Up to 69% Up to 79%
Hotel/Resort	50% 50%	Up to 49% Up to 59%	25% 42% 33%	Up to 59% Up to 69% Up to 79%
Alternative assets	75% 25%	Up to 59% Up to 69%	9% 33% 58%	Up to 59% Up to 69% Up to 79%

Investment Lending Pricing

Based on the foregoing LTVs the adjacent graph represents average pricing (above a 3-month Euribor) for each of the asset classes.



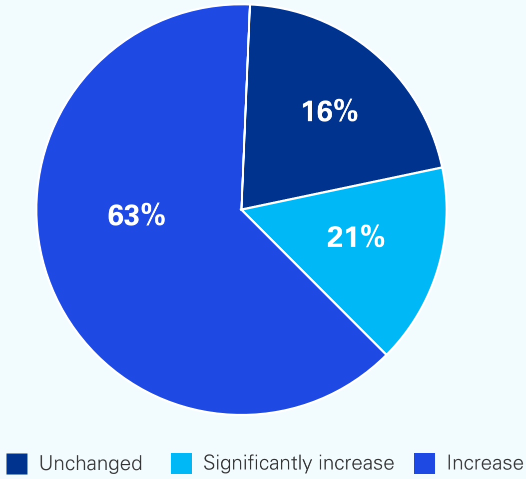


04

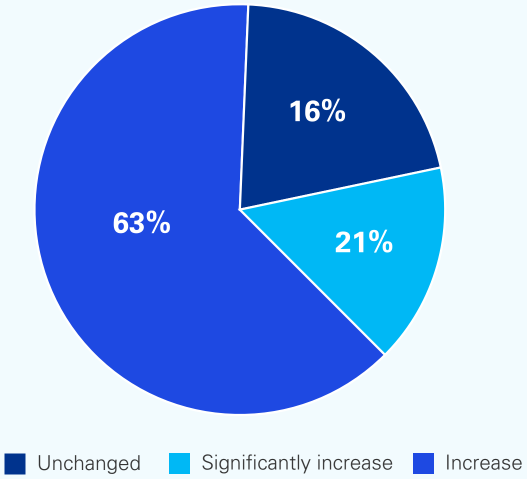
Future Prospects for Real Estate Lending

Lenders forecasted the expected change, **over the next 12 months,** in their overall real estate lending portfolio both generally and specific to Ireland. In both instances the responses were positive with the expectation that real estate lending will predominantly increase or significantly increase.

Expected Change in Overall Real Estate Lending Portfolio



Expected Change in Overall Real Estate Lending Portfolio in Ireland



05

Competition in the Market

Lenders were asked who they consider to be their **greatest competitors** when providing finance to Development and Income Generating projects.

The diagrams below are ranked from most to least and represent the majority response across lenders.

DEVELOPMENT FINANCE

1. Private Equity/ Debt Fund
2. Local Commercial Bank
3. Non-Local Commercial Bank
4. Investment Bank
5. Insurer / Pension Fund
6. Other

INCOME GENERATING

1. Local Commercial Bank
2. Private Equity/Debt Fund
3. Insurer/ Pension Fund
4. Non-Local Commercial Bank
5. Investment Bank
6. Other

06

Underwriting

Lenders were asked to rank a list of pre-set criteria in terms of most to least important when considering a **new real estate underwrite.**

UNDERWRITING CRITERIA

Lenders consider businesses with strong assets, good reputations, and high-quality operations to remain highly attractive.

1. Strong business model and quality of the asset
2. Reputation and references of the developer/ operator
3. Level of owner's equity
4. Financial background of developer/ investor
5. Pre let/ Pre-sale
6. How well the project is planned, status of planning process

In addition to ranking pre-set criteria lenders were asked to identify any other areas of focus that would be classed as priority when considering the financing of real estate projects. The responses below are not in any order of preference.

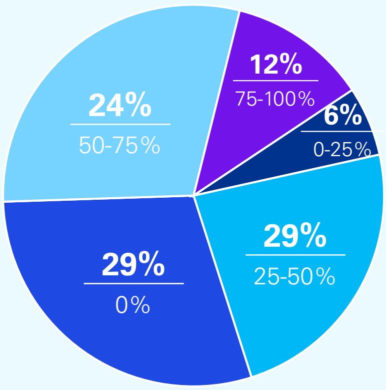
Additional Priority Factors Considered When Underwriting	
✓ Transaction metrics	✓ Longevity of income
✓ Lender's exit	✓ Transaction size
✓ Cash flow	✓ Overall IRR return
✓ Tax structure	✓ Transaction structure
✓ Underlying rental profile	✓ Asset delivery method

07

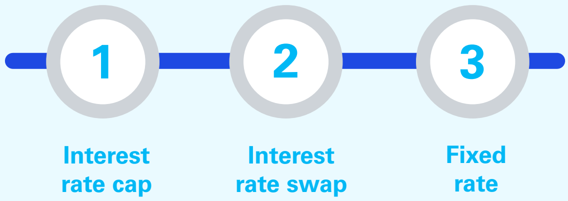
Hedging

We surveyed lenders about their current interest rate hedging requirements for borrowers seeking new loans for Development and Investment projects. They were also asked to rank the most commonly used interest rate hedging instruments. The results showed that **65% of lenders require a greater than 50% interest rate hedge for Development projects, and 68% of lenders require a greater than 50% interest rate hedge for Investment projects.** Among the hedging instruments, borrowers commonly use an **interest rate cap for Development projects and an interest rate swap for Investment projects.**

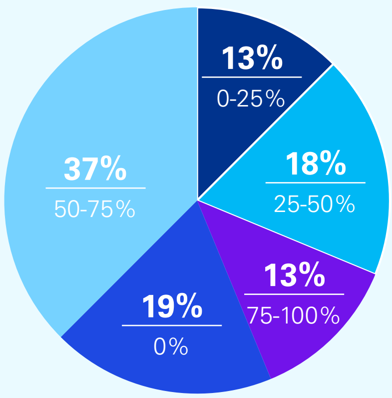
What level of interest rate hedge do you currently require borrowers to enter into for new loans for **Development projects?**



As a lending institution, what is the most common interest rate hedging instrument your borrowers put in place for **Development projects?**



What level of interest rate hedge do you currently require borrowers to enter into for new loans for **Investment (income generating) projects?**



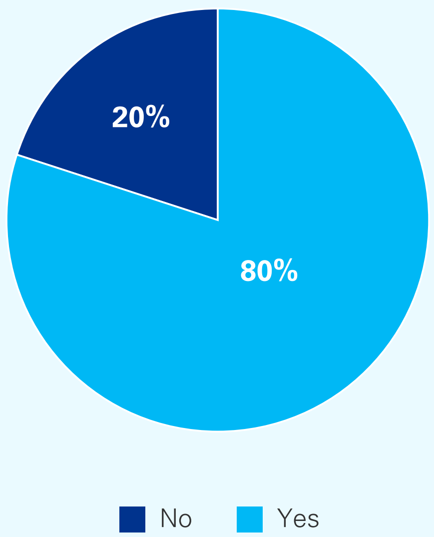
As a lending institution, what is the most common interest rate hedging instrument your borrowers put in place for **Investment (income generating) projects?**

08

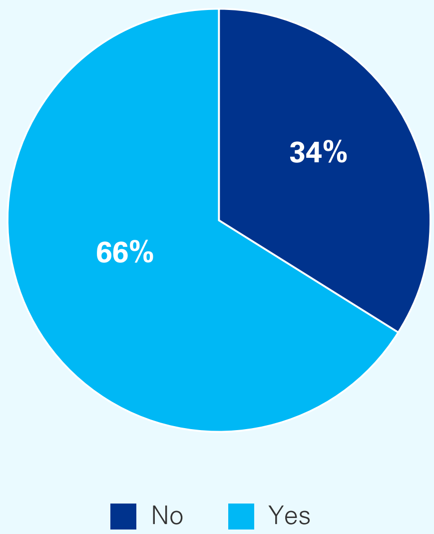
ESG

ESG is an increasingly important agenda item for both lenders and borrowers with many lenders publishing green lending frameworks. **80% of lenders surveyed said they were actively looking for ESG linked lending opportunities and 66% indicated loan pricing could be linked to ESG targets.**

Is your institution actively looking for ESG linked real estate opportunities?



Is your institution willing to link ESG targets to loan pricing?



08

Lenders and borrowers consider **regulatory and legislative requirements** as the most important driver of their current ESG strategy. Other factors, ranked in degree of importance, include the following;

1. Regulatory and legislative requirements
2. Investor expectations
3. Strategic ambition of Management
4. Brand reputation enhancement
5. Customer expectations
6. Employee satisfaction and attractiveness
7. Growth opportunities
8. Competitor activity

09

Macro Environment

Lenders and borrowers were asked which of the following factors they considered to be biggest challenges facing the Irish Real Estate sector in the **next 12 months** - Ranked by the degree of challenge.

1. Interest rate volatility
2. Planning difficulties and delays
3. Construction cost inflation
4. Changes in legislation and government policies
5. Covenant and loan servicing issues or existing loans
6. Availability of suitable assets / land for acquisition and development
7. ESG and decarbonisation requirements
8. Reduced occupier demand

Lenders and borrowers were asked which of the following factors they considered to be biggest challenges facing the Irish Real Estate sector in the **next 3 years** - Ranked by the degree of challenge.

1. Interest rate volatility
2. Planning difficulties and delays
3. Covenant and loan servicing issues for existing loans
4. Construction cost inflation
5. Availability of suitable assets / land for acquisition and development
6. ESG and decarbonisation requirements
7. Changes in legislation and government policies
8. Reduced occupier demand

Glossary

ESG	Environmental Social and Corporate Governance
LTC	Loan to Cost
LTV	Loan to Value
NBL	Non-Bank Lender
CSO	Central Statistics Office Ireland

Notes

We asked survey participants to respond to the survey questions based on a borrower with a good reputation and strong business plan.

Alternative Assets for the purpose of this survey comprise assets such as Primary Care Centres, Student Housing, Nursing Homes etc.

Regional Cities include Cork, Galway and Limerick.

Tertiary Urban Centres include Waterford, Athlone, etc.

KPMG Insight

Rising interest rates, resultant debt service challenges and falling asset values as yields rise are creating hurdles to successfully raising or refinancing development and investment facilities across most asset classes from traditional sources. Owners of offices, with occupier demand still normalising post the pandemic and facing significant ESG driven capex requirements on older stock, are facing a particularly difficult lending environment. As a result, a greater number of alternative debt funds are entering the Irish market, shifting their capital away from equity offerings to selectively provide debt at equity like return levels to borrowers. The notable exception to the rule is residential investment debt which remains highly attractive to bank and institutional lenders as a result of its incredibly strong occupier demand fundamentals.

Andrew McKenzie, Director
Corporate Finance

The survey results indicate that lenders are concerned about the impact of construction price inflation on the feasibility of projects across all industries. According to the SCSI's latest report on inflation, the annual rate of construction price inflation for 2022 was 11.5%, which is a decrease from 14% in 2021. The first six months of 2023 have seen a further decrease in tender price inflation, which is positive news for the market. However, this reduction is only from the record highs of the past two years. Residential developments face some of the biggest challenges in the market, and it will require more strategic government intervention to address them.

Wesley Jesson, Managing Director
Construction Advisory

The survey results are consistent with our experience and indicate an increasing focus among lenders on the environmental sustainability aspects of real estate loans. There is concern that if building energy standards continue to become more stringent in accordance with the Irish Government's commitment to achieving net zero carbon emissions, lenders may potentially be faced with stranded or impaired assets.

Russell Smyth, Partner
Corporate Finance – Sustainable Futures

As we see from the recent information release by the Central Statistics Office on the Census 2022, Ireland's population has now exceeded five million (5.15m), with an annual increase of almost 65,000 people over the 6-year period from 2016. This growth has major delivery requirements in terms of housing, employment, healthcare, education and transport infrastructure. It is critical that we have an effective and efficient planning system that will ensure the decision-making regarding investment delivery is fit-for-purpose. This will safeguard the required development of our critical infrastructure to meet the ongoing demand.

William Hynes, Managing Director
Corporate Finance – Future Analytics

Contact Us

Hazel Cryan
Partner, Corporate Finance

t: +353 87 050 4440
e: hazel.cryan@kpmg.ie

Russell Smyth
Partner, Corporate Finance,
Sustainable Futures

t: +44 77 3860 3869
e: russell.smyth@kpmg.ie

Wesley Jesson
Managing Director,
Construction Advisory

t: +353 86 371 5367
e: wesley.jesson@kpmg.ie

William Hynes
Managing Director,
Corporate Finance, Future Analytics

t: +353 86 852 4438
e: william.hynes@kpmg.ie

Andrew McKenzie
Director, Corporate Finance

t: +353 87 050 4420
e: andrew.mckenzie@kpmg.ie

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