Irish Residential Properties REIT plc (IRES)
Conclusion of Strategic Review

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08 August 2024

Irish Residential Properties REIT plc
("I-RES" or the "Company")

Conclusion of Strategic Review

I-RES today announces that the Board of Directors ("the Board") has unanimously decided to conclude the Strategic Review ("The Strategic Review" or the "Review") and is updating shareholders with the outcomes and the Board's strategy to maximise value.

Background

On 8 January 2024 the Company announced it would be conducting a rigorous and comprehensive Strategic Review to consider and appraise all strategic alternatives available to maximise and unlock value for shareholders in the Company. The Review commenced following the release of the Company's full year 2023 financial results on 23 February 2024, and the Board provided an update to shareholders on the progress of the Review on 25 April 2024.

The Review considered a range of options including a sale or liquidation of the entire issued share capital or assets of the Company, operational and asset management initiatives and the regulatory environment including the REIT status of the Company. The Review was overseen by a Board sub-Committee, led by Chair Hugh Scott-Barrett with newly appointed CEO Eddie Byrne and non-executive directors Denise Turner, Philip Burns and Richard Nesbitt who joined the Board on May 10, 2024. The Board sub-Committee was supported in conducting the Strategic Review by independent international financial and real estate advisors.

Key conclusions

Sale or liquidation of the entire issued share capital or assets highly unlikely to deliver value

The Strategic Review conducted an extensive analysis on whether returning capital to shareholders through a sale of the Company or a sale of its assets would maximise value. This evaluation included rigorous market testing with suitable counterparties familiar with the Irish PRS market and possessing the requisite capital to execute such transactions. Despite the public announcement of the Strategic Review and the active market testing, the Board confirms that no proposals were received to acquire the Company or a significant proportion of its assets. The Board believes the outcome of this market testing process is reflective of the current market environment such as the higher interest rate environment (and the resultant impact on financing potential leveraged takeovers), the current regulatory environment (specifically rent caps) and uncertainty created by an upcoming Irish general election.

As outlined in the Strategic Review update released by the Company on 25 April, comprehensive analysis has also indicated that a strategy requiring an accelerated sale of the Company's assets in the direct market, including to occupiers and social providers such as the government, would be challenging to maximise value for shareholders in the short-term. This view remains unchanged. Analysis has also observed that residential investment volumes are not currently supportive of a material asset disposal. Volumes in the Irish residential sector remain at historically low levels, with c. €240 million of transactions completed in 2023, c. 73% below the historical 10-year average[1].

The Board has unanimously concluded that, in the current macroeconomic and regulatory environment, a sale of the Company or a liquidation of its assets is highly unlikely to deliver an outcome that maximises value for shareholders at present. The Board remains open minded to the possibility of a sale of the Company or its assets in the future and will carefully assess any potential proposals that are received.

I-RES can be a market consolidator in an Irish PRS market characterised by exceptional demand and low supply

Based on data from Savills, the total PRS market in the greater Dublin area currently stands at c. 125,000 units, with c. 100,000 of those units held by micro landlords where 90% own 3 units or less[1]. These micro landlords, many of whom purchased rental properties during the Celtic Tiger era, are now exiting the market at an increasing rate due to factors including the loss of incentives and more restrictive tax treatment on rental income. As a result, one in three houses being sold in Dublin is an individual property investor leaving the market. Estimates suggest that the 100,000 units held by individuals is now shrinking by 8 to 10% per annum, creating demand for a minimum 8,000 additional PRS units per year in an already undersupplied market.

The remaining c. 25,000-units held by institutional capital remains relatively static, with supply constrained by current rental regulation including the 2% cap on annual rental increases, and by prevailing short-term debt and equity market headwinds. State bodies have been the primary purchaser of developments over the past 24 months, with these developments allocated to social and affordable housing and therefore not increasing the supply of PRS units available to rent.

The 25,000-unit institutional Irish PRS market can be segmented into three categories of capital investment:

1. I-RES (largest individual market share) and a very limited number of other market participants possessing a permanent capital base.

2. Private equity and closed end fund participants represent the largest segment of the market (c. 50%+), spread across multiple institutions. A significant proportion of this segment is expected to come to market over the next 12 to 24 months as closed end funds begin to reach maturity and institutions seek to either refinance in a more challenging interest rate environment or return capital to investors.

3. The remainder of the PRS market comprises pension and insurance funds, who have long-term investment horizons but are generally focused on individual assets or a portfolio of assets rather than business operations which are typically outsourced.

The demand fundamentals that underpin the Irish PRS market remain some of the strongest globally. The greater Dublin area population, estimated at c. 2.1 million in 2022, is forecasted to grow by c. +18% out to 2035[1]. Population growth alone will therefore increase demand for PRS by c. 20,000 units or 2,000 units per annum over this period. Other factors contributing to elevated levels of demand include the low level of the Irish population currently living in apartments (11% versus the EU average of 48%) and net inward migration driven by an economy which continues to outperform EU averages.

Recent publications from the Irish government have indicated that it is set to publish revised completion targets for the Housing for All programme under the National Planning Framework in Autumn 2024. The new target is currently estimated by the government to be approximately 50,000 units per year, up from the prevailing 30,000 target. If PRS maintains its current share of c. 8% of the housing market, the increased targets will translate to a demand for c. 4,000 additional units per annum but, due to factors such as those outlined above, the Board believes that the actual level of demand is between 10,000 and 14,000 new units per annum. Considering this new product demand and the fact that a very significant share (c. 50%) of the existing stock may trade over the next 24 to 36 months, the Board believes that there is a significant market opportunity.

Following the conclusion of the Strategic Review, the Company will continue to actively engage in constructive discussions with other relevant participants in the Irish PRS sector around these potential opportunities through consolidation and other capital-light joint ventures which are accretive to earnings. I-RES holds a market-leading position, supported by a permanent capital base and a leading operating platform and retains significant agility to scale effectively and capitalise on the attractive long-term opportunities created from the demand-supply backdrop. The Board believes that I-RES is therefore well placed to act as a consolidator in the Irish PRS market post the Strategic Review, with significant organic and inorganic opportunities expected to arise in the short to medium term.

The Review has identified Operational and Asset Management levers to create value

The Strategic Review has considered the key levers for generating further operational efficiencies within the I-RES platform to maximise returns. The Review has identified three primary initiatives to achieve this objective: (i) conducting selective capital recycling which is accretive to value; (ii) generating supplementary revenue consistent with existing Irish regulations; and (iii) managing costs, both in relation to Net Rental Income Margin ("NRI") and General & Administrative costs ("G&A"), to ensure the Company is best placed to leverage future growth opportunities.

As outlined in the Strategic Review update on 25 April, analysis has explored achieving value accretion through selective asset recycling, including individual unit sales. Commencing in the latter part of H1 2024, the Company has completed the disposal of a small number of individual units, all to the private market, and generated sales proceeds at a significant premium to latest book value. These transactions, while small in scale to date, reflect the disparity between liquidity in the institutional real estate market and the retail market, the latter of which remains buoyant.

The Review has identified approximately 315 suitable units (c. 8% of the portfolio and c. 23% of the Company's market capitalisation[2]) for disposal which would generate between €110 and €115 million of proceeds over a 3 to 5 year timeframe, based on estimated current Open Market Value ("OMV)[3]. Disposals are expected to take place over a 3 to 5 year period as turnover of current tenancies is a prerequisite for the disposal of these units under Irish law. Factors contributing to suitability for disposal include assets located in properties that are not wholly controlled by I-RES and assets with upcoming capital expenditure requirements. The Company intends to deploy proceeds from the asset disposal programme in line with our capital allocation priorities, initially reducing higher cost debt and actively managing LTV, whilst retaining flexibility for initiatives that are accretive to our earnings profile over time. This ongoing strategy is expected to be value enhancing, optimise overall portfolio quality, and generate capital which can be reallocated in line with our capital allocation strategy.

In addition to 3,728 residential units, the I-RES portfolio includes 4,500+ dedicated car parking spaces. The Review has identified implementing an extensive car parking policy across the Company's portfolio to drive supplementary revenue from underutilised parking facilities by leveraging demand from the I-RES commercial footprint, which includes 50 units covering c. 270,000 square feet of floor space. The Review has also identified several other incremental revenue generating initiatives, realising the Company's significant real estate footprint, which will continue to be actively explored post the conclusion of the Strategic Review.

The Review also conducted a thorough examination of the Company's cost base and the Company intends to develop a detailed business plan to further refine both direct property and G&A costs. The Review notes the challenges presented for cost and margin management by the current rental regulation, where rental income growth is capped at 2% but costs remain uncapped, and no allowances are made for investment expenditure in properties. However, the Board is confident that it can leverage its existing cost base to own and operate a greater number of properties than is currently the case.

Review of the Company's REIT status and the regulatory rental environment

The REIT structure offers I-RES shareholders access to the highly attractive long-term dynamics of the Irish PRS market through a low risk, moderate returns investment vehicle, and offers significant advantages over non-REIT structures such as increased liquidity and tax efficiency. The Strategic Review has confirmed that certain elements of the Irish REIT regime remain somewhat restrictive when compared to more progressive REIT frameworks in other European countries. Most notably, the Irish REIT structure does not allow constituents to transition from the designation of Alternative Investment Funds ("AIFs"), while in the UK, Germany, France, the Netherlands, and several other jurisdictions, designated AIF status is optional and self-determined by the REIT. The requirement for an AIF status adds an additional regulatory, resourcing, and financial burden to I-RES, and also makes it more difficult to market shares to small private investors which significantly reduces the scope of available capital for real estate investment.

During the Strategic Review the Company has had further direct engagement with the relevant policy makers to outline this inconsistency between the Irish and other comparable European REIT regimes. Such changes could offer significant flexibility to the Company both operationally and strategically. The Irish government's review of the Funds sector is expected to be published in the coming months at which point the Board will carefully assess any potential impact from the review.

The Board continues to believe, and findings from the Review have supported the view, that the current regulatory structure in the Irish rental market, in particular the acute restrictions currently in place on annual rent increases, is negatively impacting the market and curtailing the delivery of new developments required to address the increasing supply-demand imbalance. The Company welcomed the findings from the Department of Housing review of the PRS sector in July, which highlighted several limitations and unintended consequences of the current regulatory structure and recommended a dedicated review of Rent Pressure Zones to be carried out by the Housing Agency to see what rent control measures, if any, should continue beyond the expiration of the current measures. The Company will continue our engagement with industry stakeholders and government to support the development of a fair regulatory regime that balances both the interests of tenants, who can access accommodation at sustainable rent levels, and the interests of property owners and developers in order to attract the necessary significant capital investment required to address the supply deficit.

Summary

In conclusion, the Strategic Review has identified the following initiatives or actions, which the Board believes will drive value maximisation for shareholders over the medium-term:

- Initiating a programme to drive value accretion and improve portfolio composition by recycling c. 315 units and releasing between €110 and

€115 million of value over a 3 to 5 year period (based estimated current OMV[3]). The programme represents c. 8% of the current portfolio and c. 23% of the Company's market capitalisation[1]. Disposal proceeds are expected to be deployed in line with our capital allocation priorities, initially strengthening our balance sheet by reducing higher cost debt, whilst retaining flexibility for initiatives that are accretive to our earnings profile over time.

- Generation of supplementary revenue streams consistent with existing Irish regulations.
- Optimising the Company's cost structure to maximise Net Rental Income Margin and adjusted EBITDA Margin to ensure the Company is best placed to leverage future growth opportunities.
- Exploring the very significant growth and consolidation opportunities which currently exist in the Irish PRS market over the medium-term. The Board believes that's I-RES is uniquely positioned to take advantage of these and is actively exploring them alongside other commercial ventures.
- Continuing to work constructively with stakeholders, including government, to push for positive change in the Irish residential regulation system, most particularly the current acute restrictions on annual rent increases which, the Board believes, have had a severe negative impact on the supply of new product into the Irish rental market.
- Continuing to advocate with the relevant Irish authorities for changes to the Irish REIT regime to better align with progressive REIT systems in other European jurisdictions.
- Seeking attractive opportunities to partner, inter alia, with Irish government bodies to deliver new supply to the affordable housing market; the most relevant scheme for the Company is the Secure Tenancy Affordable Rental programme ("STAR") and the Company is in dialogue with government agencies to support the development of a workable scheme

The Board will continue to actively review all strategic options available to the Company as part of its normal course duties, maintaining its open and constructive approach to potential value creation avenues.

Irish Takeover Rules

As noted above, the Board has unanimously decided to conclude the Strategic Review. The Company also confirms it is not currently in receipt of any approach nor in any discussion with any offeror or in talks with any potential counterparty generally in connection with a transaction. The Company is therefore no longer deemed to be in an "offer period" for the purposes of the Irish Takeover Rules. Shareholders are advised that the obligation to file Rule 8 disclosures pertaining to dealings in the Company's shares has now ceased.

2024 Interim Results

The Company has today separately published its interim results for the six-month period to 30 June 2024 and will host a live audio webcast and conference call of the results presentation this morning at 09:00am BST. Access details are listed in Interim Results statement released this morning.

[1]: Savills Research
[2]: based on closing share price on 7 August 2024
[3]: Open Market Value at 30 June 2024 based on expected proceeds from individual sales

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About Irish Residential Properties REIT plc
Irish Residential Properties REIT plc ("I-RES") is a growth oriented Real Estate Investment Trust providing quality professionally managed homes in sustainable communities in Ireland. The Group owns 3,728 apartments and houses for private rental in Dublin and Cork. I-RES aims to be the provider of choice for the Irish living sector, known for excellent service and for operating responsibly, minimising its environmental impact, and maximising its contribution to the community. The Company's shares are listed on Euronext Dublin. Further information at www.iresreit.ie.

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