

NORTHERN IRELAND COMMERCIAL PROPERTY INVESTMENT REVIEW 2015

Prepared by MSCI in conjunction with Ulster University



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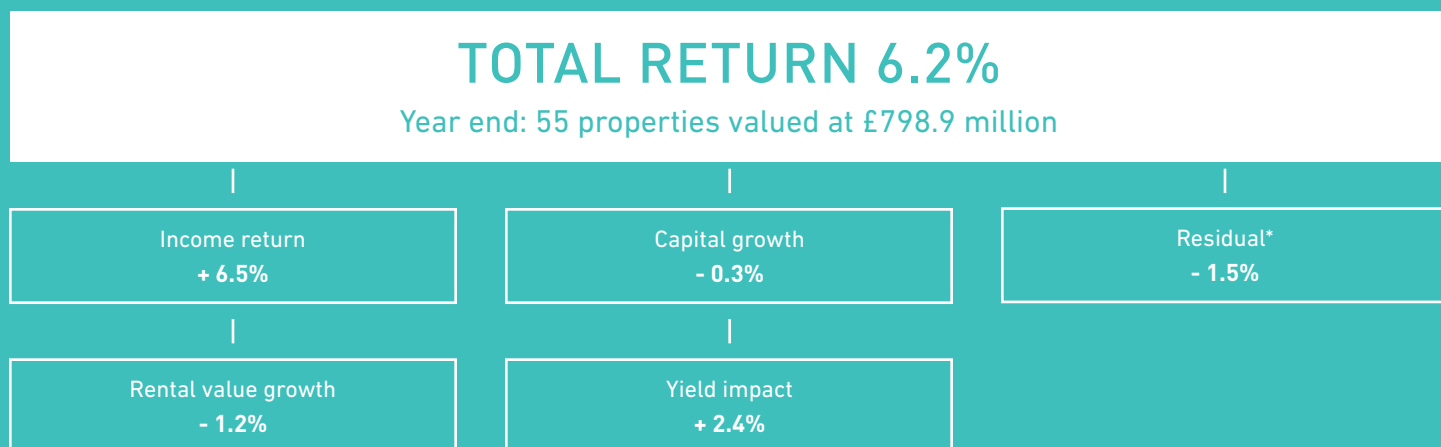
Northern Ireland

PERFORMANCE REVIEW 2015

KEY POINTS

- Commercial property in Northern Ireland posted a total return of **6.2%** in 2015. This represented a weakening in performance from the market return of 10.9% posted in 2014 and mirrors the cooling trend experienced by the rest of UK and Republic of Ireland;
- The Northern Ireland market continued to exhibit strong levels of passing rent which resulted in an income return of **6.5%** in 2015. This remains amongst the highest income return recorded by an MSCI-measured market and provides a competitive pricing advantage for assets in Northern Ireland;
- Market rents recorded a marginal decline for the second consecutive year, with average rental values falling by **1.2%** for commercial property overall. Retail over-supply and the lack of modern office space is inhibiting rental growth, but overall market trends show stability in rental values dominating valuations;
- Equivalent yields moved in through the course of 2015 to close out the year at **6.9%**, down from 7.8% in 2014. This suggests a further warming in investor sentiment as the broader recovery begins to take hold.
- At city level, Belfast property recorded an average positive total return of **6.9%** outperforming a number of key European cities including Rome, Milan and Frankfurt;
- Belfast offices were amongst the top performing in Europe with a total return of **22%** in 2015;

FIGURE 1: NORTHERN IRELAND PERFORMANCE SUMMARY 2015, % YEAR-ON-YEAR



* Residual: impact of delays in income stream, mainly effect of over-renting

Source: MSCI

INVESTMENT TRENDS

The year 2015 was a strong period of growth for the UK commercial property market, as sustained growth for both capital and rents spread nationwide. Total returns for the UK market hit their highest level since 2005, capital values strengthened for the majority of locations and rents grew for all key property sectors as confidence returned for occupiers. Similarly, the market in the Republic of Ireland continued to strengthen with capital values edging back toward highs not seen since 2006 in Dublin. Broadly positive economic news further boosted attitudes towards investment in real estate as the expectations of future rental value growth spur on investors to bid higher and on riskier income streams.

This significantly improved economic climate in both the UK and Republic of Ireland has helped fuel a major rebound in the performance of commercial property in both countries over the last three years. Crucially in 2015, regional markets outside of the respective capital cities, which had previously been the main drivers of performance, saw improving rental and capital trends.

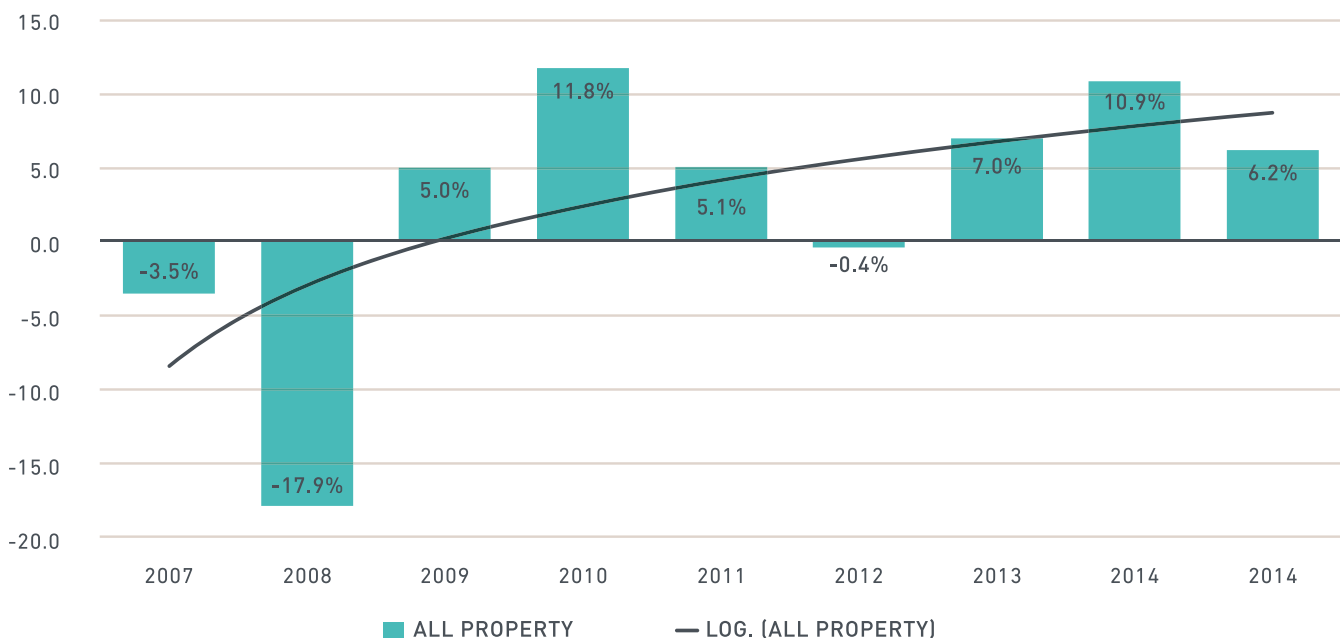
UK commercial property saw total returns grow to 13.1% in 2015 while the third year of buoyant recovery in the Republic of Ireland saw returns hit 25.0% – the highest recorded globally for 2015.

The strong recoveries in both of these key markets was not as apparent in the Northern Ireland commercial property market as total returns closed at 6.2%, compared to 10.9% in 2014.

The performance of the Northern Ireland commercial property market has tended to follow the rest of the UK closer than the Republic of Ireland, with the primary institutional investors being London, rather than Belfast or Dublin, based and asset preference leaning to long-term income streams from the likes of retail warehouses and supermarkets. **Figure 2** illustrates total return trends in the Northern Ireland market between 2007 and 2015.

Overall for 2015, the total return of 6.2% from Northern Ireland real estate still outpaced both UK Equities which returned a negative 2.2% for the calendar year and UK Government Bonds which returned 1.0%. Property Equities (predominately REIT's and listed property companies) underperformed the direct property sector with a return of 5.1% as analysts took a pessimistic view on future expectations of growth, especially in London where many fear a pricing bubble.

FIGURE 2: TOTAL RETURN TREND, 2007-15, % YEAR-ON-YEAR



Source: MSCI

Capital values in Northern Ireland fell by up to 33% since the peak in 2006 but returned to growth in 2014 with values rising by 2.3%. However, a flat market during the course of 2015 saw values fall back marginally, by 0.3% over the course of the year. As a result, it was the continued strong level of income return, rather than capital value growth, which was the main driver behind the 6.2% total return achieved for Northern Ireland. This, contrasted with both the rest of the UK and the Republic of Ireland, where impressive levels of capital growth helped drive performance.

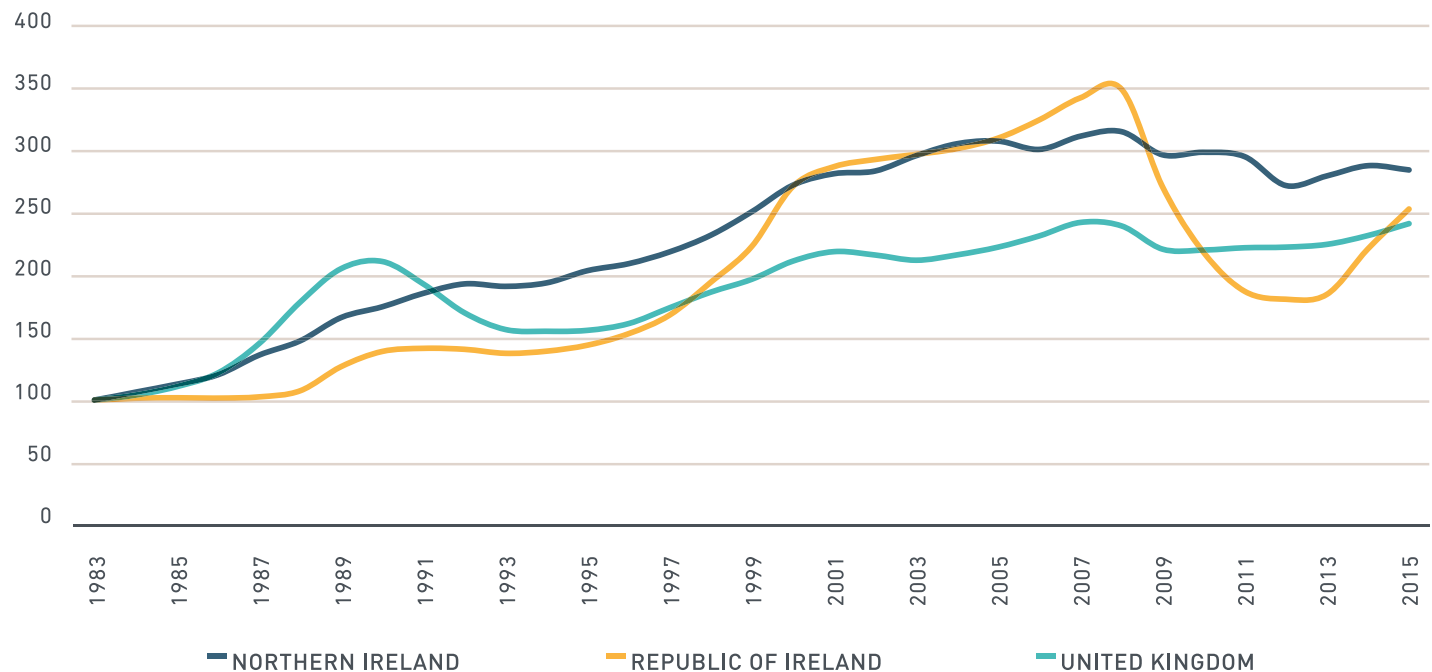
Income return has averaged 7.6% y/y over the 33 years in which MSCI has been analysing investor performance in Northern Ireland, with the 2013 income return of 8.9% y/y amongst the highest annual income rate across the time series. This moderated in 2014 and 2015 as stability returned to the market, but nonetheless income levels remain strong compared to neighbouring markets.

This strong income return along with the fact that capital values remain highly discounted (31% off the 2006 peak on average) has made assets in Northern Ireland highly competitive compared to the rest of the UK, and indeed other European markets. This has clearly tempted more investors into the market with transaction volumes continuing to grow through the year 2015 as expectations of strong returns and future value growth raise investor sentiment.

Rental values fell back in 2015 following two consecutive years of growth in 2013 and 2014. Market rental values in Northern Ireland recorded their severest declines during 2012 with an annual fall of 7.9% as a number of major defaults hit the retail sector across the UK. Since 2013, rents in Northern Ireland have recovered some of their value, but still remain 9.7% down from the 2008 market peak.

Overall, rental values have only fallen by a modest level in Northern Ireland since rents peaked in 2008, compared to an average decline of 27.5% in the Republic of Ireland. This places the occupier market in Northern Ireland more in line with the rest of UK market where rents are now down by only 0.8% compared to the 2007 peak. This highlights the fact that assets held by institutional investors in Northern Ireland tend to be longer-leased and with strong covenants and predominantly out-of-town retail properties which have proven more stable in the economic downturn. **Figure 3** highlights the long-term rental trends for Northern Ireland, Republic of Ireland and United Kingdom.

FIGURE 3: NOMINAL MARKET RENTAL VALUE INDEX, 1983-2015



Source: MSCI

DRIVERS OF PERFORMANCE

Total return is made up of two components; capital value growth and income return. In turn, capital value growth is primarily driven by rental value and yield movements, with a residual element that reflects valuer perception of the risk of the future cash flow.

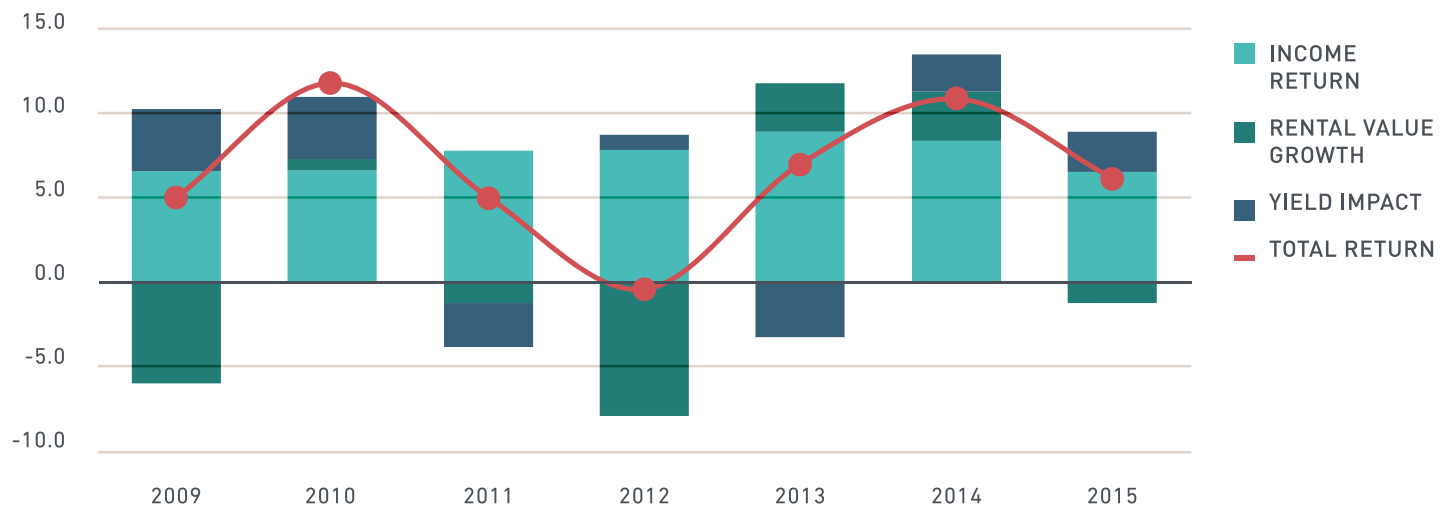
The continued improvement in equivalent and initial yields in 2015 set a positive tone for investor demand in the Northern Ireland property market. The strengthening in yields suggests that investor demand has improved, however limited availability of investment grade stock has limited transactions somewhat. However, competition for office space continues to grow amongst occupiers but the limited supply of modern space is curtailing performance as evident in the marginal fall in headline rental values. This trend is illustrated by **Figure 4** which shows the key drivers behind total returns for the Northern Ireland market over the last seven years.

Income return remains positive provided rent being collected exceeds the investors' expenses, improving income (passing rent) levels push income return higher while declining capital values have a similar effect provided passing rent is stable. This means that income return plays a dual proxy role of occupier and income risk in the market.

The strong, albeit moderating, level of income return during 2015 in the Northern Ireland market was due to strong income streams combined with heavily discounted capital values. Income returns fell from a high of 8.9% in 2013 to 6.5% in 2015, as the perception of occupier risk in the market receded somewhat.

Improving investor attitudes towards Northern Ireland real estate also boosted performance further in 2015, providing modest levels of yield compression as demand for assets grew, thus tightening pricing as the year progresses. This was reflected by the positive yield impact of 2.4% feeding into the 6.2% total return. Equivalent yields compressed to 6.9% from 7.8% at the start of 2015, further evidence of the strengthening of pricing in the market. Despite this yield compression, pricing in Northern Ireland remains comparatively discounted compared to the rest of the UK and the Republic of Ireland.

FIGURE 4: DRIVERS OF NORTHERN IRELAND TOTAL RETURN, 2009-15, ALL PROPERTY % YEAR-ON-YEAR



Source: MSCI

BELFAST MARKET IN CONTEXT

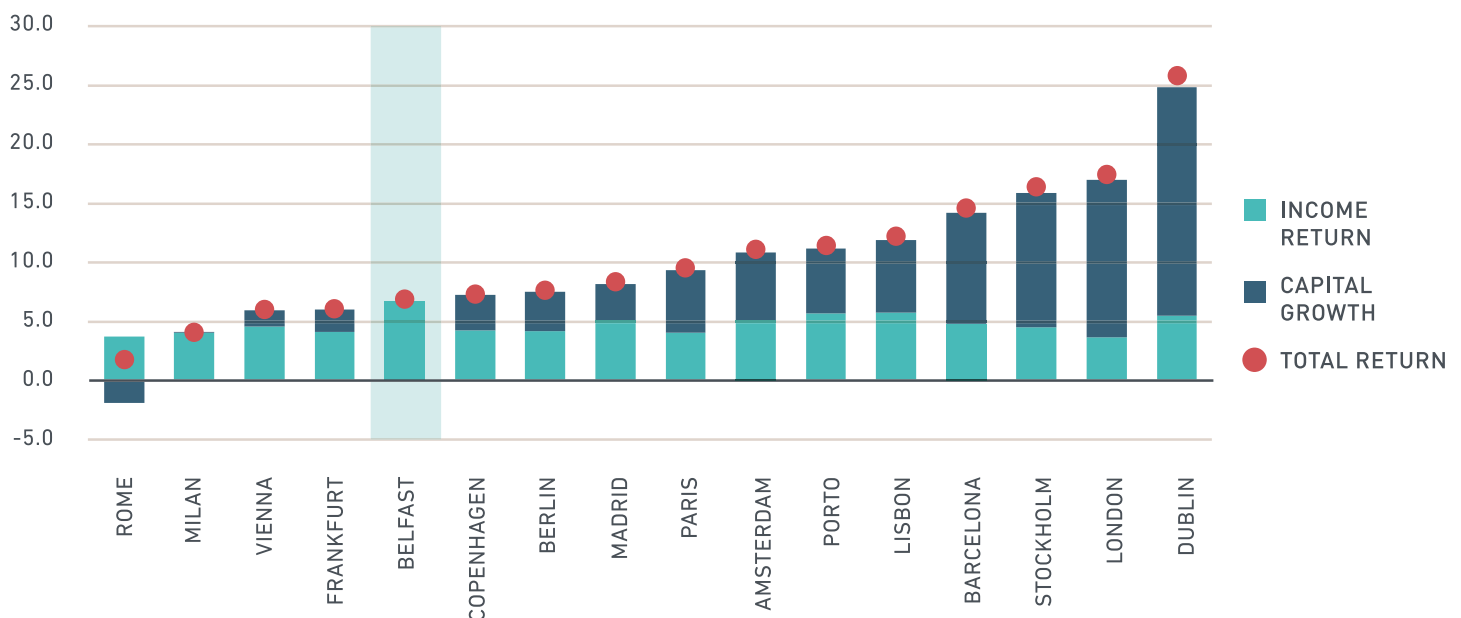
This analysis compares the Belfast commercial property market with 15 other key cities across the European Union as well as 32 cities and towns across the UK and Ireland. Belfast commercial property posted total returns of 6.9% in 2015 outperforming many major European cities including Rome, Milan, Vienna and Frankfurt. The leading markets, like Dublin and London, outperformed due to their impressive levels of capital value growth driven by similarly impressive rental growth. These comparable European investment markets are illustrated by **Figure 5**.

Belfast offices posted impressive total returns of 22.2%, making it the second best performing office location in Europe during 2015 (Figure 6). Belfast office returns were bolstered by a return to capital value growth, values rose by 10.1%, on top of the existing high level of income return, at 11.2% for 2015.

The Belfast office income return was the highest recorded for the European city markets in this analysis. Pertinently, the Belfast offices outperformed almost all key peer cities in the UK including Manchester, Cardiff and Liverpool. The comparatively high level of income return in the Belfast market continues to make it highly competitive, in a European context, to new investors, especially given the strong leasing structures and income profiles of these cities.

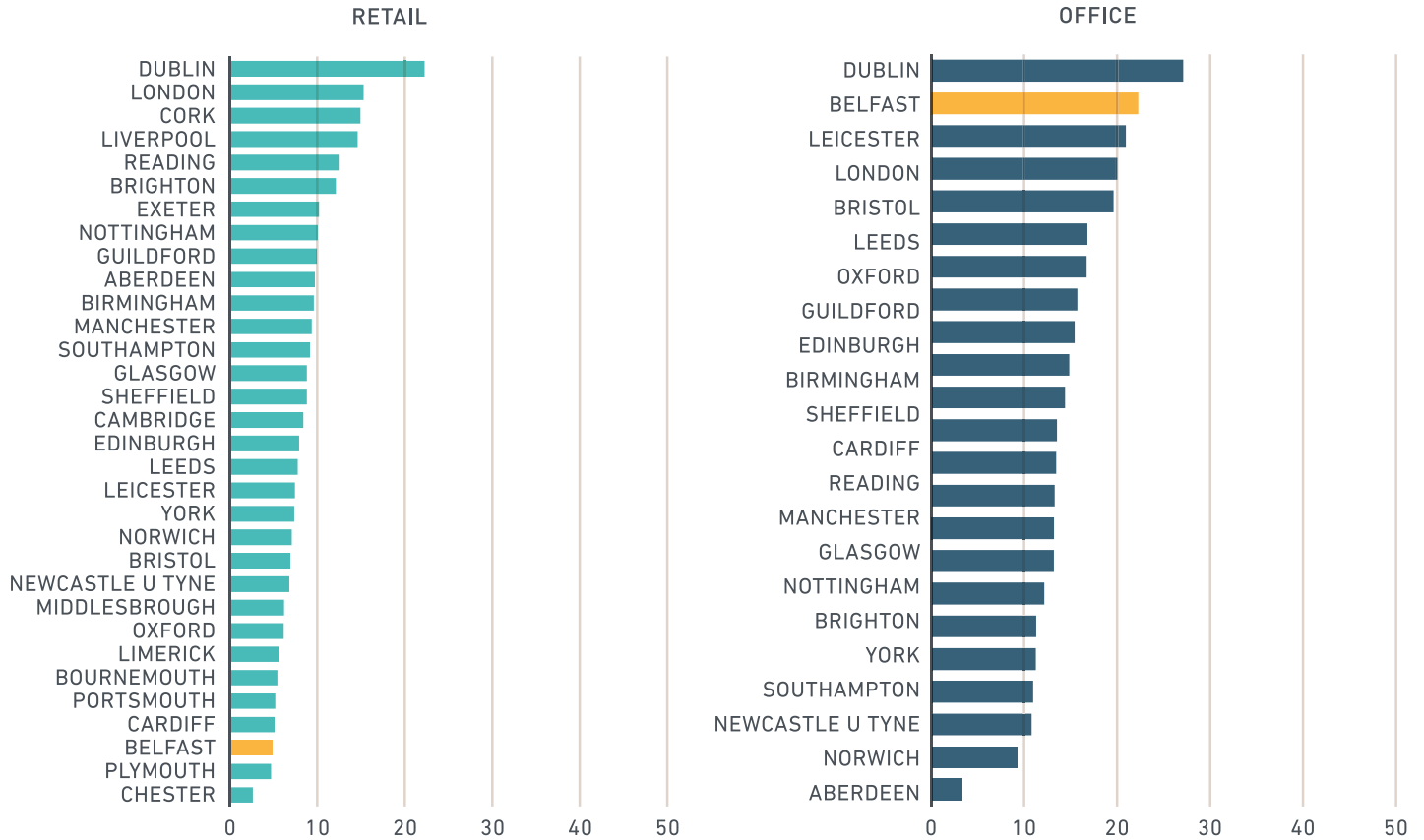
The strong performance in the Belfast office market was in stark contrast to the retail sector. As expected, Dublin and London dominate Retail performance due to strong levels of rental value growth and unmatched investor demand with the Belfast retail sector posting total returns of 4.9% in 2015.

FIGURE 5: BELFAST VERSUS KEY EUROPEAN CITIES IN 2015, ALL PROPERTY % YEAR-ON-YEAR



Source: MSCI

FIGURE 6: TOTAL RETURN FOR UK AND IRELAND CITIES IN 2015, % YEAR-ON-YEAR



Source: MSCI



MSCI SAMPLE OVERVIEW

The MSCI commercial property sample for Northern Ireland comprised **55** properties with a total capital value of **£799 million** as at the end of December 2015. The average lot size of assets in this sample was **£14.5 million**. **Table 1** illustrates the sample breakdown, by capital value, for each commercial property sector in 2015. **Figure 7** shows the breakdown by geographical location of assets in the analysis.

TABLE 1: TOTAL SAMPLE SIZE

	No. of properties	Value £m	% of Total Value
ALL PROPERTY	55	799	100
RETAIL	33	696	87
OFFICE	10	29	4
INDUSTRIAL	4	30	4
OTHER	8	43	5

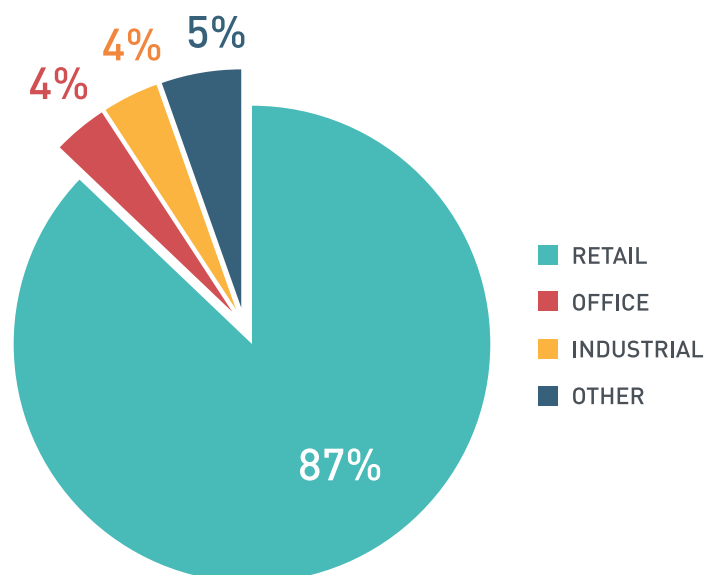
Source: MSCI

TABLE 2: BELFAST SAMPLE SIZE

	No. of properties	Value £m	% of Total Value
ALL PROPERTY	55	798.8	100
BELFAST RETAIL	17	376.5	47.1
BELFAST OFFICE	9	28.7	3.6

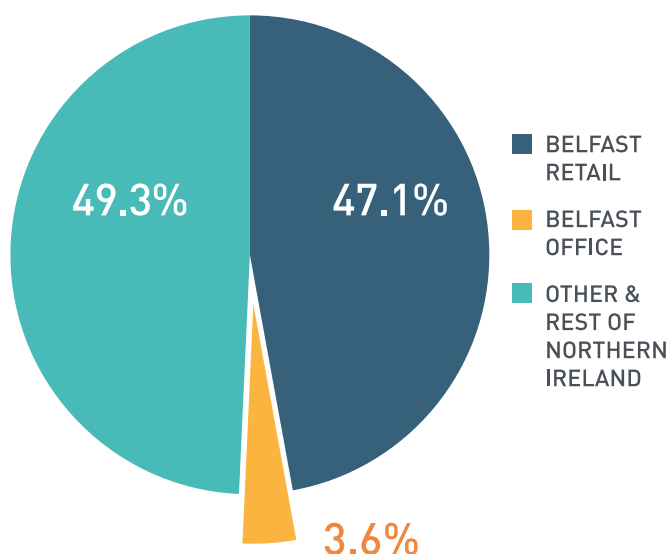
Source: MSCI

FIGURE 7: MSCI NORTHERN IRELAND SAMPLE 2015, % OF CAPITAL VALUE



Source: MSCI

FIGURE 8: MSCI NORTHERN IRELAND SAMPLE 2015, % OF CAPITAL VALUE



Source: MSCI

NOTES





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CONTACT

realestate@msci.com

Tel: +44 (0)20 7336 9200

Martin Haran

Professor of Real Estate and Urban Studies, Ulster University

Tel: +44 (0)28 9036 8757

m.haran@ulster.ac.uk

msci.com

clientservice@msci.com



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