ITNI

Investment Transactions Northern Ireland Bulletin

H1 2017

Lambert Smith Hampton

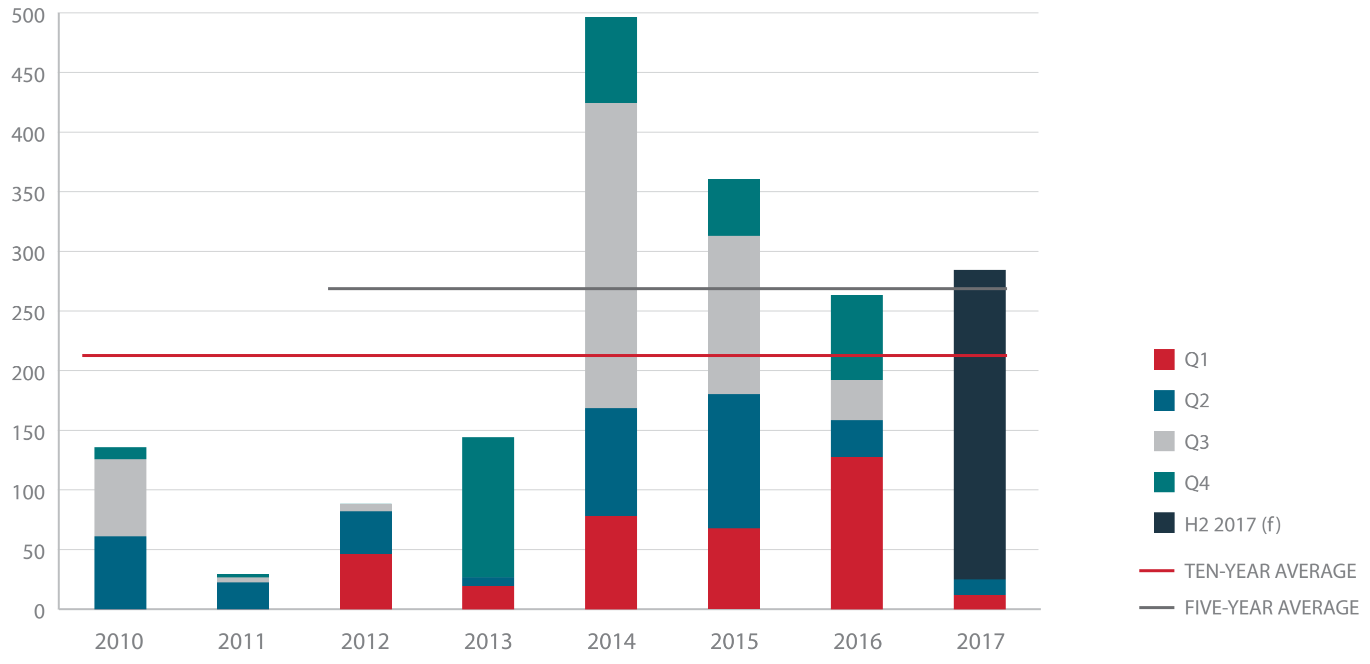
One year post the Brexit referendum, the Northern Ireland commercial property investment market has experienced fluctuations, but more recently there are signs of market resilience in the wake of Brexit, the Stormont collapse, slowing economic growth and the broader climate of uncertainty.

SECTOR FOCUS

At £25.9m, investment volume in the first half of 2017 was low, standing 78% below the five-year H1 average. However, a number of large deals narrowly missed the deadline for inclusion in Q2 2017 and therefore the H1 2017 figure provides a distorted impression of market activity.

Investment activity will be far stronger in the second half of 2017, with almost £260m of deals currently under offer and set to complete during H2 2017. While this figure is boosted by purchase of CastleCourt Shopping Centre in Belfast for £123m, the core sectors are gaining momentum.

INVESTMENT VOLUME (£M)



Source: LSH Research, Property Data, Property Archive

Brexit: One year on

The performance of the investment market in the 12 months post-Brexit has been undeniably poorer than the preceding 12 months. Volume, since the referendum, has amounted to £130m, less than half of the £338.5m in the 12 months before it.

Market activity in Northern Ireland has been characterised by peaks and troughs in the past 24 months, with the market dipping in the quarters immediately prior to and after the referendum. This trend was not unique to Northern Ireland, with quarterly volumes falling below the five-year average in the UK during Q2 and Q3 2016.

Investors have been more cautious post-Brexit

In the post-Brexit period, there were reductions in total volume, the number of deals, the average lot size and the completion of deals above £10m. This reflected a combination of uncertainty caused by Brexit, caution around the larger transactions, a wait-and-see approach by investors and a flight to quality (or 'risk averse') approach. The forthcoming buoyant period, however, will have a positive impact on these performance indicators.

Growth in the industrial sector

Whilst retail and office experienced a sharp fall in volume during H1 2017, industrial assets have traded well and were the only core sector to record an increase in volume since the Brexit vote. Volume currently stands 78% above H2 2016. The industrial sector is typically less active in Northern Ireland but, in this time of uncertainty, offers a good quality product at a reasonable cost.

Improving depth to the market

Over the last five years the average lot size has reduced from circa £8.5m in 2013 to £1.4m in 2017. The transactional activity has risen from 17 deals in 2013 to a peak of 56 in 2015, and year-to- date 46 deals are agreed or complete in 2017. This trend is arguably a sign of confidence as more investors enter the market.

Institutions and propcos remain largest net investors

Larger lot size investments continue to be dominated by UK-based institutional investors and propcos. In the past 18 months, Ellandi, Tristan Capital Partners and Cordatus have purchased assets in excess of £10m at a combined value of £103.7m. The smaller lot size market (sub £2m) remains dominated by high net-worth individuals and families, many of whom are resident in Northern Ireland.

Q2 2017 PRIME YIELDS

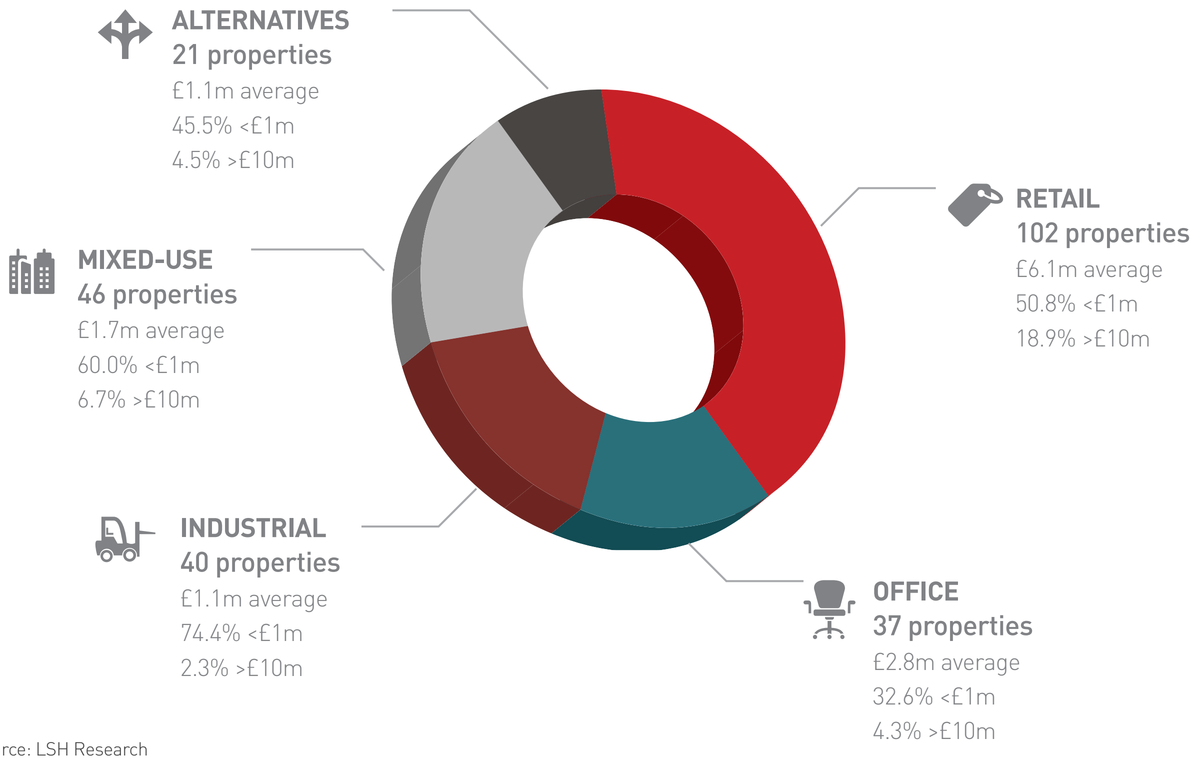
SECTOR	Prime yields			YIELD SENTIMENT
	Q2 2017	3 MONTH MOVEMENT (BPS)	12 MONTH MOVEMENT (BPS)	
Prime shops	5.50%	◀▶	▼ 50	◀▶
Prime shopping centres	6.00%	◀▶	◀▶	◀▶
Office	6.25%	◀▶	◀▶	◀▶
Industrial	6.00%	◀▶	◀▶	◀▶

Source: LSH Research

SUPPLY, DEMAND AND QUALITY

Since the beginning of 2015, around 250 properties have been brought to market, of which 43% have sold (or are currently under offer).

STOCK MADE AVAILABLE SINCE 2015



Source: LSH Research

Demand is consistent

Since the referendum there has been a small reduction (8.7%) in overall stock coming to the market, although the proportion of larger assets (over £2m) has reduced considerably. In spite of the continued uncertainty, however, there is no significant difference in the number of assets that have sold each year since 2015, and in the 12 months pre and post-Brexit, indicating that investor demand remains healthy despite increased caution.

Stronger appetite for higher value assets

Assets valued under £1m make up the majority of stock (circa 60%) but only 1 in 4 sold due to typically poorer quality and higher risk returns. Higher value lower risk assets were considerably more likely to transact as a result of greater potential to meet institutional buyers' requirements, are more likely to maintain liquidity and usually benefit from a more comprehensive marketing campaign. Since the beginning of 2015, 61% of assets valued between £1m and £9.9m have sold and 71% of those valued £10m and over.

Brexit and a flight to quality

The proportion of all properties brought to market valued at less than £1m increased from 55% pre-Brexit to 68% post-Brexit, demonstrating an increase in lower value properties coming to market. However, many investors are displaying 'Flight to Quality' behaviour, and therefore good quality stock is performing well and attracting multiple expressions of interest, but secondary stock is suffering a dent in value and liquidity.

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PROPERTY MARKET OUTLOOK

Whilst activity in commercial property has been in flux in the wake of Brexit and subsequent political events, there is definite cause for optimism for the remainder of 2017.

Investment volume expected to improve on 2016

Total investment volume in 2017 is expected to surpass the annual average and exceed 2016's £263m. We forecast that total volume will exceed £300m, with transactional activity heavily weighted in the second half of the year and boosted by the recently completed CastleCourt Shopping Centre deal.

Lack of opportunity remains a challenge

The key challenge for the second half of 2017 remains the mismatch between investor demand (which remains healthy) and the scarcity of good quality assets coming to the market. Whilst there is a significant pick-up forthcoming in activity, there is a requirement for supply of good quality stock to relieve investor frustrations.

Healthy demand in the office market

Over the past 12 months, office assets brought to market have generated keen interest from a variety of types of investors, in spite of the uncertain economic climate, companies looking to (re)locate outside the UK and the delay in reducing the Corporation Tax rate. Belfast occupier market demand is reflected by its steady rental growth, strong demand for grade A space, recent FDI announcements and circa 1m sq ft of new or refurbished space under development.

Belfast is also the perfect strategic post-Brexit location between the UK and the EU offering good value for money, a skilled and educated population and convenient access to both markets. In comparison to similar-sized cities, such as Cardiff and Bristol, Belfast continues to offer the lowest occupational office costs.

The alternatives sector

Development in hotels and purpose-built student accommodation is flourishing, reflecting Northern Ireland's booming tourist industry and the impending influx of students into Belfast city centre. We anticipate that growth in the alternatives investment sector will continue in line with the development activity in these areas.

Economic conditions, Brexit negotiations and an improving picture

The commercial property market will continue to be influenced by the broader economic and political climate, with future fluctuations in activity anticipated. Despite this, the overall picture is improving. H2 2017 will demonstrate investor activity in a low interest rate/secure yield market and the resilience of commercial property in a climate of uncertainty.

Caution and consideration

Market changes and increased risk have prompted a change in investor behaviour. A flight to quality, increased caution and enhanced consideration across the sectors has been observed. Investors have not retreated from the commercial property market, but are being more considered about where they choose to invest and are more focused on the merits of the opportunity in question.

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