KEY POINTS

- Commercial property in Northern Ireland posted a total return of **10.9% y/y** in 2014. This represented a continued improvement in market performance, building on the 7.0% y/y returned in 2013, the latter a major turnaround after the negative return of -0.4% y/y in 2012;

- The Northern Ireland market was boosted by continuing strong levels of passing rent, resulting in an income return of **8.4% y/y** in 2014. This remains amongst the highest real estate income returns recorded by MSCI and provides a competitive pricing advantage for the market;

- Market rents recorded a second consecutive year of increase following the downturn, with average rental values growing by **2.9% y/y** for commercial property in 2014. This is clear evidence of improving confidence among occupiers, especially in the retail sector, as the economy begins to rally;

- The Belfast commercial property market recorded a positive total return of **10.6% y/y**, outperforming a number of key European cities including Amsterdam, Lisbon and Stockholm;

- Equivalent yields shortened through the course of 2014 to close out the year at **7.8%**, down from 8.0% in 2013. This suggests warming investor sentiment as the broader commercial property market recovery begins to take hold.

FIGURE 1: NORTHERN IRELAND PERFORMANCE SUMMARY 2014, % YEAR-ON-YEAR

<table>
<thead>
<tr>
<th>TOTAL RETURN 10.9%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year end: 66 properties valued at £877.4 million</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income return</th>
<th>Capital growth</th>
<th>Cross product*</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 8.4%</td>
<td>+ 2.3%</td>
<td>+ 0.2%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Rental value growth</th>
<th>Yield impact</th>
<th>Residual**</th>
</tr>
</thead>
<tbody>
<tr>
<td>+ 2.9%</td>
<td>+ 2.2%</td>
<td>- 2.8%</td>
</tr>
</tbody>
</table>

* Cross product: capital gain/loss in reinvested income
** Residual: impact of delays in income stream, mainly effect of over-renting

Source: MSCI
The year 2014 marked a significant turning point for the UK commercial property market, as sustained growth in both capital and rental values 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 among occupiers. Broadly positive economic news further boosted sentiment towards investment real estate as the expectation of future rental value growth spurred on investors to bid higher and take on riskier income streams.

The significantly improved economic climate in both the UK and the Republic of Ireland fuelled a major rebound in the performance of commercial property in both countries during 2014, most crucially in regional markets outside their respective capital cities. This strong investment performance, driven by recovering rents and tightening yields, reached levels not seen in either market since before the market crash.

UK commercial property saw total returns grow to 17.8% y/y in 2014, while recovery in the Republic of Ireland was even more rapid, with returns surging to 40.1% y/y, the highest level recorded globally last year. The strong recovery in both these markets fed through to investor returns in Northern Ireland, resulting in a total return of 10.9% y/y, up from 7.0% in 2013. Performance in Northern Ireland has tended to follow the rest of the UK more closely than the Republic of Ireland, with London based institutional investors entering the market targeting long-term income streams from segments such as retail warehouses and supermarkets. Figure 2 shows total returns in the Northern Ireland market between 2007 and 2014.

In 2014 the total return of 10.9% y/y from Northern Ireland real estate outpaced UK Equities, which returned just 0.5% for the calendar year, but lagged UK Government Bonds which returned 12.9%. Property Equities (predominately REITs and listed property companies) performed strongly with a return of 24.3% y/y, reflecting analysts’ increasingly optimistic view of future rental expectations, with economic recovery bolstering the retail sector in particular.

**Figure 2: Total Return Trend, 2007-14, % Year-on-Year**

Source: MSCI
Capital values in Northern Ireland fell by nearly 33% after peaking in 2006, but returned to growth in 2014, rising by 2.3% y/y. As a result, values were 31% off peak by the end of 2014, compared to 17% for the rest of the UK and a substantial 56% for the Republic of Ireland. However, a strong income return rather than accelerating capital value growth was mainly responsible for the 10.9% y/y total return achieved in Northern Ireland, contrasting with both the rest of the UK and the Republic of Ireland, where impressive levels of capital growth drove the markets higher.

Income return has averaged 7.6% y/y over the 33 years for which the IPD UK Annual Property Index has reported investor performance in Northern Ireland, with the 2013 income return of 8.9% y/y amongst the highest annual income returns through this period. Income return moderated somewhat in 2014 as stability returned to the investment market, but at 8.3% y/y it remained significantly above the historic average.

High income return combined with strongly discounted capital values continue to make Northern Ireland assets highly competitive compared to the rest of the UK and other European markets. This has tempted investors into the market, with transaction volumes growing through 2013 and 2014 as expectations of strengthening values and increasing rents feed through into investor sentiment.

Northern Ireland rental values grew for the second year in succession in 2014, following declines in the previous two years. The most severe rental fall of 7.9% y/y occurred in 2012, as a number of major defaults hit the retail sector across the UK as a whole. Since 2013, rents have recovered 5.8% of their value, but still remain 8.7% down from the 2008 market peak. In 2014, rents grew by 2.9% y/y, a marginal improvement on the 2.8% posted in the previous year.

Overall, rental values in Northern Ireland only fell modestly after peaking in 2008, compared to a decline of 36.6% in the Republic of Ireland. As a result, the occupier market in Northern Ireland shows greater similarity with the rest of the UK, where rents are down by 7.2% since their peak. This reflects the fact that institutional investments in Northern Ireland tend to be held on longer leases, typically on out-of-town retail properties with strong covenants that have proved relatively 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, 1984-2014

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 perceptions of the risk to the future cash flow.

The continuing improvement in both capital and rental values during 2014 reflected the positive mood in the Northern Ireland property market. Rental value growth indicated growing competition from occupiers for space, especially in the retail sector, where the implication was that retailers expect trading conditions to improve in the years to come. Meanwhile, competition amongst office occupiers continues to grow as the domestic economy strengthens, while the supply of modern space is limited. These positive trends are illustrated in Figure 4, which shows the key drivers behind total returns for the Northern Ireland market over the last six years.

A property’s income return will always be positive as long as the rent collected by the investor exceeds their expenses. Rising income (passing rent) pushes income return higher, while declining capital values have a similar effect provided that passing rent is stable. This means that income return can be seen as an indicator of occupier and income risk in the market.

Northern Ireland’s high level of income return in 2014 reflected a combination of strong income streams and heavily discounted capital values. Income returns fell between 2013 and 2014, from 8.9% y/y to 8.4% y/y, as capital values grew and the perception of occupier risk in the market receded somewhat. Crucially, net rent passing grew in 2014 for the first time since 2011, a rise of 3.0% y/y, stemming declines of 6.4% and 0.7% in the two previous years.

Improving investor sentiment also boosted Northern Ireland real estate performance in 2014, leading to some yield compression as the demand for assets grew, and prices tightened as the year progressed. This was reflected by a positive yield impact of 2.2% within the total return of 10.9%. Equivalent yields compressed from 8.0% to 7.8% over the year, further evidence of the strengthening of pricing in the market. Despite this, pricing in Northern Ireland remains comparatively discounted against the rest of the UK and Republic of Ireland, where end-2014 equivalent yields were 6.0% and 6.5% respectively.

![Figure 4: Drivers of Total Return, 2009-14, All Property % Year-on-Year](source: MSCI)
Belfast returns were bolstered by the re-emergence of capital growth in 2014, with values rising by 2.6% y/y, while income return remained high at 7.8% y/y. Belfast’s income return was the highest of the 15 European city markets in this analysis, just ahead of Dublin on 7.5% y/y. Across Europe, the average income return fell from 5.5% y/y to 5.3% y/y in 2014 as declining income risk combined with modest capital value growth, especially in recovering markets like the Republic or Ireland, Spain and the UK. The comparatively high level of income return in both the Belfast and Dublin markets continue to make them very competitive in the eyes of investors. Compared to other European cities, Irish markets also benefit from relatively favourable leasing structures and cash-flow profiles.

As well as comparing Belfast to 15 European cities at the all-property level, this analysis examines each sector of the Belfast market against 32 different UK and Irish cities. Figure 6 shows their ranked total returns across both the retail and office sectors. Unsurprisingly, Dublin and London lead the performance hierarchy due to strong rental value growth and unmatched investor demand. However, Belfast outperformed a number of its peer cities: for example Manchester, Cardiff and Liverpool in the retail sector, and Edinburgh, Newcastle and Glasgow for offices.

Source: MSCI
FIGURE 6: TOTAL RETURN FOR UK AND IRELAND CITIES IN 2014, % YEAR-ON-YEAR

Source: MSCI
The IPD commercial property sample for Northern Ireland comprised 66 properties with a total capital value of £877 million as at the end of December 2014. The average lot size of assets in this sample was £13.3 million at the end of 2014, with 85% of properties by value in the retail sector. Figure 7 illustrates the sample breakdown, by capital value, for each sector in 2014. Figure 8 shows the breakdown by geographical location.

**TABLE 1: TOTAL SAMPLE SIZE**

<table>
<thead>
<tr>
<th></th>
<th>No. of properties</th>
<th>Value £m</th>
<th>% of Total Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALL PROPERTY</td>
<td>66</td>
<td>877</td>
<td>100</td>
</tr>
<tr>
<td>RETAIL</td>
<td>37</td>
<td>744</td>
<td>85</td>
</tr>
<tr>
<td>OFFICE</td>
<td>17</td>
<td>61</td>
<td>7</td>
</tr>
<tr>
<td>INDUSTRIAL</td>
<td>4</td>
<td>32</td>
<td>4</td>
</tr>
<tr>
<td>OTHER</td>
<td>8</td>
<td>41</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: MSCI

**TABLE 2: BELFAST SAMPLE SIZE**

<table>
<thead>
<tr>
<th></th>
<th>No. of properties</th>
<th>Value £m</th>
<th>% of Total Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALL PROPERTY</td>
<td>66</td>
<td>844</td>
<td>100</td>
</tr>
<tr>
<td>BELFAST RETAIL</td>
<td>23</td>
<td>476</td>
<td>54</td>
</tr>
<tr>
<td>BELFAST OFFICE</td>
<td>16</td>
<td>60</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: MSCI
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