Market Failure

We have continuously highlighted a significant issue for the office market being the non-existence of new Grade A supply being built. Government, following research undertaken by RSM McClure Watters reporting to Invest NI, have recently recognised that the market has failed. To counter this and by seeking formal ‘Expressions of Interest’, the prospect of intervention measures being offered to the development sector is now real.

The proposed assistance in the form of short term Mezzanine finance (up to 40% of the Capital Value of the project), has the objective of stimulating construction in the absence of adequate traditional bank funding. It is understood that a number of applications are under active consideration and announcements are likely in 2016. It is worth noting that the availability of funding generally is a hot topic and a number of private equity houses have floated the concept of support for speculative building for the first time in many years. The traditional banks are still not considered to be in that space, a position which is likely to prevail for some time yet.

The recent announcement that the much awaited Corporation Tax rate reduction will arrive in April 2018 has been widely welcomed by the business community. The likely effect of this being felt in the office market beforehand is expected as developers, assuming they...
can secure senior development finance, prepare for anticipated rising demand levels from both FDI occupiers as well as local companies. We have already witnessed a number of significant planning applications working their way through the new planning regime controlled by Belfast City Council since April 2015.

Activity in the office market was subdued in Q1 - Q3 2015 with the volume of actual transactions completed totalling only 119,000 sq ft. Most disappointing, the volume of lettings recorded in Q3 was only 31,000 sq ft, which is a significant reduction on the 117,000 sq ft recorded in the same period in 2014. In our view this is largely due to a lack of opportunity rather than a significantly reduced appetite from occupiers.

In Q4 a number of key deals completed towards the end of 2015 which boosted the take up figures by 90,000 sq ft. A number of other deals were delayed but this should mean a positive start to 2016. There is evidence of pressure growing on rents and incentive packages are diminishing as demand strengthens against limited supply.

**Supply**

Generally levels of supply across Grades A and B are falling. More specifically the supply levels of Grade A stock currently stand at approximately 150,000 sq ft. The volume of available good quality stock will continue to be an issue in the short-term as occupiers will be, in the absence of new stock coming on line, forced to consider previously occupied stock, albeit in some cases refurbished, Grade B stock.

Outside the traditional city centre core, promoted by Belfast Harbour Commissioners, the last remaining floor space at City Quays (CQ1) is understood to be ‘under offer’ at the time of writing and the formalities are likely to be concluded in Q4 2015.

The second phase of this scheme, (CQ2) totalling 96,000 sq ft, is now under construction but will not be available until Q2 2017. Once complete, the overall project will provide a mix of commercial uses including hotel, car parking and much needed new Grade A office space.

Whilst this is to be welcomed the absence of a significant development pipeline in the city centre core, will keep supply tight until new stock is provided.

Overall stock levels are currently assessed to be 488,000 sq ft made up of:

- Grade A – 150,000 sq ft
- Grade B – 338,000 sq ft

The graph above compares current stock levels with previously reported figures from 2012 onwards.

It is worth noting that of the stock that is available, a significant proportion is in small floor plate sizes across a large number of buildings thus making it difficult for Belfast to satisfy large scale ‘footloose’ requirements particularly those that are likely to be originating from FDI.

In terms of new stock delivery we are aware that a new challenge has surfaced recently because of trade skills being lost during the crash and a restricted number of contractors available to complete construction projects. Due to a lack of activity in Northern Ireland many of our indigenous contractors have been deployed in a number of other ‘more profitable’ locations across GB and Ireland.

The only crane currently visible on the city centre core skyline is at the site of the Queen’s Square, Belfast - 80,000 sq ft, project by Stargime.
new 'pre sold' 126,000 sq ft City Council building in Adelaide Street, a freehold 'design and build' project being promoted by McAleer & Rushe. On a further positive note recent announcements have been made by Kilmona which has declared that c 600,000 sq ft of space is in the pipeline across a number of projects.

Take Up

As already stated activity in the office market was subdued throughout Q1 - Q3 with transactions completed totalling 119,000 sq ft in 32 deals. In the context of restricted supply the largest letting was to PWC which secured c 21,200 sq ft adjacent to it’s existing presence at Laganbank Road. It is understood that this space will be used to accommodate a Joint Venture with Google.

Two other notable lettings in the survey period were the acquisition by Whitehat Security which acquired c 9,000 sq ft in The Linenhall Building and Capita which secured c 5,000 sq ft in Capital House. The volume of lettings in the Q3 totalled only 31,000 sq ft, which is a significant reduction on the 117,000 sq ft recorded in the same period in 2014. As already stated, in our view this is largely due to a lack of opportunity rather than a significantly reduced appetite from occupiers.

Quarter 4 buoyed the market as the year closed out with a total of 18 deals making it the strongest quarter of 2015. This late flurry resulted in take up exceeding initial estimates.

However this late boost to the annual office take up figure for 2015, that pushed the year end total to c 210,000 sq ft, was not enough to bring the final annual figure anywhere near that of previous years.

There is currently a combined unsatisfied ‘stated’ requirement for in excess of 330,000 sq ft of space across central Belfast, which includes a number of sizable requirements in a range of sectors. Invest NI have predicted that there will be a potential need for c 677,000 sq ft over a 3 year period from 2014 - 2017 focused on the recognised office locations. This is interesting as in the period 2012 – 2014 FDI activity resulted in an average take up of 143,000 sq ft pa.

Rents

Given the strengthening demand and lack of supply, evidence shows that Grade A rents are rising beyond £15.50 per sq ft for the first time and incentive packages are continuing to reduce. We predict that these headline figures will continue to come under further pressure in the short-term.

The corporate occupier market is beginning to appreciate that to secure quality space, comparable to that offered in other UK cities, rents must grow to in excess of £18 psf to justify Grade A specification.
Whilst reaching £18 psf appears to be a large uplift, when compared to other large cities across Great Britain and Ireland providing large scale employment, this level remains competitive. The ‘City Comparison’ graph illustrates that even at these levels Belfast will remain a competitive proposition.

Outlook
- Lack of Grade A availability to continue
- Refurbishment activity in key locations
- New stock levels to diminish further due to construction activity remaining restricted in the immediate future
- Demand growing due to economic recovery, the arrival of key lease events and FDI
- Pressure to continue on prime rental levels and incentive packages
- Vacancy rates will continue to fall in short term
- Viability of previously uneconomic schemes being assessed in the light of new market evidence
- Speculative site acquisition to continue.
- Lack of contractors

Definitions
In our research we use the following to categorise office space:-
Take Up – Refers to leasehold space only.
Grade A – New or refurbished buildings/suites fitted with fully accessible floors, suspended ceilings, lighting and air conditioning.
Grade B – Previously occupied buildings/suites which are capable of occupation but would benefit from refurbishment.
Grade C – Previously occupied buildings/suites which are not capable of occupation.