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DAVY REAL ESTATE

Davy Irish Property Fund

Quarterly report for the quarter ended 30th September 2017.

Fund Metrics

Net Asset Value (NAV)	€290m
NAV per Unit	€15,162
NAV Change Q on Q	1.55%
Dividend per Unit – Q3/YTD	€149/€479
Distribution Date	20 Oct 2017
Total Rent – Q3	€3.3m
Vacancy Rate*	3.03%
WAULT – to break/expiry**	5.44/6.39

*** Vacancy Rate by value**
**** Weighted average unexpired lease term**

Fund Performance

	Capital Return	Income Return	Total Return*
Qtr	1.55%	1.00%	2.54%
YTD	2.67%	3.24%	5.91%
1 yr	4.74%	4.48%	9.21%
3 yrs p.a.	16.29%	4.99%	21.29%
5 yrs p.a.	18.35%	3.86%	22.20%

All performance figures are for the period ending 30th September 2017
3 and 5 year figures show the annual average performance for those periods
***Net total return based on NAV growth and distributions**
Sources: Northern Trust and J&E Davy

Warning: Past performance is not a reliable guide to future performance. Indications of future performance are estimates only. The value of your investment may go down as well as up. The income you get from this investment may go down as well as up.

Introduction

Welcome to the Q3 2017 quarterly report to unitholders in the Davy Irish Property Fund ("DIPF" or "the Fund").

The Fund has declared a distribution of net rental income for Q3 equating to €149 per unit. This distribution will be made in October. The amount distributed to date equates to 4.3% annualized and we would expect the Q4 distribution to bring this higher. The Investment Manager continues to market the Fund and attract new investors.

DIPF pays out to investors the net income return on a quarterly basis which provides very strong ongoing cashflow for investors in a low yield environment. We project that income generated by the Fund should grow by almost 20% over the next five years as the Fund's office assets increase their rents from a relatively low base.

The Fund made significant progress during the quarter in letting the remaining vacant space in the Fund and should reach close to zero vacancy during Q4. It also made progress in relation to its two projects at Patrick Street in Cork and Nutgrove Shopping Centre.

The Fund made progress in relation to the acquisition of two small assets and expects to complete these purchases during Q4.

Photo 1: Nutgrove refurbishment work proceeding well

Performance

The Fund's bid unit price as at 30th September 2017 was €15,162.53 (Offer price €15,962.16). This reflects an increase of 1.55% in the unit price of the Fund for the quarter and a total return of 2.54% when the distribution for the quarter is taken into account.

The unit prices for the Fund are published and updated monthly on Davy's website at www.davy.ie/real-estate/dipf.

Property values were broadly stable quarter on quarter and the increases came as a result of asset management where leases were finalized. The additional leasing activity during Q3 should also result in further increases during Q4. In the broader Irish commercial property market the rate of increase in values has slowed down but overall returns from the property market remain strong.

Portfolio

The top five assets in the Fund by value as at 30th September 2017 are as follows:

1. 20 On Hatch (office).
2. Nutgrove Shopping Centre (retail).
3. Ferry House (office).
4. Treasury Building (office).
5. 8/34 Percy Place (office).

Distributions

The distribution of net Q3 income was declared at the end of Q3 and will be distributed during October. This distribution equates to €149 per unit and brings the income distributed to date for 2017 to €479 per unit.

Investment activity

The Fund completed the acquisition of two units in Nutgrove Shopping Centre in the first week in October. The total consideration for these units is €1.655m. The Fund has also agreed to acquire another unit in Nutgrove and is working through the legal due diligence process. The Fund sold no assets in Q3.

Asset management activity

Vacancy within the Fund reduced to 8.49% (Q2: 10.9%) as measured by sq ftage and to 3.03% (Q2: 3.5%) as measured by value at quarter end. The reduction in Q3 was achieved through the lettings of:

- 4th floor in Treasury Building which had been vacated by the National Treasury Management Agency (NTMA) and has now been leased to Perrigo; and
- 2 Grafton Street, which has been leased to Claddagh Jewellers who opened for trade early in Q3 following a vacancy period of less than 4 months

Photo 2: 2 Grafton Street, newly occupied by Claddagh Jewellers

Significant progress has also been made in leasing the remaining vacant space and we expect that the Fund to have almost no vacancy by the end of Q4. The current vacancy in the Fund comprises the following:

- 83-85 Patrick Street: the redevelopment of these buildings into a single property has now been completed. The Fund has reached heads of terms with a fashion retailer and hope to finalise lease documentation over the next few weeks in time for the unit to be open and trading in advance of Christmas.
- 2 Parkway: Debenhams vacated during Q1. Agreement in principal reached with an occupier and the Fund is in the process of completing landlord works. We expect this letting to complete shortly and for the tenant to take up occupation during Q4.
- One Airton: as reported many times in the past this building has proved very difficult to lease due to its location rather than the quality of the space. We are currently in discussions with two parties and we expect to have finalized this letting in Q4

Photo 3: Refurbished St Patrick's St Property – progress being made on leasing this in advance of Christmas 2017

In Nutgrove façade works started in Q2 and are currently progressing well. Both entrances have now been completed and the paving replaced. The ongoing work relates to replacing the old façade with stone and this is due to complete by the end of October.

In Broomhill, a lease expired during September and a deal has been agreed with the subtenant to lease the unit from expiry. This has ensured no vacancy or void cost.

The rent review remains ongoing in Warrington Place although some progress has been made recently and it is expected this will complete in Q4. Reviews in relation to two floors in the Treasury Building completed in Q2 and increased rents have been implemented.

Market and economic outlook
Investment volumes in 2017 continue to trend lower than 2016 but €1.3m of commercial property sales have completed year to date. The slower pace of transactions is due to several factors including that the 2014 to 2016 period was very strong in terms of the volume of transaction and a lot of assets are now held in longer term vehicles and are therefore unlikely to trade again in the short term.

In the office sector valuations have been quite stable during 2017. Recent investment activity would suggest that the market yield may move down from its current level at c. 4.65% and may be at 4.50% or 4.25% by year end. Quoting rent on city centre grade A remains at €65 per sq ft and at present this does not look like moving significantly higher.

We are continuing to see strong take up in the occupational market. Based on lettings year to date letting agents are forecasting the final outcome for 2017 at between 2.5m sq ft and 3m sq ft. At these levels there is sufficient demand to lease the space currently being developed. This development cycle has been marked to date by its restraint as developers and funding banks have been very slow to fund speculative development. To date this has meant that the space being developed is either prelet or let soon after development at rents at or close to headline levels.

We continue to see little evidence of a flood of expansions or new lettings attributable to Brexit. The occupiers taking large space in Dublin to date have been the technology companies, pharmaceutical companies and the domestic professional and financial services firms. To the extent that foreign financial services companies such as Barclays or JP Morgan have signed up to or indicated that they would sign up for new space it is difficult to assess how much if any of this is Brexit related. Ultimately, this will depend on how Brexit plays out and how Ireland fares in attracting the groups that decide to move functions and businesses. Currently it appears that this potential additional requirement would add demand but is not essential to take up the space currently being developed.

As commented on many times before, the retail market is improving at a far slower pace than the office sector as it is influenced entirely by the improvement in the Irish economy and consumer sentiment. It is also subject to headwinds from technology and other sources that are far more muted in the office sector. We are seeing gradual growth in sales values and volumes and retail property values (driven by the rental growth achieved since the trough) remain well behind where they were at the peak.

However, Brexit has affected the UK groups taking new space in the Irish market. With a few exceptions these groups are no longer active in the Irish market and while this may change in the short to medium term for the moment it has significantly reduced the number of groups vying for retail space.

The gradual improvement in the overall Irish economic picture continues as highlighted in the following data:

- Retail sales have continued to improve with data to the end of August showing retail sales excluding cars up slightly (0.2%) month on month and up 6.7% year on year[1]. This is still being corroborated to some degree by increased footfall in shopping centres. In addition, retail goods prices fell 2.8% in the year to August helping affordability.
- The rate of unemployment continues to fall but at a slower pace. The unemployment rate and was 6.1% at the end of September compared to 7.2% at the end of December 2016[2]. While the pace of job growth has slowed, the rotation from part time work to full time continues and income growth is running higher than the increase in employment rate.
- Tax receipts for 2017 continue to be well ahead of 2016 but behind the targeted numbers set by the Department of Finance. Tax revenues year to date are up 5.4% on the same period in 2016 but 0.6% behind target. Improved tax receipts and lower than expected spending leaves the government €677m better than expected at the end of September[3].

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[1] Davy Research Irish Economy 29th September 2017
[2] Davy Research Irish Economy 4th October 2017
[3] Davy Research Irish Economy 3rd October 2017

- Mortgage growth continues its upward trajectory. Mortgage approvals in August were up 25% on the prior year and the average mortgage level has also increased[4]. Projections are that mortgage lending in 2017 will reach €7.5bn compared to €5.7bn in 2016.
- Irish household debt continues to fall and as at early September was at 145% of disposable income[5].
- Business confidence within Irish manufacturing business also improved significantly with a Purchasing Manager's Index (PMI) reading of 56.1 at the end of August, up from 54.6 in July[6].

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[4] Davy Research Irish Economy 27th September 2017
[5] Davy Research Irish Economy 12th September 2017
[6] Davy Research Irish Economy 1st September 2017