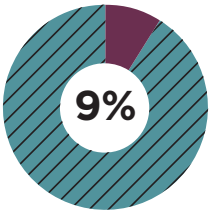
MARKET IN MINUTES
*Savills Research*

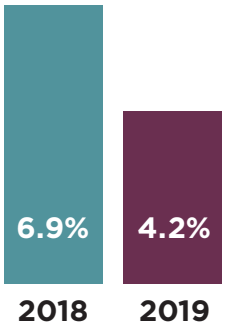
# Dublin and Cork Offices

savills

76 Sir John Rogerson's Quay on Dublin's South Docks




'Strongest economic growth in the EU with output rising by **9%** in Q2 compared with Q2 2017'




'Forecasting institutions predict that the Irish economy should expand by **6.9%** and **4.2%** in 2018 and 2019 respectively'

## Introduction

Ireland continues to enjoy the strongest economic growth in the EU with output rising by 9% per annum in Q2. Consistent with this, employment is up 3% in the year and has now surpassed its previous boom-time peak.

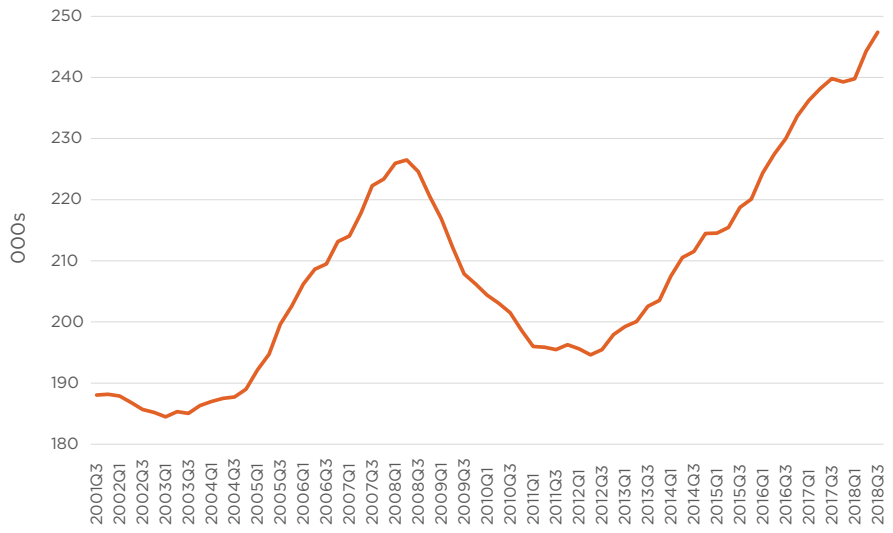
PMI and labour market data in Europe show some signs of softer expansion in recent months, and the uncertainties that have been hanging over the global economy such as Brexit and the US / China trade war still persist. Nonetheless, Ireland is carrying very strong economic momentum and the outlook remains positive. On average, forecasting institutions predict that the Irish economy should expand by 6.9% and 4.2% in 2018 and 2019 respectively – very strong growth by historical and international comparisons. Jobs growth is also forecast to remain strong at 2.9% this year and 2.3% in 2019.

### Market Demand
### Lettings

While Ireland's labour market performance has been exceptional by any yardstick, office-based employment in Dublin has outstripped overall jobs growth, increasing by 5.1% in the year to September. This reflects two long-term trends; the ongoing structural shift towards service-based activities and the continued urbanisation of Irish society.[1]

[1] Census data show that Ireland's population increased by 173,613 between April 2011 and April 2016. 80% of this increase was concentrated in urban centres (53% in Dublin) and Dublin accounts for 44% of the State's urban population.

## Figure 1: Dublin Office Based Employment – 4QMA




**Source** CSO

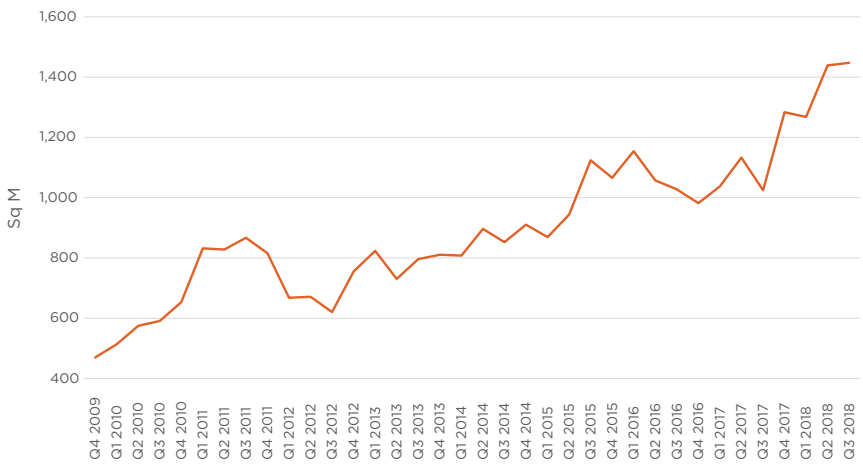
Because Q3 incorporates the traditional holiday season it often has the lowest office take-up of the year. This pattern looks likely to be repeated in 2018. Nonetheless, reflecting strong underlying jobs growth, 45,155 sq m of Dublin office space was taken-up between July and September - a 52% increase compared with Q3 2017. This brings the running total of take-up for the first nine months of the year to a whisker under 200,000 sq m.

### Larger Lettings

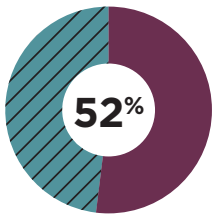
56 lettings were signed in Q3 – compared with 39 in the third quarter of 2017. However the amount of space being taken has grown faster than the number of transactions, indicating a continued increase in the average letting size.

The biggest deal of Q3 was the 5,388 sq m letting of No. 1 Grand Canal Quay to Google. Traditionally, transactions of 5,000 sq m or more have been a rarity in Dublin. However there have now been 17 such deals in the last year, accounting for 142,186 sq m of take-up (46% of the market total). The demand for larger parcels of space reflects the changing occupier base. Replicating a pattern observed in other countries, large ICT firms are increasingly favouring a city campus model that facilitates the recruitment and retention of talent in an increasingly competitive labour market. Behind this is the declining propensity for younger people to own cars and their preference to be in urban environments which provide a range of social and cultural amenities and which enable them to walk or take public transport to work.

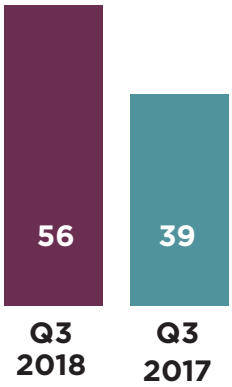
## Figure 2: Average Letting Size, Dublin Offices 4QMA




**Source** Savills Research

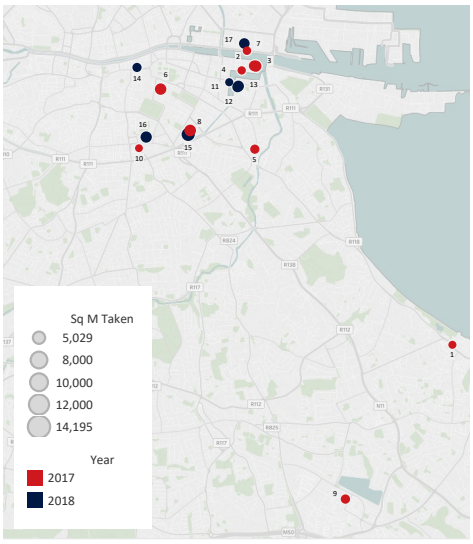



**'52%**
Increase in Dublin office taken-up between July and September compared with Q3 2017'




**'56**
Lettings were signed in Q3 – compared with 39 in the third quarter of 2017'

## Figure 3: Large Lettings in the Dublin Market




| ID | Address | Occupier | Year of Letting year | Sq M Taken |
|---|---|---|---|---|
| 1 | New Enterprise House (under construction - previously UID 298) | Zurich | 2017 | 5,330 |
| 2 | 300, Capital Dock, Sir John Rogersons Quay | Indeed | 2017 | 9,213 |
| 3 | 100, Capital Dock, Sir John Rogersons Quay | Indeed | 2017 | 10,425 |
| 4 | 5 Hanover Quay, Dublin 2 | Delphi | 2017 | 5,698 |
| 5 | Building 1, Number One Ballsbridge, Shelbourne Road | Avolon | 2017 | 6,985 |
| 6 | 10 Molesworth Street | AIB | 2017 | 10,708 |
| 7 | No 1. Cublin Landings | NTMA | 2017 | 5,934 |
| 8 | Lad Lane LinkedIn HQ | LinkedIn | 2017 | 11,148 |
| 9 | The Atrium, Block A, Sandyford | Fleetmatics | 2017 | 7,100 |
| 10 | Iveagh Court, 4 Harcourt Road | WeWork | 2017 | 5,029 |
| 11 | No. 1 Grand Canal Quay | Google | 2018 | 5,388 |
| 12 | Number 2, Bolands Quay, Barrow Street | Google | 2018 | 8,472 |
| 13 | Number 1, Bolands Quay, Barrow Street | Google | 2018 | 10,037 |
| 14 | One Central Plaza, Dame Street | WeWork | 2018 | 6,875 |
| 15 | Wilton Terrace | LinkedIn | 2018 | 14,195 |
| 16 | Adelaide Court/Three Park Place | IDA | 2018 | 10,405 |
| 17 | No.2, Dublin Landings, North Wall Quay | WeWork | 2018 | 9,244 |

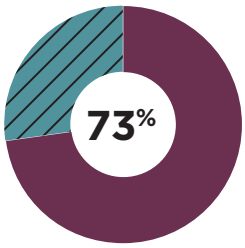
Interestingly, nearly 73% of the space taken in these bigger transactions has been prelet. One reason is that, although space requirements are rising, larger buildings are not necessarily available to meet occupiers' demands. The average size of existing office buildings in Dublin currently stands at 3,108 sq m, and only six parcels of 5,000 sq m or more are currently available in the CBD / South Docks area. However, this is being addressed by new development, with the average size of office blocks delivered since 2015 being 6,257 sq m – more than twice the size of buildings in the standing stock.

### Lettings by Sector

As has become normal in recent times, Information and Communications Technology (ICT) companies were the biggest takers of Dublin office space in Q3, accounting for just over 20,000 sq m or 44% of transacted space. In addition to Google, the technology companies taking space in Q3 included Huawei, VSware and Game On Media. On a cumulative basis tech has now taken-up over 90,000 sq m of accommodation in the year-to-date.

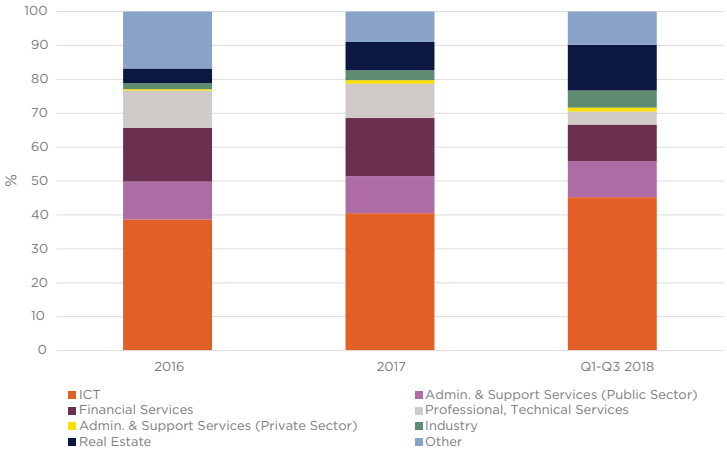
The continued demand from technology companies follows developments in the labour market. 6,700 additional ICT jobs were created between July and September, making Q3 2018 Dublin's strongest ever quarter of jobs growth in the technology sector. Over a 12m period ICT employment in Dublin has risen by 6.6%.

Intuitively one might expect a lag between employment growth and the procurement of additional space. However in a tightening market occupiers are beginning their searches for new space earlier than before and are increasingly signing leases in advance of expansion to ensure headroom for seamless growth. This has given rise to the phenomenon of 'Swing Space' – the short-term subletting of space which is ultimately earmarked for the lessee's own expansion plans. As a high-growth sector ICT inevitably provides good examples of this and Twitter, Informatica and Stripe have all taken this approach in the recent past. However the swing space strategy is not limited to ICT firms, with Grant Thornton providing an example of a professional services occupier that has taken a similar tack.




**'73%**
Of the space taken in these bigger transactions has been
**prelet'**

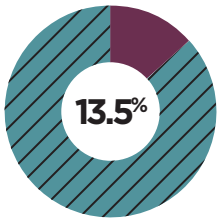
## Figure 4: Dublin Office Take-Up by Sector: 2016 – Q3 2018




**Source** Savills Research

**'6,700**
ICT jobs were created in Q3; Dublin's strongest ever quarter of jobs growth in the tech sector'


Beaux Lane House - Refurbished Office Suites in Dublin 2




26,910 sq m of serviced offices have been let in Dublin over the first 9m – accounting for **13.5%** of total take-up.

Although ICT is the largest employer of office-based staff in Dublin (69,400 employees), and has been expanding rapidly, the public sector is actually the fastest growing sector for office jobs. Public administration comprises 34,800 persons in Dublin, and has expanded by 27% over the last 12 months. During this time Government bodies have leased 29,180 sq m of office space, accounting for just under 10% of total take-up. The largest such letting was 10,405 sq m to IDA Ireland in Three Park Place earlier this year.

### Serviced Ofice Take-up

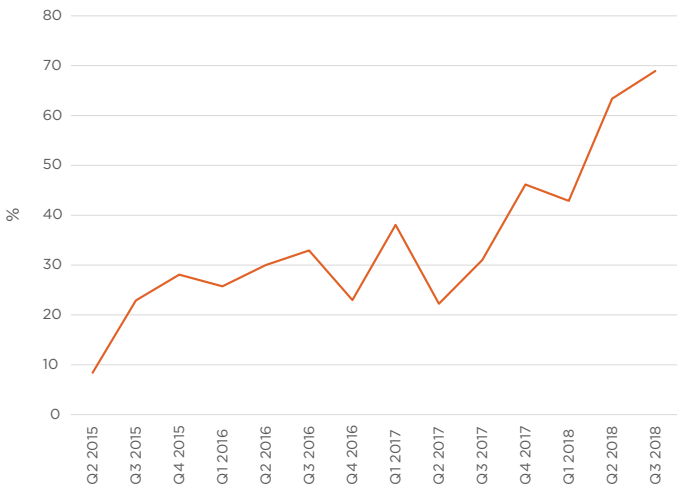
The rise of flexible workspace has been a major theme throughout Europe in recent years. Given that the serviced office model is well established in the UK, and that Brexit-related uncertainty is feeding occupiers' demand for flexibility, it is not surprising that serviced workspace suppliers have accounted for a sizable 13% of London's office take-up in the first nine months of 2018. More surprising is that, relative to the size of the market, flex-space providers have been even more active in Dublin. Although there was only one serviced office transaction in Q3 – IWG's letting of 1,523 sq m in Blanchardstown – some 26,910 sq m of serviced offices have been let in Dublin over the first 9m – accounting for 13.5% of total take-up. This reflects factors which are common across borders. Like their UK counterparts some Dublin occupiers are also using flexible workspace to mitigate Brexit uncertainty. Furthermore new lease accounting standards under IFRS 16 are pushing some occupiers in Ireland and elsewhere towards the serviced office model. Especially pertinent to Dublin, however, is the rapidly increasing presence of US technology companies within the occupier base.[2] American business culture naturally tends towards shorter planning horizons. Moreover, because many of the US companies in Ireland are ICT firms, there is an added imperative for flexibility. Technology changes quickly, is highly globalised and often involves the formation and dissolution of task-orientated project teams – all factors that feed into a demand for flexible business space. In addition, many young tech companies resist taking long leases because these could impact on buy-out pricing in the event of changes to the local tax code.

It will be interesting to observe how the flexible model develops over time and interacts with the offering from traditional business space suppliers. Mainstream landlords may come under increasing pressure to relax their lease terms and provide a more flexible offering to the market, especially on smaller lettings. Indeed we already observe that the serviced office option is impacting on the demand for direct space from small and medium sized tenants. Equally, however, the flex model could itself evolve and branch-out in different directions. Some operators are already diversifying from the original concept of supplying small quantities of flex-space and bundled services towards subletting big parcels of space to major corporate tenants.[3] Examples include Regus which has sub-let floors in 77 SJRQ to Wells Fargo and Udemy while Facebook, Accenture, Indeed and EY are believed to be taking more flexible space – often to align their office commitments to particular projects. On the other hand, it is possible that serviced offices may evolve towards a trojan horse model that, in addition to generating property-related income streams, facilitates the sale of business-to-business services such as software, telecommunications and even residential stock to small enterprises.

'Public administration employment has expanded by **27%** over the last 12 months'

[2] ICT occupiers accounted for 45% of Dublin's office take-up in the first three quarters of 2018 compared with 28% in London, for example.
[3] WeWork, which accounts for 77% of the serviced office space that has been leased in Dublin over the first 9 months of 2028, recently revealed that established enterprises now represent 29% of its client base.

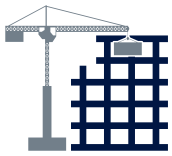
**Figure 5: Net Absorption As Percentage of Gross Lettings – 4QMA**




**Source** Savills Research

### Net Absorption

Based on a typical occupancy rate of 10 sq m per employee, the 17,500 additional office jobs that have been created in Dublin in the first nine months of 2018 should ultimately translate to approximately 175,000 sq m of business space absorption. In line with this back-of-the-envelope estimate, and allowing for some lag between jobs growth and the procurement of additional business space, net absorption of 147,646 sq m was recorded in the first three quarters. In percentage terms, the 'conversion rate' between gross lettings and net absorption continues to rise as corporate expansions and new entrants account for a higher proportion of take-up.



**'75,358 sq m**
of new office buildings were delivered in Q3 2018'

# Market Supply and Vacancy

### Development

In total 75,358 sq m of new office buildings were delivered in Q3 2018, bringing completions for the first nine months of the year to 164,775 sq m. In keeping with development trends in the cycle to date, nearly 70% of new space in the third quarter was located in Dublin 2. However the biggest completion of the quarter was a 15,579 sq m building developed by Starwood Capital Group in Elm Park Dublin 4. Offsetting the completions, however, 20,723 sq m of older stock was decommissioned for redevelopment. As a result net delivery of new space into the market was less than 54,000 sq m in Q3.

### Vacancy

Despite strong net absorption and the impact of demolitions, vacant space rose by just under 17,000 sq m in Q3 as some new stock was not fully let upon completion. This caused the overall vacancy rate to edge up from 8.4% to 8.8%.

Despite the focus of development in prime locations and the high specification of the newest buildings, 51,995 sq m of the 164,775 sq m completed in the first nine months of 2018 remained unlet at end-September, giving a 31.6% vacancy rate among new stock. Savills closely monitors this figure and has observed it rising in recent quarters. Although this figure is likely to fall in Q4 it reinforces the message that prudent developers need to be realistic about absorption rates for new space and, despite strong demand, should be pricing some post-completion letting voids into their arithmetic.

It is worth noting that the quality of vacant space has steadily disimproved through the upswing in the lettings cycle. This is typical and reflects the fact that, as companies expand and move to bigger premises, they tend to leave behind older buildings, some with tired fit-outs. Recent examples of older buildings that are being vacated by expanding occupiers in Dublin include 124 St Stephens Green which formerly housed online recruitment company Indeed.com and 5 Georges Dock which was occupied by JP Morgan before its move to Capital Dock. The declining quality makes vacant lots, on average, harder to let. However this does also provide refurbishment opportunities for landlords and investors, and more of this is expected as we get closer to the end of the cycle.

### Rents

With vacancy rates well below their natural level, benchmark rents for the best buildings in Dublin's CBD have increased by approximately 5% over the last 12 months, although there was no change in Q3. Savills' view is that headline rents of up to €700 per sq m per annum are being achieved for the best buildings in the best locations, although most CBD lettings are at rent levels which are below this. Typical rent-frees are 6 months.


nearly
**70%**
of new space in the third quarter was located in Dublin 2

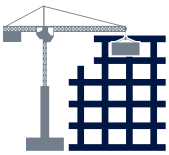

42 Westland Row - Ideal HQ Office in Dublin 2

## Outlook

The office development cycle in Dublin has now been underway for more than three years and 438,000 sq m of new space have been delivered in this time. However, when we subtract demolitions, net additional space is a modest 188,000 sq m. In a booming economy all of this, and more, has been absorbed, driving the vacancy rate down from a cycle-high of over 23% to its current 8.8%. Looking ahead, onsite construction activity indicates that completions will be lower in 2019 than 2018, particularly when demolitions are considered. Moreover 47.6% of all the stock that is currently under development is pre-committed – the highest percentage in the cycle so far.

On the demand-side, considering deals that have signed since the start of Q4 and the 167,800 sq m of space that is currently reserved, we expect 2018 to be a record breaking year for Dublin office take-up. The consensus macro outlook, and active requirements identified by Savills' demand tracker, suggest that the absorption of business space will remain strong for the foreseeable future. Therefore vacancy rates are unlikely to rise materially over the next 18 months and may even edge lower.

The natural vacancy rate – the fulcrum between positive and negative rental growth - has historically been between 12%-15% in Dublin. In light of the above, vacancy is unlikely to approach these levels before late 2020. Feeding this into our econometric model generates positive rental growth forecasts for both 2019 and 2020 (see Table 1). However, there are two important caveats to this research-led view. Firstly, the econometric modelling partially relies on information from the era of upward-only rent reviews, and the reliability of the modelled forecasts could be affected by the shift to upward-and-downward leases in recent years.[4] Secondly, and related to the fact that modern leases lock-in minimum rental income for a shorter period, investors are tending to price buildings on a rent that is averaged through the cycle. In this context agents report that, once acceptable minimum rents are achieved then, conditional on the tenant's financial strength, landlords are prioritising minimised Tenant Inducements ('TIs') and mechanisms to protect future rents (e.g. caps and collars, fixed uplifts, CPI indexation) over incremental gains in the headline rent.



'The office development cycle in Dublin has now been underway for more than three years

**438,000 sq m**
of new space have been delivered in this time'

### Table 1: Forecast Growth in Prime Dublin Office Rents 2019-2021[5]

| | €psm | %Y/Y (Nominal) |
|---|---|---|
| 2018(f) | 700 | 3.17 |
| 2019(f) | 744 | 6.34 |
| 2020(f) | 772 | 3.78 |
| 2021(f) | 771 | -0.15 |

**Source** Savills Research

[4] Once a sufficient period of upward-and-downward leases has accumulated the modelling will be able to adjust for any possible impact of this change.
[5] Again, these rental forecasts refer to the highest achievable headline rents in prime locations rather than the average.

While the central-case outlook is very positive it behoves us to consider factors which could lead to unexpected negatives for Dublin's office market. Some of these are domestic. The National Competitiveness Council has repeatedly highlighted the scarcity and high cost of urban housing as a potential barrier to attracting and retaining talent. Through our Tenant Representation business we are conscious that housing represents a genuine pinch-point for expanding corporations as it drives wage demands which can have a much bigger influence on overheads and profitability than office rents. However, the scope of Savills' services also extends to every stage of the residential supply-chain, and we equally see that the housing shortage is being addressed. Our analysis is that the residential market imbalance is now at its peak and will gradually abate from this point.

For the most part, however, the risk factors facing the Dublin office market are external. The most obvious is Brexit. While this has undoubtedly created certain opportunities in the market it is also contributing substantial uncertainty. Acceptance by the UK Cabinet of the draft withdrawal agreement in November has helped to clarify options. It seems increasingly clear that all parties would like to avoid a no-deal Brexit. However the path to achieving either of the obvious alternatives – acceptance of the draft deal or a Brexit U-turn – is likely to prove very difficult, and so we expect uncertainty to dominate for some time to come.

While Brexit is understandably generating much discussion, US developments are arguably the more relevant risks given the weighting of American tech companies in Dublin's occupier base. Changes to the US corporation tax code, the potential for the US / China trade war to escalate, and the recent sell-off of technology shares on US stock markets are all factors that are notable in this context.

'While Brexit is understandably generating much discussion, **US developments** are arguably the more relevant risks given the weighting of American tech companies in Dublin's occupier base.'

Charlemont Square - Landmark New Development in Dublin's CBD

'Continued development will provide opportunities for **tenants and investors'**

**Summary**

While it is prudent to take cognisance of the risk-factors, the outlook for Dublin's office market is very favourable at present. To summarise expected conditions over the next 18 months we can say;

- Continued development will provide opportunities for tenants and investors
- However the pace of office completions will slow in 2019 before rising again in 2020
- Pre-commitment rates for on-site development will remain elevated
- Absorption looks set to remain very strong due to underlying growth in occupier headcount
- A combination of slower completions and continuing strong demand will maintain downward pressure on vacancy rates and modest upward pressure on rents.

85 South Mall Cork - Fully Committed in Advance of Completion

# Cork At A Glance

### Take-Up

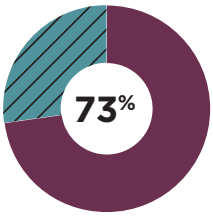
Take Up in Q3 of 10,344sqm. Deals during the quarter include:

- Datastax, 6 Lapps Quay, 340 sq m
- Dornan Engineering, 6 Eastgate Avenue, 670 sq m
- Dassalt, Phoenix House, 1,400 sq m
- Voxpro, City Gate, 3,600 sq m (Take up of the sub-lease).

### Development

43,633 sq m under construction, 73% of which is located in the City Centre

- Navigation Square approx. 22,300 sq m
- 85 South Mall approx. 4,275 sq m
- Counting House at the Former Beamish & Crawford approx. 5,100 sq m.




**'43,633 sq m**
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construction,
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### In Planning

207,224 sq m with planning granted, 53% of which is located in the City Centre

- Horgans Quay approx 37,200 sq m
- Penrose Dock approx. 2,690 sq m
- Navigation Square (Block C&D) approx. 6,410 sq m

### Vacancy rates

- Vacancy Rate in Q3 of 9.84%

### Rental trends and outlook

The limited Supply of modern Grade A1 office space in city centre locations has led to an upward trend in prime rental values. As of Q3 2018 Headline Rental Values for prime space is €350 per sq m with strong demand for Grade A city centre space. Quoting rents for new schemes in the city centre are at €377 per sq m with the trend towards city centre development. Tenant incentives are tightening.

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