

Savills Research – Q2 2022

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**MARKET
IN
MINUTES**
Savills Research

Dublin Industrial and Logistics Market

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Macro view • Market activity • Supply

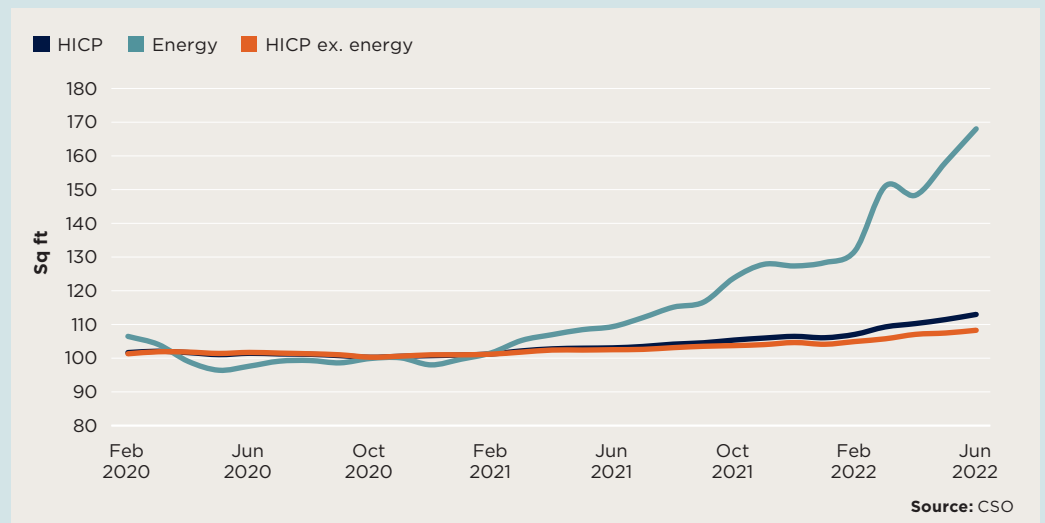
Macro View

Inflation soars on the back of an energy crisis

After a decade of low inflation rates, the lingering effects of the pandemic on supply chains and interruptions to commodity and energy prices stemming from Russia's invasion of Ukraine have seen a sharp rise in inflation in both the global and domestic economies. Data

from the Harmonised Index of Consumer Prices (HICP) shows that inflation reached 9.6% y/y in June 2022, with energy prices rising by 54% y/y. Inflation has the potential to affect the industrial and logistics market through a few key channels:

Figure 1: HICP – Energy vs. ex. energy



1.3m sq ft
of take-up in H1



86%
of take-up was for
Logistics



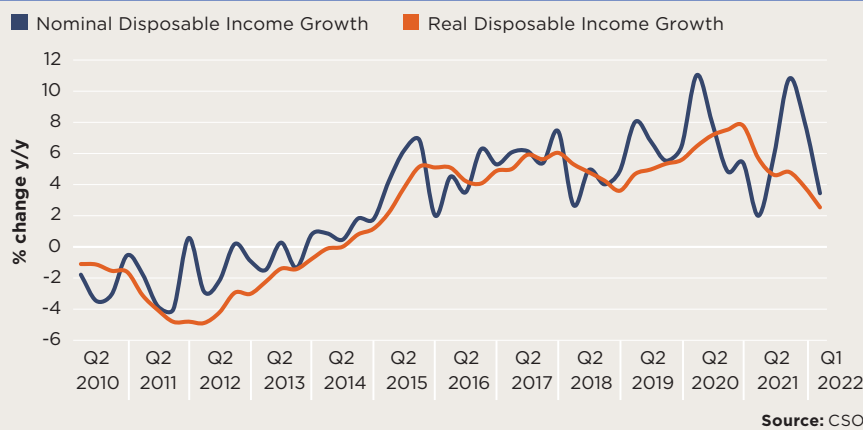
Vacancy rate remains
steady at
1.0%



E-commerce growth
has reverted to its
pre-pandemic trend

1. Higher prices can weigh down consumer spending

Firstly, higher prices reduce real incomes and thus personal consumption expenditure. When price growth outpaces income growth, consumer spending power declines, reducing the flow of goods through the economy, which can materialise as a fall in demand for logistics space and manufacturing capacity. As of Q1, disposable income had outpaced inflation, increasing by 2.3% y/y in real terms, which should help preserve households' spending power. Despite incomes rising, consumer sentiment weakened during the quarter, which saw seasonally adjusted personal consumption expenditure decline slightly, falling by -0.7% since Q4 2021.

Figure 2: Disposable income growth


Because quarterly income and consumption data are published on a lag, the impact of inflation ramping up in Q2 is not yet affecting these indicators. We need to consider more high-frequency indicators. The June reading of the Retail Sales Index shows a decline of 6.7% y/y after the index reached a series high in 2021. That said, part of the index's decline can be attributed to consumers' spending more money on holidays and other services which were restricted during the pandemic. The index remains 5.2% higher than in June 2019, suggesting consumption is remaining at elevated levels. Similarly, net consumer credit has increased by 2.7% y/y, with growth in non-mortgage borrowing pointing to confidence amongst banks and consumers.

One tailwind for logistics demand during the pandemic was an acceleration in growth of e-commerce, with e-commerce's share of debit and credit card spending hitting a series high in the depths of the January 2021 lockdown. As the economy has re-opened, we have seen e-commerce's share of expenditure revert to its pre-pandemic trend. Notably, the post-pandemic decline has now stabilised, and crucially overall e-commerce expenditure has continued to grow, rising by 22.9% y/y in June. The performance of e-commerce is crucial to the logistics market, with inventory requirements for online sales estimated to be three times as intensive as those of brick-and-mortar retail.

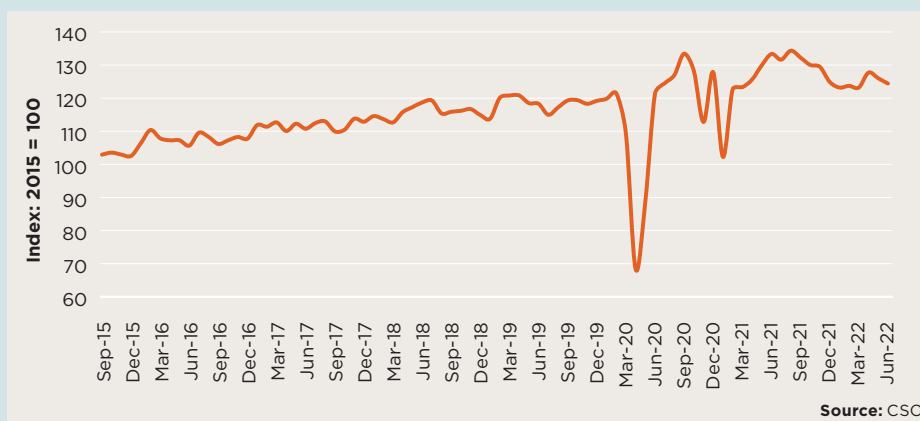
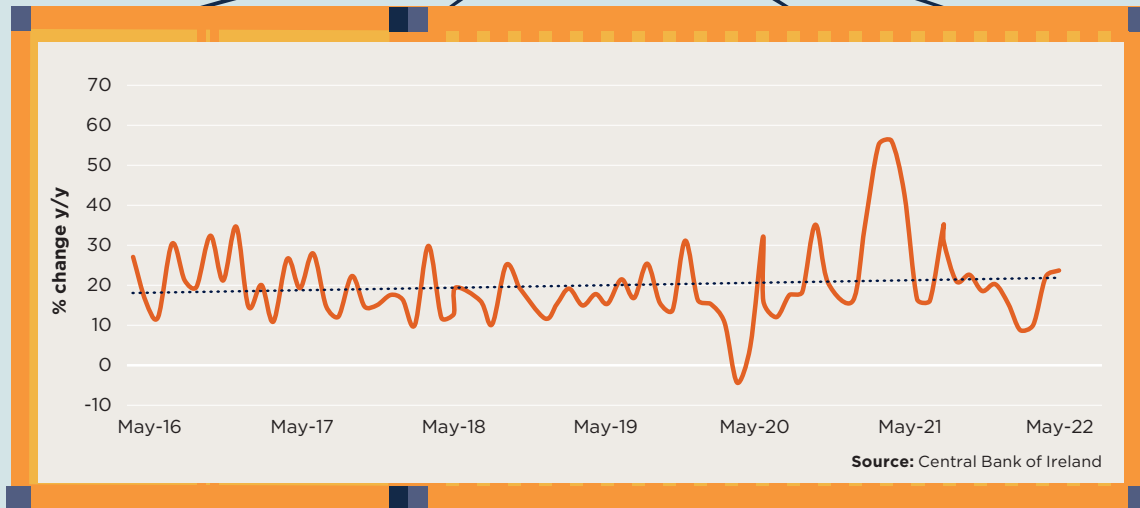
Figure 3: Retail Sales Index


Figure 4: E-commerce expenditure growth

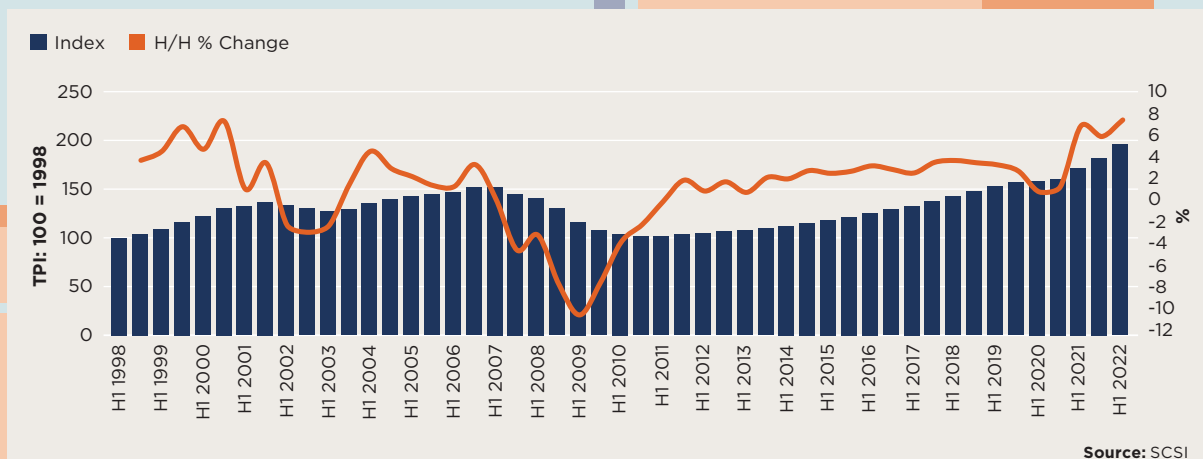


2. Rising construction costs can drive rental growth

Secondly, higher commodity prices and rising wages will have an impact on the costs of construction. As we noted in our Q1 report, construction consulting company, Linesight, estimates that upper-bound construction costs for warehouses increased by 8.8% y/y in Q1 2022. Looking at construction costs more generally, the Society of Chartered Surveyors' latest Tender Price Index points to price growth of 7.5% in the first half of 2022 and 14.0% y/y. Growth in H1 represents the sharpest increase in the series, which dates back to 1998.

Pricing pressure, in tandem with rising borrowing costs, will have a detrimental effect on the viability of development. The speed with which prices have risen will also reduce developers' and builders' ability to accurately forecast build costs, leading to uncertainty. Notably, given supply constraints that currently characterise Dublin's industrial market, this will fuel further rental growth in the occupier market where pricing power lies with the landlords.

Figure 5: SCSl Tender Price Index



3. Logistics operators are more sensitive to transport costs

Finally, and potentially the most sensitive channel in this context is the increase in energy prices, which include the price of fuel, for transport functions. Research by Savills UK and Hatmill shows that fuel accounts for the largest share of costs for logistics operations¹. Transport costs account for 75% of costs for parcel delivery companies (e.g., DPD), 50% of costs for E-Commerce companies and 41% of costs for highstreet retailers' logistics functions. By contrast, rent accounts for just 8%, 13% and 16% respectively. With cost splits weighted heavily towards transport costs, increases in fuel prices have a disproportion effect on logistics firms' overall costs relative to rental cost growth. As such we would expect to see logistics firms seeking to reduce transport costs by locating as close as possible to metropolitan areas, like Dublin, where they can efficiently meet the demand generated by a larger population. What this means for Dublin is that business parks located along the M50 will continue to have a competitive advantage over business parks located outside of County Dublin where rent levels are lower.

Table 1: Logistics occupier typical cost split

Category	Sub-category	High street	Parcel	E-com
Property	Rent	16%	8%	13%
Property	Rates	7%	4%	6%
Property	Utilities	4%	2%	3%
Labour	Labour	27%	10%	27%
Other	Other costs	5%	1%	1%
Transport	Transport	41%	75%	50%
Total	Total	100%	100%	100%

Source: Savills UK, Hatmill

75%
of parcel companies' total costs are related to transport.

¹ The analysis was conducted solely for logistics occupiers, manufacturing cost inputs are subject to greater variance based off the product being produced.

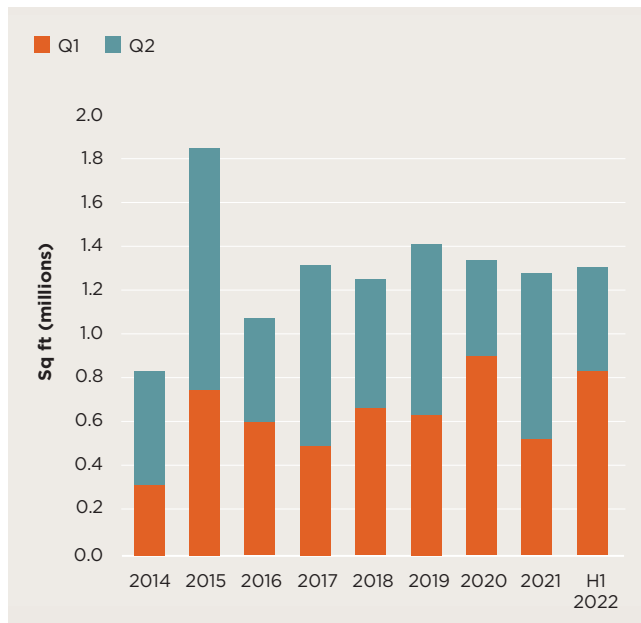
Market activity

In total, 473,000 sq ft of industrial and logistics space transacted in Q2 2022, which is well below the five-year quarterly average of 714,000 sq ft. This likely reflects the timing of deals after a strong Q1 which was 33% higher than the five-year Q1 average. In combination with the strong Q1, take-up in the first half of the year totaled 1.3m sq ft, in line with the five-year average.

Three units larger than 50,000 sq ft traded in the quarter, just ahead of the quarterly average of two units. The absence of deals for

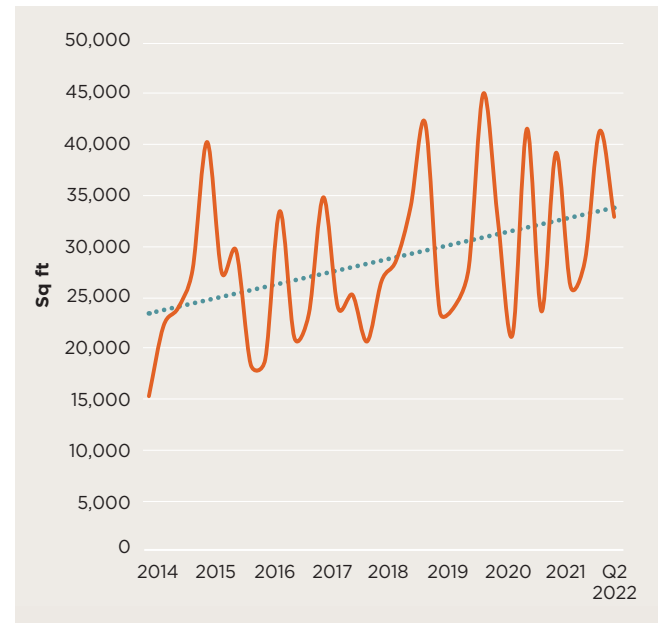
units over 100,000 sq ft had a clear impact on take-up. There has been a substantial decline in small deals between 5,000 and 10,000 sq ft, with only one unit of this size signing in the quarter, the lowest level since the GFC. Deals for big-box units have driven take-up in H1 2022, with units greater than 50,000 sq ft accounting for 55% of take-up, in line with the five-year average. With big boxes continuing to trade and a sharp fall off in the number of small deals, the quarterly average deal size was 33,800 sq ft, 8% higher than the five-year quarterly average of 31,300 sq ft.

Figure 6: Take-up



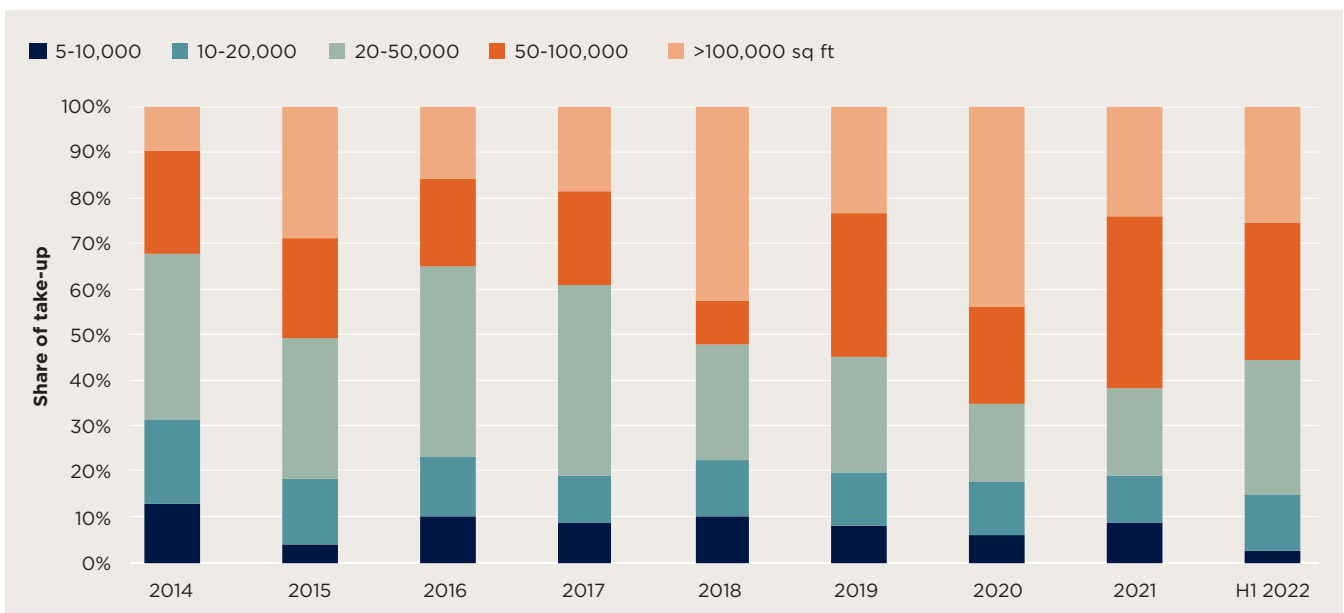
Source: Savills Research

Figure 7: Take-up – average deal size



Source: Savills Research

Figure 8: Take-up by deal size



Source: Savills Research

An expansion by Dunnes Stores – who leased 78,400 sq ft of space in Stadium Business Park – was the largest deal of the quarter. The second-largest deal of the quarter was a pre-let by third-party logistics (3PL) provider GLS from developer Henderson Park. This design and build unit will provide the firm with a bespoke unit to service their growing logistics needs. Indeed, we are aware of at least one other international 3PL firm that has a similar requirement in the market. The third-largest deal was the forward sale of the 70,000 sq ft Contrail House unit in Dublin Airport Logistics Park for €17 million to Yourway. Contrail House

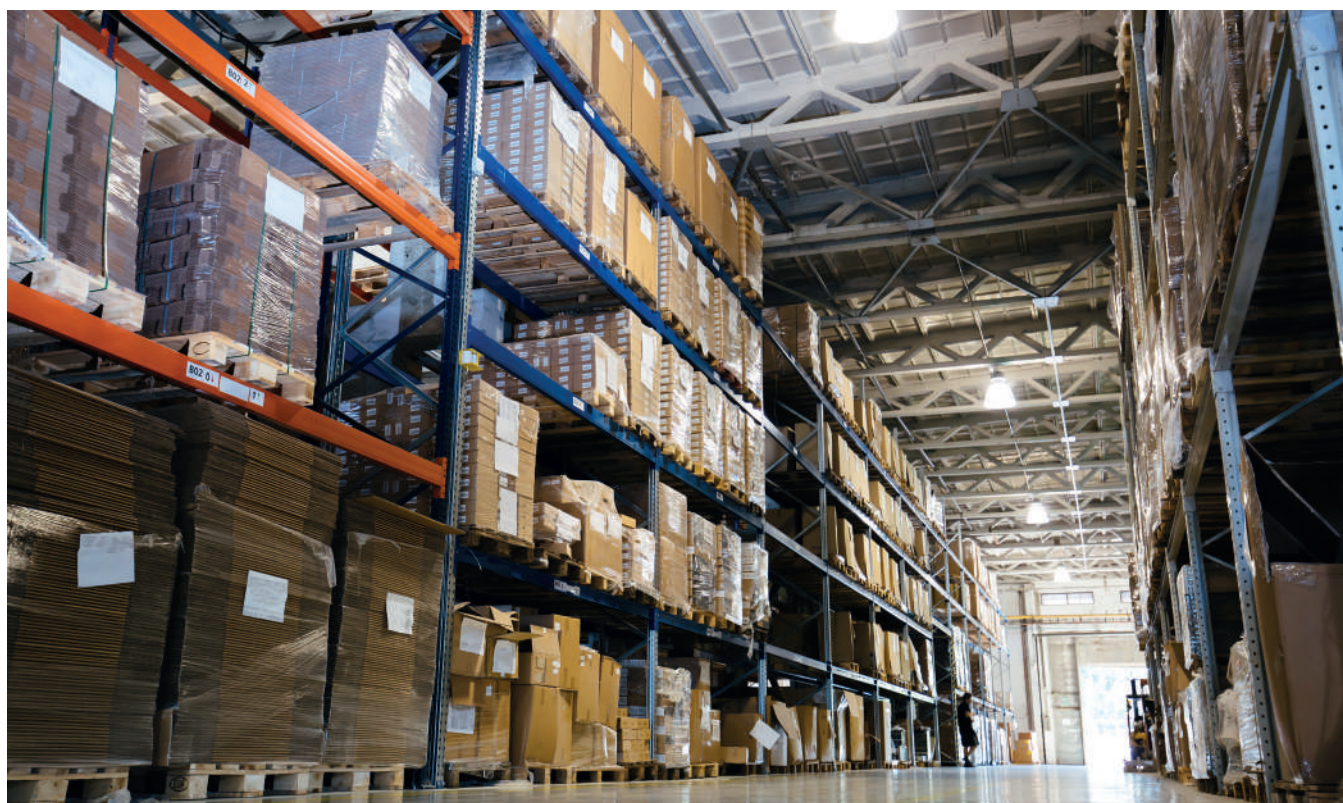
will serve as a European flagship depot for the US specialist pharmaceutical and clinical packing specialist, with the firm's founder noting Ireland's strong biopharma sector as a key reason for the firm's expansion in the market. In a similar vein, Clinigen a pharmaceutical firm expanded its presence in Ireland, leasing an additional 46,000 sq ft of space in Unit 12, Airways Industrial Estate in the fifth-largest deal of the quarter. The unit has undergone recent renovations and its adjacency to Dublin Airport was a key factor in attracting Clinigen.

Table 2: Top five deals

Property	District	Sq ft	Tenant	Type
Unit 1, Stadium Business Park	NW	78,400	Dunnes Stores	Standing Stock
Unit P1, Horizon Logistics Park	SW	74,300	GLS	New Build
Contrail House, Dublin Airport Logistics Park	NE	69,100	Yourway Logistics	New Build
Unit 2, Harris Truck Centre	SW	49,900	P&C	Standing Stock
Unit 12, Airways Industrial Estate	NE	46,000	Clinigen	Standing Stock

Source: Savills Research

“ Contrail house will serve as a European flagship depot for the US specialist pharmaceutical and clinical packing specialist, with the firm's founder noting Ireland's strong biopharma sector as a key reason for the firm's expansion in the market. ”

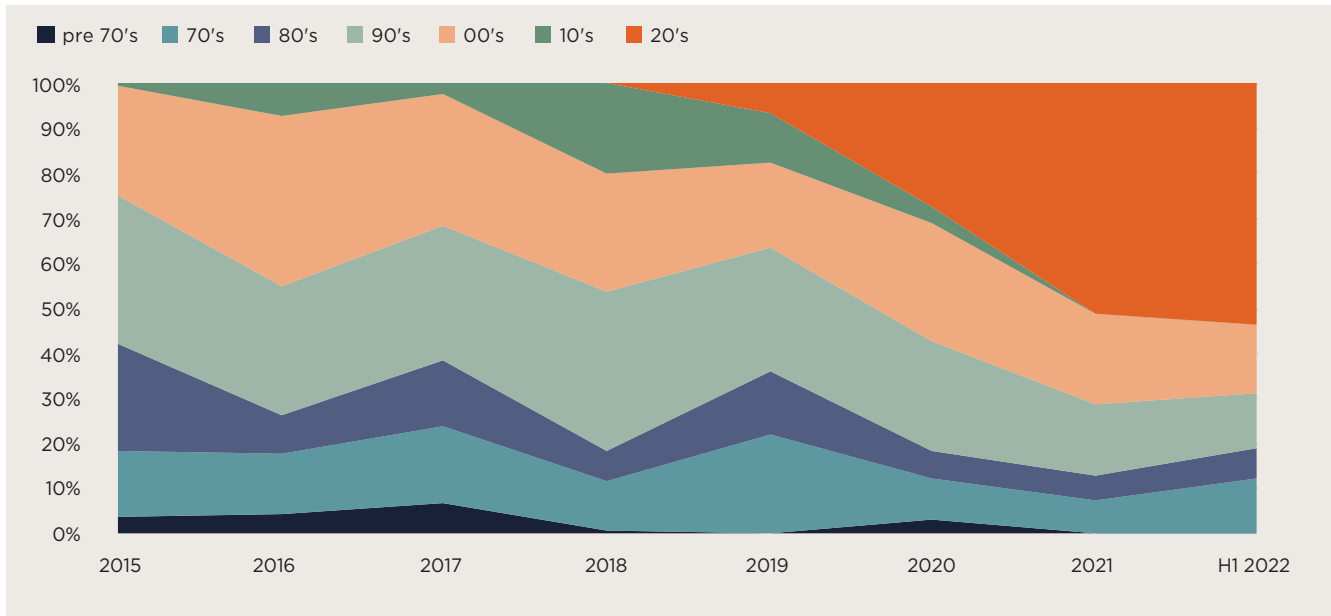


Take-up of new stock cools off in Q2

Take-up of modern stock slowed slightly in Q2, with four units transacting, accounting for just 42% of take-up, compared to an average of 54% over the last four quarters. Three deals were pre-lets, accounting for 38% of quarterly take-up. While this represents a

fall relative to the previous four quarters, the volume of deals for modern stock has risen substantially in recent years: the four-quarter average is more than double the five-year quarterly average of 26%.

Figure 9: Take-up by age



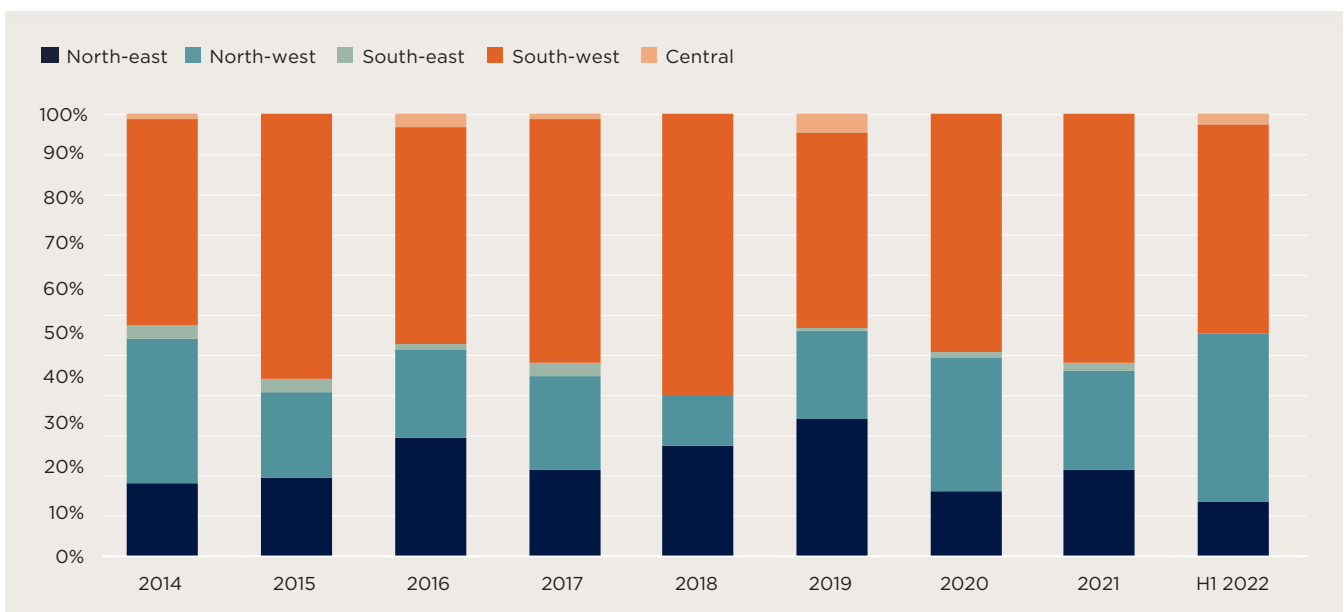
Source: Savills Research

North suburbs account for over half of take-up

The South-west accounted for 41% of take-up in Q2, below the location's long-run average of 52%. The North-east and North-west accounted for 26% and 25% of take-up, respectively. In aggregate, the North suburbs accounted for the majority of overall take-up for a third consecutive quarter. Notably, there were two deals for units

in Central Dublin this quarter, deals in this location are rare due to a lack of standing stock or viable space for development. Unlike larger metropolitan areas like London or Paris, Dublin is relatively compact which reduces the need for last-mile logistics hubs in the city centre.

Figure 10: Take-up by location



Source: Savills Research

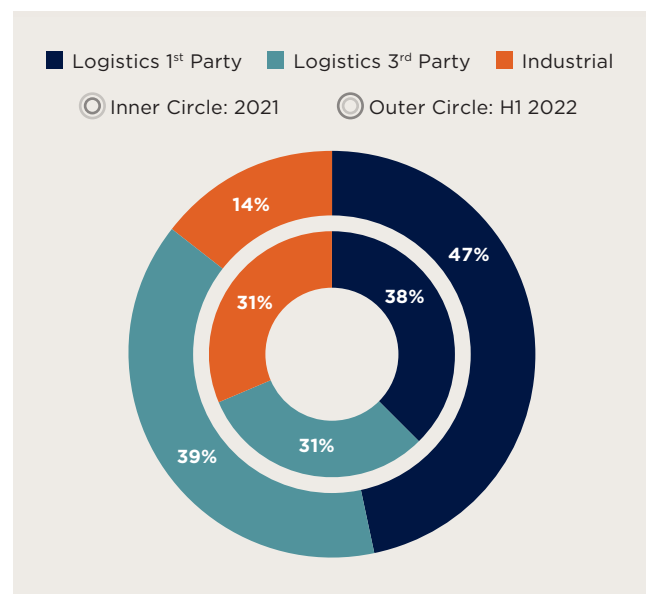


Logistics firms dominate industrial in H1

H1 saw logistics firms account for 86% of overall take-up. Third-party logistics (3PLs) accounted for 143,000 sq ft of take-up in Q2. First party logistics – where a retailer occupies space to support management or distribution of their inventory – accounted for 32% of take-up in the quarter. Strong performances by these sectors follow an even stronger Q1 when 1st party-logistics and 3PLs accounted for 54% and 36% of take-up, respectively. Industrial occupiers have had a relatively slow start to the year, accounting for just 14% of take-up in H1 compared to 21% in 2020 and 31% in 2021.

86%
of take-up was accounted for by
logistics firms.

Figure 11: Take-up by sector H1 2022 v full-year 2021



Source: Savills Research

Supply

Pipeline remains strong despite rising input costs

Q2 saw five units, totalling 409,000 sq ft, reach practical completion. In addition, Amazon's 650,000 sq ft fulfilment centre, which was pre-let in Q4 2020, finished its final fit-out and is now operational. The largest completion of the quarter was Unit D in Mountpark Baldonnell, which was pre-let to DB Schenker in Q1 2022. Building 1.0 and Building 1.1 in Greenogue Business Park were the second and third largest completions in Q2. Developed by Palm Capital, these units were prelet to Logistics firm Fastway and food packaging firm Tosca in Q1 2022 and Q3 2021, respectively.

Construction output is expected to reach its highest levels since the GFC this year, with a further 1.1m sq ft of stock due during the remainder of the year and an expected year-end total of 2.4m sq ft. Total additions to new stock in 2022 will be 142% higher than in 2021, representing a greater volume of stock than cumulative completions in the five years before the pandemic.

Of the remaining stock due to be complete this year: 25% is already let, with a further 21% currently reserved, leaving just 627,000 sq ft of stock available to lease. Six units are due to be delivered in Q4, totalling 279,000 sq ft. Two of these units are committed: Contrail House, Dublin Airport which prelet this quarter and Unit 4 and Quantum Distribution Park is reserved. This means four units will be available when they come to the market next quarter. These are relatively small units ranging from 20,000 to 50,000 sq ft and would add 136,000 sq ft of vacant space to the market, with all things held equal, would see the vacancy rate rise by 0.2 percentage points. Looking ahead to 2023, we forecast completions of 2.7 million sq ft, although just 922,000 of this has started construction. However, with 781,000 sq ft of the stock due to be delivered in 2023, either reserved or pre-let, we expect further development to commence in the coming months. As noted in our macro-view build-cost inflation may have an adverse effect on

construction. Volatile input prices may complicate the calculus of development and lead to more hesitance for speculative development.

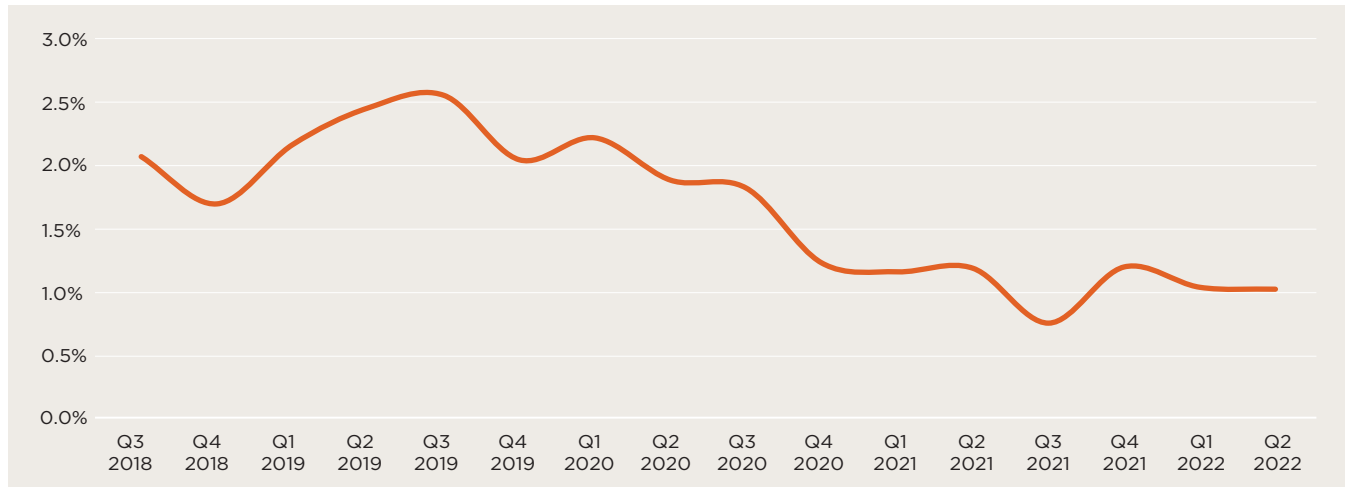
Figure 12: Pipeline commitment



Source: Savills Research



Figure 13: Vacancy rate



Source: Savills Research

Q2 2022 saw the vacancy rate remain unchanged at
1.0%.

The number of vacant units has declined sharply in the last year

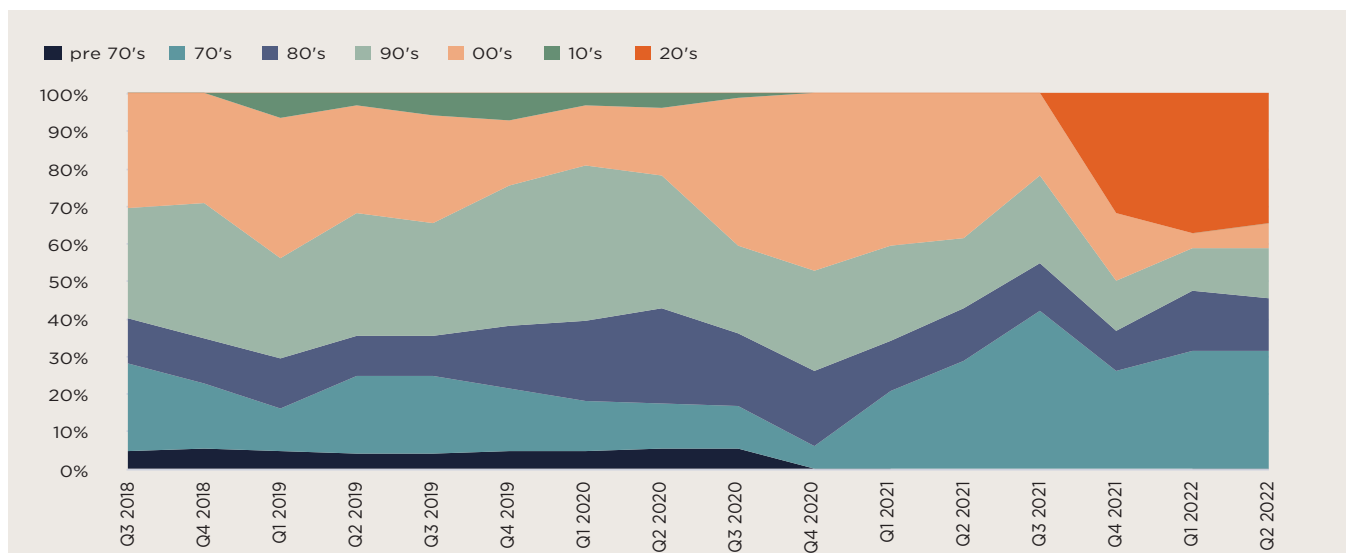
Due to a high share of pre-lets and churn, the volume of vacant space was flat in Q2, leaving the vacancy rate unchanged at 1.0%. While the completion of 409,000 sq ft of occupied stock in addition to Amazon's 650,000 sq ft fulfilment centre drove absorption of 1.0m sq ft, at 1.0%, the vacancy rate is currently so low that an increase of 1.3% in occupied stock has a negligible impact on the vacancy rate. While the quantum of vacant stock has only fallen by 12% in the last year, the number of vacant units has fallen by 22%. There are just 29 vacant units available, just four of which were built since 2000. Notably, Building 2, Greenogue Business Park – which accounts for 35% of vacancy – is distorting the volume of vacant space relative to the number of vacant units leading to a higher vacancy rate. Building 2 is an outlier in terms of its size relative to the rest of stock, and as such the volume of vacant space from this unit has an disproportionate impact on total vacancy relative to a typical unit. The

decline in the number of vacant units demonstrates that the availability has continued to tighten over the last year.

The market remains characterised by a severe shortage of large units needed by modern occupiers, with just three units of greater than 50,000 sq ft currently available, one of which was built in the 70s and the second in the 90s. Notably, these units have both been on the market since 2021, which suggests that they fail to meet potential occupiers' needs.

Nine units are available in the 20,000 to 50,000 sq ft category, most of which are smaller than 30,000 sq ft and built before the 2000s. These units are less than ideal for many occupiers in both size and quality, with many units built in the 70s facing issues with asbestos. While these units have started to transact more regularly than expected in a less constrained market in recent quarters. The availability of four additional units due this year in this size range is likely to slow the absorption of these older units.

Figure 14: Vacant space by age



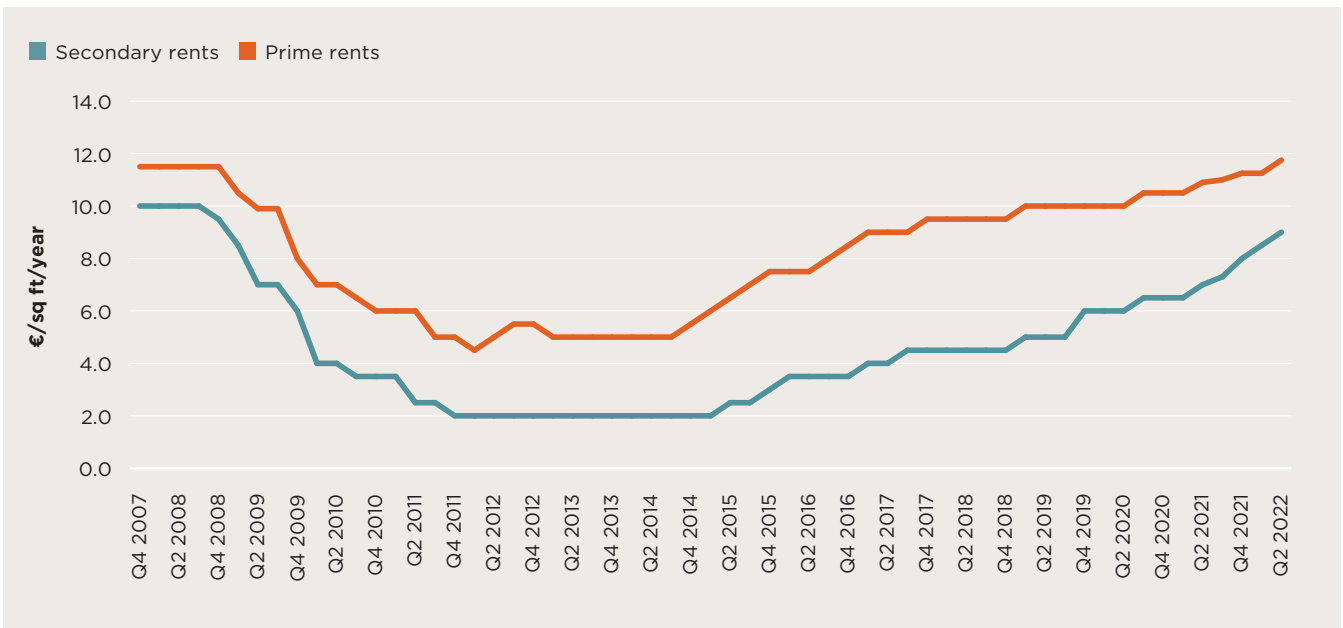
Source: Savills Research

Prime Rents

A mixture of construction cost inflation and a chronic lack of supply has led to sustained upward pressure on rents for industrial and logistics units in Dublin. Rents for prime stock have increased from €10.90 psf to €11.75 psf over the last year, representing an increase of 7.8%. The inflationary impact of the shortage of modern stock is that surplus demand has fed through into an already constrained

secondary market where rents have risen from €7.00 psf to €9.00 psf, an increase of 28.6%. With the market strongly favouring landlords, covenants have strengthened as tenants commit to longer lease lengths to obtain stock. A minimum term of ten years for prime stock is now the standard expectation and is likely to continue to rise in the future.

Figure 15: Prime and secondary rents



Source: Savills Research





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