Savills Offices
Ireland

Market in Minutes
Dublin Offices

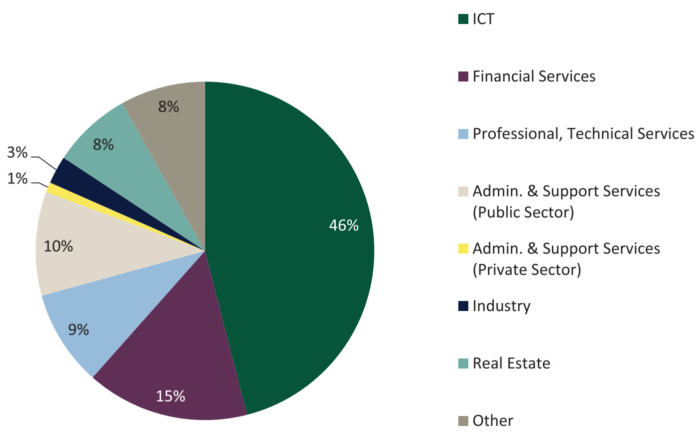
Q4 2017

Introduction

Ireland's economy continues to perform exceptionally well with output growing by 7.8% in 2017. Almost 67,000 jobs have been added in the last 12 months and employment is back to within 1 percent of its 2007 peak. This has contributed to a marked recovery in Ireland's public finances and a balanced budget is now likely in 2018. Looking ahead, and notwithstanding the ongoing risks from Brexit and US tax reform, a strong pick-up in economic growth across Europe should ensure that external demand remains robust. Consensus GDP growth forecasts of 3.8% for 2018 and 3.1% for 2019 are now likely to be revised up.

In the last two years office-based employment in Dublin has risen by 6%. An additional 13,600 office based jobs have been created in that time, a figure which would be expected to generate net absorption of around 165,000 sq m at standard occupational densities. All sectors of the office based economy have contributed to this jobs growth, including Information and Communication Technology (ICT) (+12.1%), Professional Services (+6.8%), Public Sector (+4.5%), Private Administration (+2.5%) and Financial, Insurance and Real Estate Services (+2.0%). As a result office based employment now accounts for 35.3% of all jobs in Dublin.

Graph 1:
Dublin Office Take-Up by Sector 2017



Source: Savills Research

Market Demand

Take-Up

The second half of 2017 provides a case study in how volatile office take-up can be from period to period. Q3 was the quietest quarter for four years with just 29,628 sq m of space taken. However this was immediately followed by 136,851 sq m of take-up in Q4 - the strongest ever quarter for the Dublin market. This exceptionally busy end to the year propelled 2017 to a new annual record with total take-up of 304,683 sq m - 1% above the 2015 record and 2.5% ahead of the 2007 peak.

Take-Up by Sector

The pattern of lettings has been broadly consistent with the sectoral breakdown of jobs growth. ICT, in particular, accounted for 46% of gross take-up in 2017. However professional services and finance and real estate companies (including serviced office providers) were also significant takers of space.

Serviced Offices

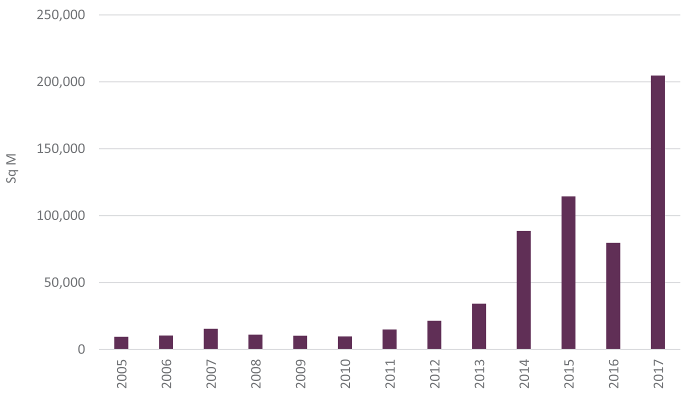
In our last report we highlighted a marked increase in take-up by serviced workspace providers since 2015. While their business models vary somewhat, these operators generally seek to earn a margin by taking space on standard leases, then subletting or licencing it onwards on flexible terms. This trend gathered momentum in Q4. WeWork leased 5,029 sq m at Iveagh Court, with Microsoft and Twillio among their clients for flexible space. The same company pre-let 4,712 sq m in a heavily refurbished building at 1 George's Quay, with Facebook believed to be taking desks. These transactions contributed to a total of 17,503 sq m of lettings by serviced workspace providers in 2017 – a 169% increase over the previous year. While WeWork has been the most active in recent months, several other serviced office providers, including Huckletree, Glandore and Iconic Offices also took space in 2017. Other players in the market since 2015 include Regus, Connect Serviced Offices and Coworkinn.

Table 1:
Analysis of Serviced Office Lettings 2015-2017

Indicator	Total Lettings (Sq. M.)	Serviced Offices (Sq. M.)	Serviced Office %
2015	302,352	1,072	0.4
2016	224,834	6,501	2.9
2017	304,683	17,503	5.7

Several factors are driving the demand from serviced office providers. Throughout the world business patterns are changing more frequently and planning horizons are shortening due to technological advances and the rise of project work. This puts a premium on flexibility which may be even more acute in Ireland because of rapid economic expansion[1] and the uncertainties associated with Brexit and global tax reform. Indeed, illustrating the relevance of Brexit, the rise of serviced offices has been even more pronounced in London – see Graph 2.

Graph 2: Take-Up of Serviced Offices, London City and West End



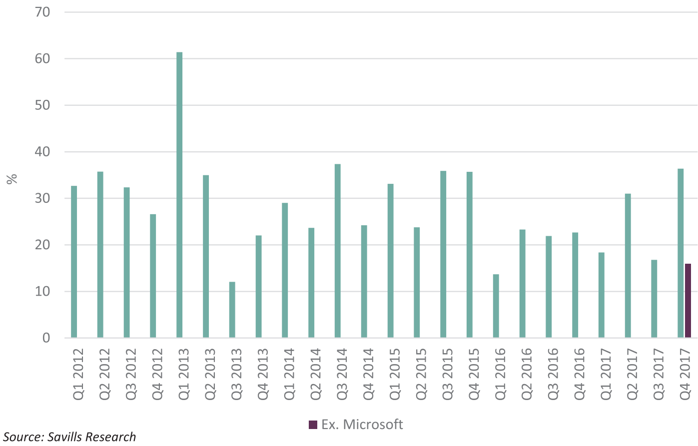
Source: Savills Research

Cultural change may also be driving serviced office suppliers to take more space. In an increasingly competitive recruitment market employers may be attracted to serviced workspace models which can provide their staff with network orientated co-working environments. Looking ahead the move to balance-sheet leases under international financial accounting standards could also potentially impact on corporate occupational strategies and encourage some organisations to enter short term arrangements for space, even at elevated rents.[2]

Take-Up by Location

The single biggest take-up of space in Q4 was unusual for two reasons. Firstly it was an owner occupation rather than a letting – Microsoft developed its own 28,000 sq m facility and moved in towards year-end. Secondly it involved suburban space at South County Business Park in Dublin 18. The scale of Microsoft's move drove suburban take-up to 36.4% of the market total – its highest share since Q3 2014. However, without the Microsoft influence, suburban take-up would have been a much more modest 15.9% of the Q4 total. Indeed, if we adjust for this, it is clear that the share of suburban take-up has continued on a broadly downward trend in recent years (see Graph 3).

Graph 3: Suburban Take-Up as Percent of Total



Source: Savills Research

A supply pinch-point in 2014-2015 diverted office demand from the city centre towards city fringe and suburban locations. Since then, however, the development pipeline has got going and is increasingly providing opportunities for occupiers to find space in town. Pre-letting has made high quality city centre space accessible to those who can afford to wait. In total, 209,000 sq m of office space has been pre-let in Dublin since Q4 2014, with 72% of this located in the prime postcodes of Dublin 2 and 4. For occupiers with more urgent space requirements speculatively developed office accommodation is now beginning to come onstream providing city centre options. Savills' active demand database shows that over 83% of requirements currently include D1, D2 or D4 among their target locations. Reflecting this, and given the increasing opportunities presented by new development, we believe that market activity in 2018 and beyond will continue to be concentrated in the city centre. Suburban activity will remain focused on Sandyford and, secondary to that, in other locations along the Luas green line.

Net Absorption

Given an increased weighting of new entrants and expansions in take-up, net absorption (the change in occupied space) came in at a robust 113,381 sq m for the year. Lettings that did not result in the immediate occupation of additional space were pre-lets[3] (124,997 sq m) and 'churn' (movement within the market) of 66,305 sq m. There is an important distinction between the two – whereas churn will not add to occupied space, pre-lets are a deferred form of net absorption. That is, once a pre-let building reaches practical completion, it automatically adds to occupied space.

Total net absorption over 2016 and 2017 came to 158,541 sq m – almost exactly in line with what would be expected given 13,600 additional office jobs at a typical occupancy rate of 12.1 sq m per employee. Another way to view this is that, as the economy has grown, an increased proportion of lettings involve net additional demand for space to accommodate the staff being recruited by businesses start-ups and expansions. As a result the 'conversion rate' between gross take-up and net absorption has risen over the last three years (see Graph 4)

[1] In a strong economy start-ups and new entrants typically enjoy a greater share of office demand. Given their life cycle stage, these occupiers naturally require flexible space that allows room for further – and sometimes rapid – expansion. According to Vison Net, 2017 was a record year for company start-ups with 22,354 registrations. The number of start-ups grew faster in Dublin - 7.6% y/y compared with 6.4% nationally - and Dublin accounted for 45.8% of all registrations. Financial and professional services (typically office based activities) accounted for 35% of 2017 start-ups.

[2] IFRS 16 which covers the accounting treatment of leases will come into operation from 1st January 2019. This will affect assets and liabilities recorded on company balance sheets and, potentially, balance sheet gearing. It will also cause companies to recognise a front-loaded pattern of expense for most leases. The impact of this on the amount and nature of office space demanded remains to be seen. However it is likely to shine renewed light on the distinction between leases and licences.

[3] Net absorption is defined as the movement in occupied space. Pre-lets do, ultimately, contribute to this. But not immediately as there is a lag between the letting (which occurs before or during the construction phase) and the eventual occupation of the completed building. Much of the 2017 pre-lettings will therefore materialise in net absorption over the course of 2018 and 2019.

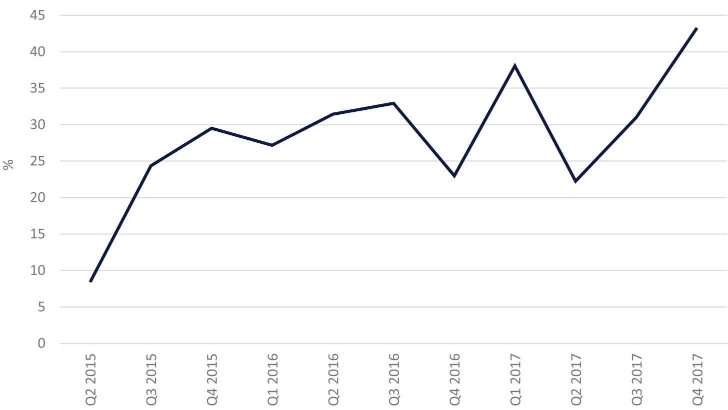
91-94 North Wall Quay

Market Supply and Vacancy

There was considerable office building activity in Dublin during 2017 with gross completions of 196,287 sq m for the year. However, netting against this, 71,063 sq m of older space was removed for redevelopment. As a result, net additions to the Dublin office stock were a much more modest 130,947 sq m.[4]

With net absorption of 113,381 sq m substantially offsetting the 130,947 sq m of additions to stock, vacant space rose by 17,566 sq m during 2017. Therefore the vacancy rate for purpose-built modern office space across Dublin only edged up marginally - from 9.0% in December 2016 to 9.2% in December 2017. As ever the vacancy rate varies by location and building quality. To illustrate this, less than 1% of the standing Grade A stock is currently available in Dublin's South Docks area.

Graph 4:
Net Absorption as Percentage of Gross Take-Up (4 Quarter Moving Average)



Source: Savills Research

Table 2:
Analysis of Movement in the Vacant Stock – Dublin Purpose-Built 2017

	Sq. M.		
	Supply	Demand	Net
Completions	196,287		
Withdrawals	-71,063		
Revisions	5,723		
Net Movement in Stock	130,947		
Lettings		304,683	
Pre-lets		-124,997	
Churn		-66,305	
Net Absorption		113,381	
Movement in Vacant Space			17,566

[4] This number includes a +5,723 sq m (net) adjustment to the office stock due to data revisions. Adjustments are typically caused by updated building measurement information or, occasionally, discovery of buildings that were not previously recorded on Savills' stock list.

Rents

Intuitively and empirically, vacancy rates are the key determinant of rental growth. Although availability increased slightly during 2017 vacancy rates remain well below their natural level of 12%-15%. As a result headline rents in prime Central Business District locations rose from €646 per sq m per annum in December 2016 to €678 psm at end-2017 – an increase of 5%. This outcome is exactly as predicted by our econometric model 12 months ago.[5] Inevitably there has been variation by location, with rents trending flat in some suburban areas, but with a degree of outperformance in some of the best city fringe locations e.g. Ballsbridge.

[5] See Savills Dublin Offices Market in Minutes Q1 2017 http://pdf.euro.savills.co.uk/ireland-research/market-in-minutes/office-report-q1-2017-v6-hr.pdf

Outlook

Looking ahead, prospects for the Irish economy remain favourable with consensus forecasts pointing to average jobs growth of around 2% per annum and output growth of approximately 3.5% per annum over the next two years. Indeed, following recent upbeat data,these forecasts are likely to be uplifted. Therefore, notwithstanding the risks associated with Brexit and US tax reform, the demand for Dublin office property should remain strong.

Considerable office building is ongoing in Dublin, with 406,714 sq m currently onsite and under construction. However, 46.6% of this is already committed, and old stock is still being withdrawn from supply for redevelopment. These factors, together with the positive outlook for office demand, should ensure that new supply does not swamp the market and that the vacancy rate will only edge up slowly from this point. In any event vacancy rates will remain below their 12-15% equilibrium level for the foreseeable future. In this context, and even though prime headline rents have already more than doubled since their 2012 trough, Savills' econometric model is forecasting further modest rental growth of approximately 1% per annum in 2018 and 2019.

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