

Savills Research – Q1 2023

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MARKET
IN
MINUTES
Savills Research

Dublin Office Market



Macro view • Market activity • Outlook



**277,000
sq ft**

of take-up in Q1



5.6%

forecast GDP
growth in 2023



56%

tech's share of
take-up



**43,800
sq ft**

largest single deal
in the quarter

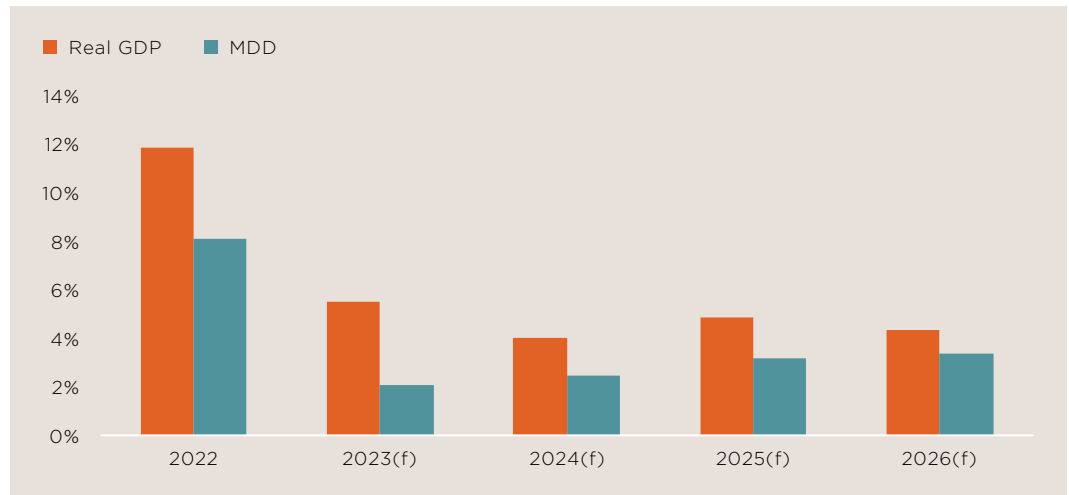
Macro view

Cautious occupational sentiment prevails due to an uncertain economic outlook.

At a headline level, the economic picture is very robust. For example, The Department of Finance is forecasting real GDP growth of 5.6% in 2023 - bringing the economy in line with the pre-pandemic growth rate of 5.4% experienced in 2019 - before slowing to 4.1% in 2024. Given that GDP is heavily influenced by multinational activity, however, it is useful to look at the

future growth forecast for modified domestic demand (MDD) which strips out many of the distortionary effects of foreign firms. This is expected to expand at a rate of 2.1% in 2023 and 2.5% in 2024, respectively. It is noteworthy that the economic outlook is expected to strengthen further from 2025 onwards, as measured by both real GDP and MDD.

Figure 1: Forecast growth in Irish GDP and MDD



Source: Dept. of Finance

While the wider macroeconomic environment is generally positive, it is being complicated by volatile inflation data and uncertainty regarding the near-term path of interest rates. Higher rates are constraining hiring as corporations are disincentivised to spend and invest due to the elevated cost of credit. They are also nervous about the economic outlook more generally, as the central bank aims for a slowdown in the pace of economic output which, if misjudged, could cause a recession. Assuming central banks tame inflation and achieve a relatively “soft landing”, this nervousness will be temporary and will translate into stronger sentiment in the office market. However, a continued stubbornly high rate of inflation, or a hard landing caused by over tightening, would both cause sentiment to deteriorate further.



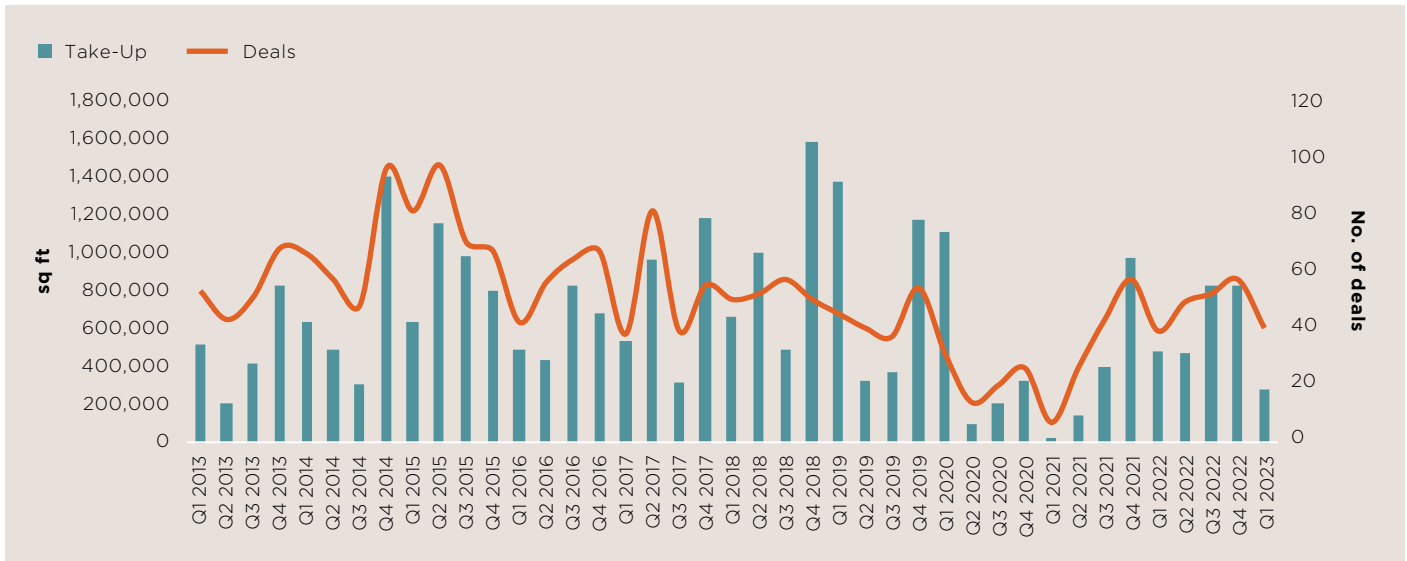
The Observatory, Dublin 2

Market activity

The Dublin office market recorded 277,000 sq ft of take-up across 40 deals in Q1. While this was the lowest level of activity

since Q2 2021, it comes after two relatively strong quarters when an average of 824,000 sq ft was taken.

Figure 2: Take-up by quarter



Source: Savills Research

The largest letting of the quarter was DataDog's relocation from 13-18 City Quay to One and Two Dockland Central, where it took 43,800 sq ft. The second biggest transaction was Pinterest's pre-letting of 27,700 sq ft at 60 Dawson Street, while the third-largest deal involved Virtual Access' taking of 25,500 sq ft at Park West. Meanwhile, financial services company Scotia Bank took 21,200 sq ft at Three Park Place to facilitate its expansion plans, while OUTsurance rounded off the top five deals after

taking 18,200 sq ft at Building 3, Cherrywood.

Other notable transactions included Pluralsight's leasing of 13,800 sq ft of Grade A space at the Reflector on Hanover Quay, as well as HorseWare's leasing of 10,300 sq ft at Two Dublin Airport Central to facilitate the expansion of its domestic and international business.

Table 1: Top deals

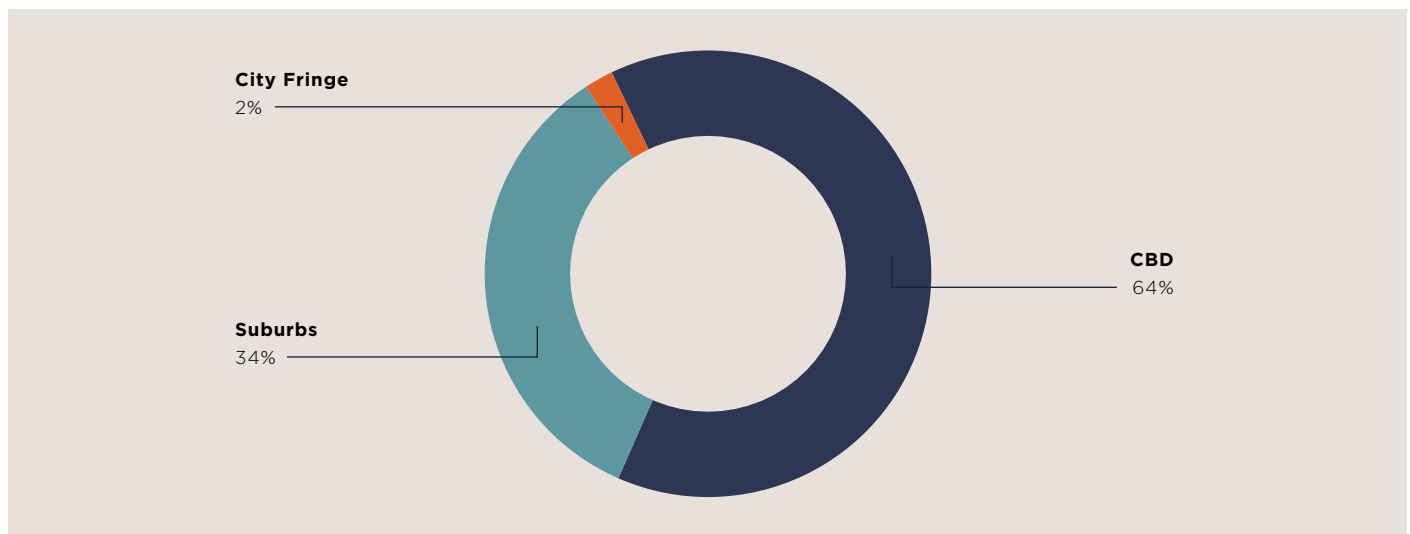
Property	Sq ft	Tenant	Sector
One and Two Dockland Central, Dublin 1	43,800	DataDog	Tech
60 Dawson Street, Dublin 2	27,700	Pinterest	Tech
Park West, Dublin 12	25,500	Virtual Access	Tech
Three Park Place, Dublin 2	21,200	Scotia Bank	Financial Services
Building 3, Cherrywood, Dublin 18	18,200	OUTsurance	Financial Services

City centre stock was the most popular among occupiers, accounting for 64% of space taken across 24 deals. Elsewhere, the suburbs accounted for 34% of activity across 14 transactions with take-up predominately being driven by requirements of 10,000 sq ft and below. Meanwhile, the city fringe made up only 2% of space taken.

While the suburbs increased its share in Q1 relative to recent

quarters, the vast majority of demand remains for centrally located offices. As an example, PayPal's recent decision to sell its Ballycoolin office campus and seek a new home in the CBD exhibits why city centre based offices, with their ancillary benefits, will be more resilient locations. The proximity to shopping, socialising, amenities and client face time centralises a dispersed workforce and broadens the purpose of the commute.

Figure 3: Take-up by location

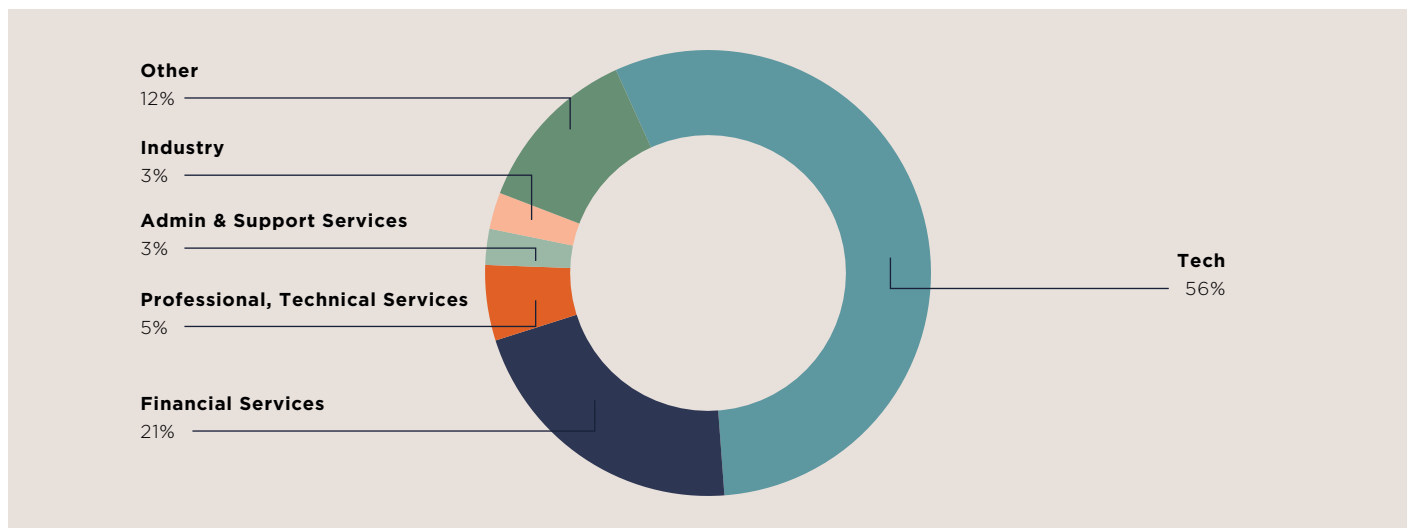


Source: Savills Research

Tech accounted for 56% of take-up, which was its highest share since Q1 2020, although overall volumes of 155,000 sq ft remain low compared to the five-year quarterly average of 367,000 sq ft. Elsewhere, the financial services sector made up 21% of take-up, with professional services accounting for 6%. We nevertheless expect this share to increase in subsequent quarters due to

demand from legal services. Up to 10 of the top global law firms are in the market for space, including Addleshaw Goddard, Eversheds Sutherland, Fieldfisher, K&L Gates, Maples, Simmons & Simmons and Taylor Wessing. Accounting firms in the market for space include EY, Deloitte and Baker Tilly.

Figure 4: Take-up by sector



Source: Savills Research

In summary, the first quarter underwent a relatively weak performance. This may at least partially reflect the fact that a single quarter of data can be skewed by one or two transactions. That said, the subdued activity partly reflects the fact that some occupiers are avoiding taking more space than absolutely necessary, even though holding a buffer helps to facilitate future headroom expansion. This can see them taking relatively long positions on buildings without allowing room for further growth, which risks future occupation being split across a number of buildings. Fragmented occupation represents a risk to the business in the long-term, as it damages the ability of the company to form a cohesive company culture.

The declining conveyor belt of ESG stock, at a time when it is most in demand, means this space is becoming increasingly difficult to source, despite market commentary. This is further evidence that occupiers who come across such space should consider giving themselves sufficient headroom for expansion. The strength of demand for ESG-rated stock also means occupiers should not get stuck with excess space as it can be subleased or otherwise returned to the market if required, especially if a well-considered and constructed lease stack is used. Many occupiers with mid-range requirements (10,000-20,000 sq ft) are seeking fitted, ESG space but finding it is not as plentiful as they expected.

“ **The declining conveyor belt of ESG stock, at a time when it is most in demand, means this space is becoming increasingly difficult to source, despite market commentary.** ”

Construction pipeline

The only Q1 2023 completion was the six storey A2 rated offices at One Le Pole Square on Ship Street, which added 113,000 sq ft to stock. Just over 16,000 sq ft has been reserved by Etsy, with the remainder available to let. We expect a further 715,000 sq ft of space to be delivered in Q2 2023. This includes 60 Dawson Street, where a combined 116,000 sq ft has been pre-let to Service Now and Pinterest, as well as 12 Dawson Street where the entire 60,000 sq ft has been pre-let to Goodbody Stockbrokers. There is a further 1.3 million sq ft of upcoming space under construction and due to be delivered in the second half of

the year. This delivery will include 270,000 sq ft at Two and Three Wilton Park, as well as 286,000 sq ft of Grade A offices at Coopers Cross in North Dublin and almost 168,000 sq ft at Boston Sidings near Grand Canal Quay.

While 25% of space scheduled for completion over the remainder of the year has been pre-let, we expect the remaining space to experience high demand from occupiers. This reflects the fact that these buildings, in the main, are well-located and feature top ESG ratings, which will make them the likely focal point of activity in the near future.

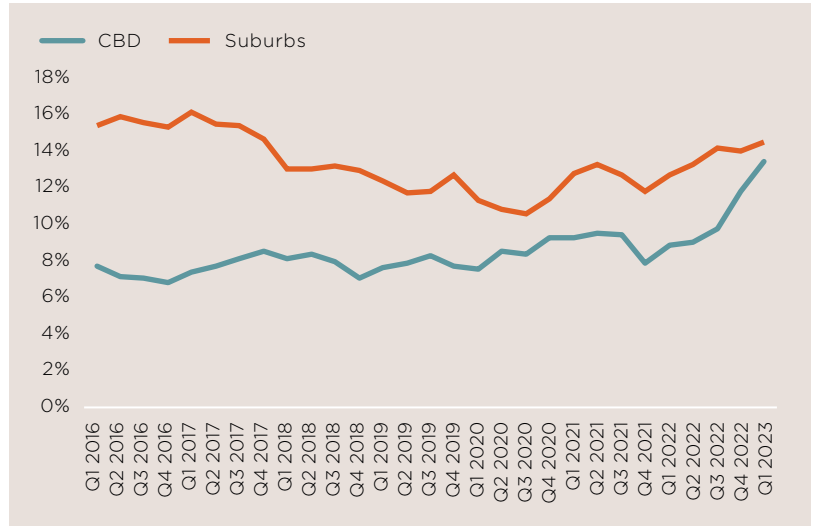


Vacancy

The Q1 completion of Le Pole Square, combined with an additional 457,000 sq ft of sublease space brought to the market, led to an increase in the vacancy rate to 14.0%, up from 12.7% in Q4 2022 and 10.5% in Q1 2022. Vacancy in the CBD reached 13.4%, which was up from 11.8% last quarter and 8.9% a year ago.

Prime headline rents are €62.50 psf in the CBD and €29.00 psf in the suburbs. In terms of rental evidence in Q1, Three Park Place commanded €62.50 psf from Scotia bank, while 60 Dawson Street exemplified the special case at the higher end of the market with Pinterest paying €67.50 psf. Elsewhere in the suburbs, rents may come under downward pressure over the rest of the year as demand is not as strong for these assets.

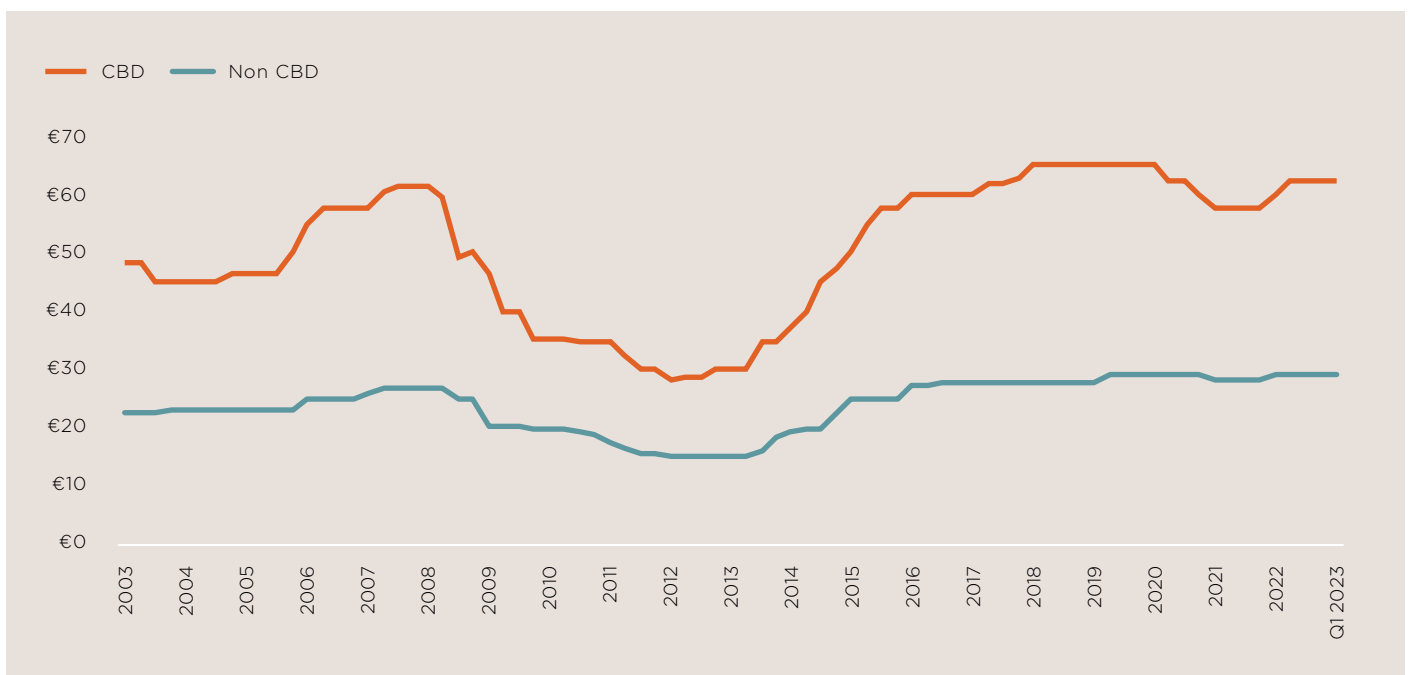
Figure 5: Vacancy rate



Source: Savills Research

🗨️ **The Q1 completion of Le Pole Square, combined with an additional 457,000 sq ft of sublease space brought to the market, led to an increase in overall vacancy to 14.0%, up from 12.7% in Q4 2022 and 10.5% in Q1 2022.** 🗨️

Figure 6: Dublin prime and suburban rents



Source: Savills Research

Outlook

The first half of 2023 is being characterised by softer activity following last year's absorption of pandemic-related pent-up demand. Furthermore, the tech sector is still finding its feet following last year's heavy declines in share prices. With 2023 dubbed "the year of efficiency" for the tech sector, there are obvious consequences for global office footprints. However, there are early signs of improvement, which may lead focus away from cost cutting to renewed growth. Elsewhere, geo-political issues have also restricted access to markets for some in bound companies and, if they settle, could prompt renewed growth. In this regard, our agency team has noticed increased activity from Asian companies investing into Ireland, perhaps reflecting the need for them to access growth markets as US companies have done in the past.

Development is being hampered by higher interest rates and access to debt as buildings approaching practical completion face refinancing challenges. Typically, developers would be able to lower their debt burden as buildings reach completion.

However, some buildings are now completing as vacant, and this is being reflected in repricing, making the cost of debt higher if not locked in or hedged previously. These dynamics will likely feed through to the office development pipeline, delaying the completion of on-site projects and disqualifying commencements on some buildings as we enter the latter stages of the current cycle. Ultimately, site values may come under pressure in the short-term but in doing so, and combined with the easing of construction cost inflation, will create more margin for those well capitalised developers willing to push on for delivery in two to three years when 2030 targets loom and when ESG stock may be in short supply.

The sluggish start to 2023 should be somewhat eclipsed by an increase in activity toward the latter half of the year and into 2024. While suburban offices with poor energy efficiency credentials are due to continue to experience weaker demand, companies' ESG agendas will continue to support demand for high quality, centrally located offices.

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Greening the State's Office Portfolio

An analysis of the State's office portfolio shows it is failing to embrace its own sustainability targets. Urgent action is needed to address the growing gap compared to the private sector.

The Government's Climate Action Plan 2023 targets a 51% reduction in direct energy-related emissions to achieve a corresponding level of decarbonisation across the public sector by the end of the decade. This will drive a move away from fossil fuel heated buildings. According to the Sustainable Energy Authority of Ireland, there are two main classes of energy consumption across public services; public sector buildings – which includes offices – and public sector utilities. Therefore, the greening of the State's office

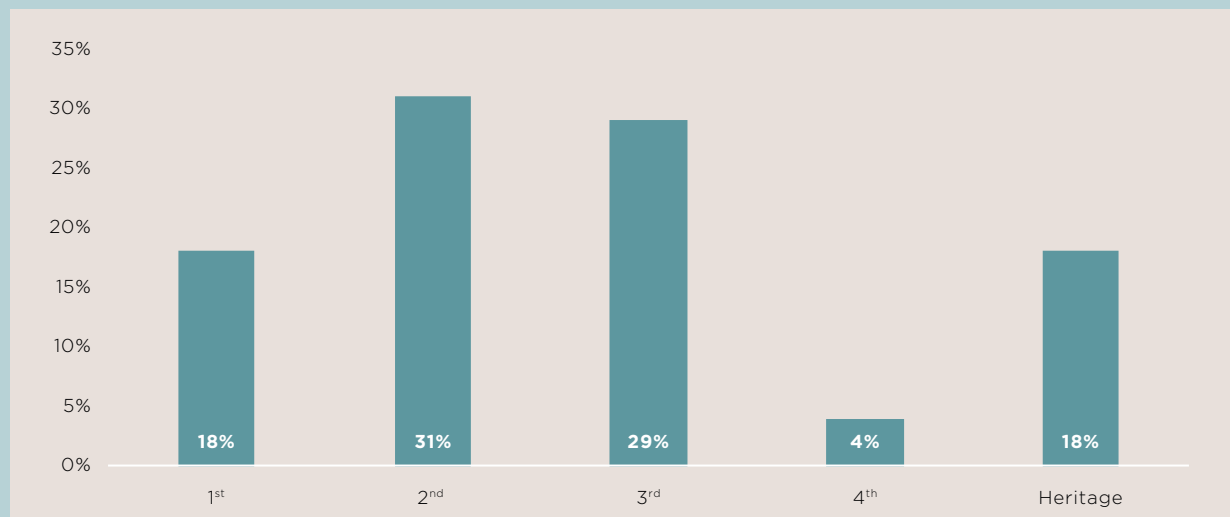
portfolio is a crucial piece of the jigsaw. However, the Office for Public Works (OPW), which manages the Government's estate portfolio, has sometimes been constrained by lengthy lease terms on its rented office buildings, which may have put the State behind on its carbon emissions targets. Other factors which may have inhibited the State's progress include budget constraints and a decision not to disrupt services even as break options and lease expiries occurred.

Need to improve ESG credentials clear

The OPW occupies 9.5 million sq ft of office accommodation across the State, according to Government figures (2021, latest available), of which 5.1 million sq ft is located in Dublin. The OPW classifies the quality of the estate portfolio as either 1st, 2nd, 3rd or 4th generation, as well as heritage. 1st and 2nd generation refers to buildings built between 1955 and 1990, while 3rd generation buildings were constructed between 1990 and 2005, and generally achieve a BER rating of at least C. 4th generation buildings have been constructed since 2005 and typically achieve a BER of at least B1. Heritage space includes Georgian town houses built before 1837 and that were later converted into offices.

More generally, only buildings delivered in the last two to three years are near zero energy buildings (NZEB) while the first zero carbon buildings are yet to deliver, although A&L Goodbody's North Wall Quay redevelopment is on-site. Accreditations have emerged over this time such as LEED and BREEAM, with Australia's NABERS rating also under consideration for use. We do not, however, have the OPW's breakdown of the estate portfolio by these classifications. Notwithstanding, a breakdown of the estate portfolio by generation as of end 2019 (latest available) is presented in Figure 7, providing some insight on the extent of upgrading required across public sector offices.

Figure 7: OPW Dublin office space by generation



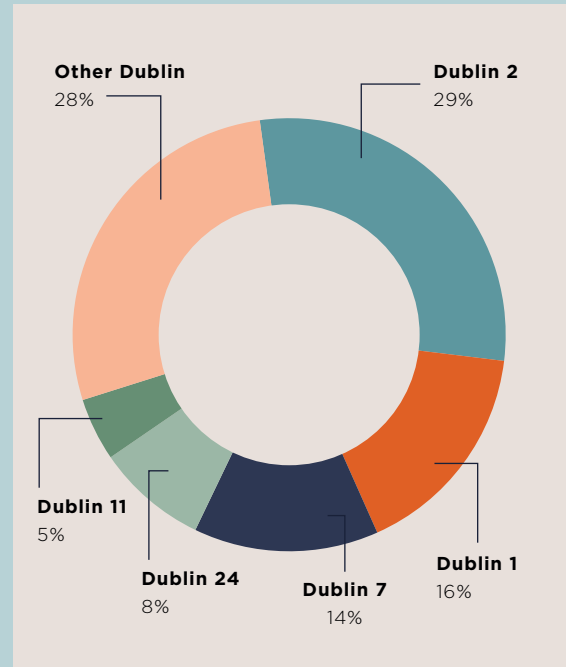
Source: IGEEES

Lease expiries offer gateway to upgrades

While refurbishments will be feasible options for upgrading the OPW's owned offices, lease breaks and expiries offer the OPW the opportunity to move into higher quality rented space. Leased properties make up 45% of the OPW's Dublin office portfolio, corresponding to almost 2.3 million sq ft. The majority of which is situated in Dublin 1, 2 and 7, which collectively account for 59% of the Dublin leased portfolio at 1.3 million sq ft. These represent the locations where efforts to enhance the stock would be best concentrated.

Irish Government Economic and Evaluation Services figures, published in 2020, indicate that 446,000 sq ft of office space being leased by the OPW is due to expire between 2023 and 2025, representing almost 20% of its total leased portfolio in Dublin. These lease expiries provide the State with an opportunity to enhance a fifth of its rented office stock over the three-year period, which is a substantial amount of space and a positive step in taking the lead on decarbonisation of the built stock. While this also demonstrates how the OPW may have been limited by long leases on sizeable amounts of space in the past, it could look to the high quality stock scheduled for completion between 2023 and 2025 to enhance its portfolio.

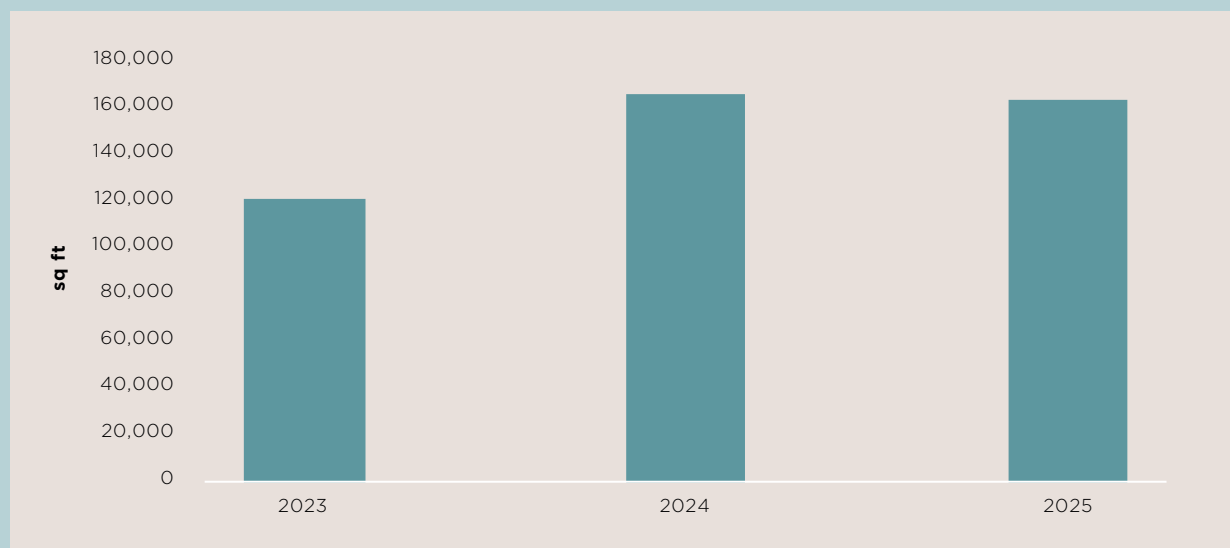
Figure 8: Distribution of OPW Dublin leased office space



Source: IGEEES

👉 These lease expiries provide the State with an opportunity to enhance a fifth of its office stock over the three-year period, which is a substantial amount of space. 👉

Figure 9: OPW Dublin leased office space due to expire



Source: Savills Research, IGEEES

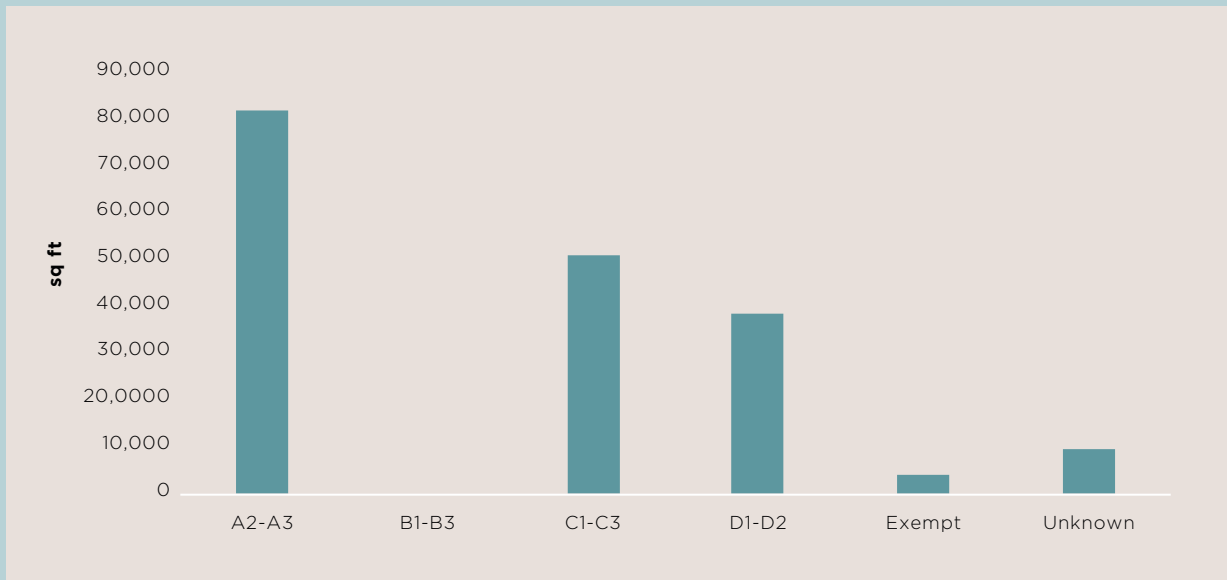
Leasing of aged stock contradictory to policy

Last year, the public sector made up 7% of take-up in the Dublin office market, representing 184,000 sq ft. While 44% of space taken had a BER rating of A3, this was attributable to An Post signing for additional space at the Exo Building. A previous notable transaction was the OPW's pre-letting of the A3 rated Distillers Building in Smithfield, which completed last year. If the State could acquire and recycle its wider office space at this pace, it would quickly catch up with the private commercial sector and operate out of more low emissions offices. On the other hand, Figure 10 below raises the question of

why the State is still taking C and D rated space, which it may, depending on the lease length (i.e., post-2030) or terms (allocated repairing/compliance obligations), be obliged to refurbish even where it does not own the building.

7%
public sector share
of take-up in 2022

Figure 10: Public sector Dublin office take-up by BER rating, 2022



Source: Savills Research



Summary

Under the wider context of the Climate Action Plan, there must be a 51% reduction in overall greenhouse gas (GHG) emissions by 2030 relative to 2018 levels. One of the strategy's key themes, *Public Sector Leading by Example*, underscores the State's commitment to spearheading action. To achieve the emissions reduction target, the Government must ramp up efforts across all sectors of the economy. Ireland's emissions declined by a mere 1.3% between 2018 and 2021, increasing the burden of action and compressing the remaining timescale for implementation in the years ahead, be that due to target dates such as 2030 or, more simply,

because of the urgency of climate action.

The bottom line is that upgrading of the State's property portfolio to higher rated buildings could significantly assist the public sector in meeting its forthcoming climate targets. While development and refurbishments will be used to enhance the OPW's owned space, relocating to higher grade offices once lease terms allow is the way to deal with rented accommodation. This upgrading of space would also help to lower the State's energy-related costs in the longer-term, which would be significant in a period of such high inflation and energy price uncertainty.

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