savills

Market in Minutes
Dublin Offices

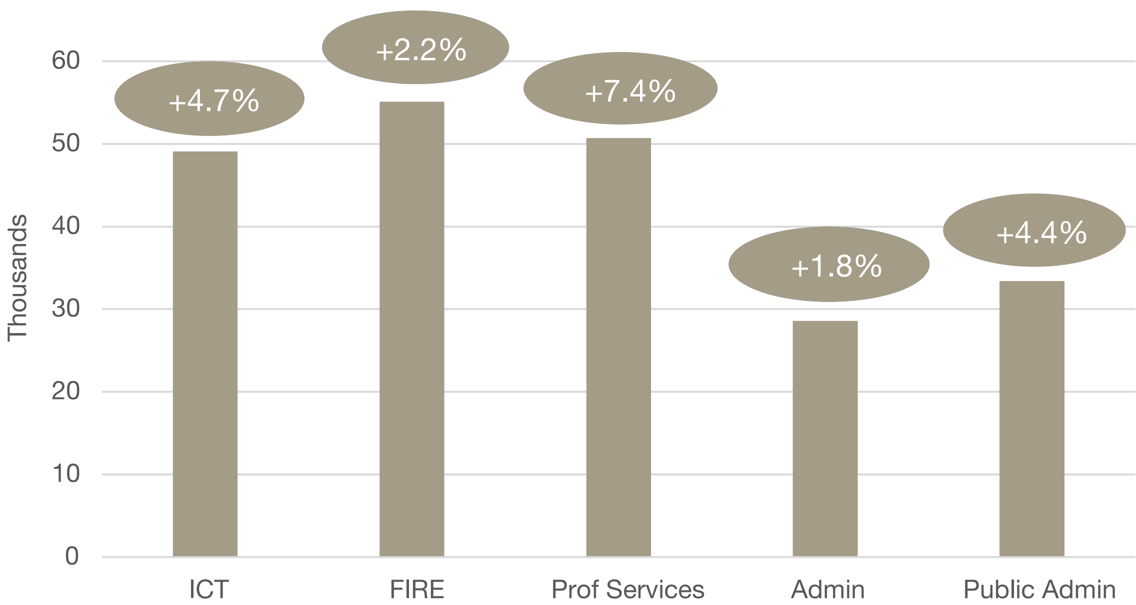
Q1 2017

Introduction

Recent data underscore the increasingly dominant role of Dublin as a driver of economic growth in Ireland. Census figures reveal that the capital's population grew almost twice as fast as that in other parts of the country between 2011 and 2016. Moreover estimates from the Quarterly National Household Survey (QNHS) show that this trend has continued since Census night – Dublin's headcount rose by 1.7% in the year to March 2017, compared with 0.8% elsewhere.

Around two-thirds of Dublin's population growth is due to internal migration, and the availability of job opportunities is clearly a factor behind this. In net terms 68,600 new posts have been created in the last year and more than 40% of these are in the Greater Dublin Area. Within Dublin 57% of all new jobs are in office dominated sectors with Finance, Insurance and Real Estate (FIRE), Professional Services and Information and Communications Technology (ICT) now accounting for one quarter of all employment in the capital.

FIGURE 1:
Dublin Office Employment by Sector and Growth Rate Q1 2016 - Q1 2017

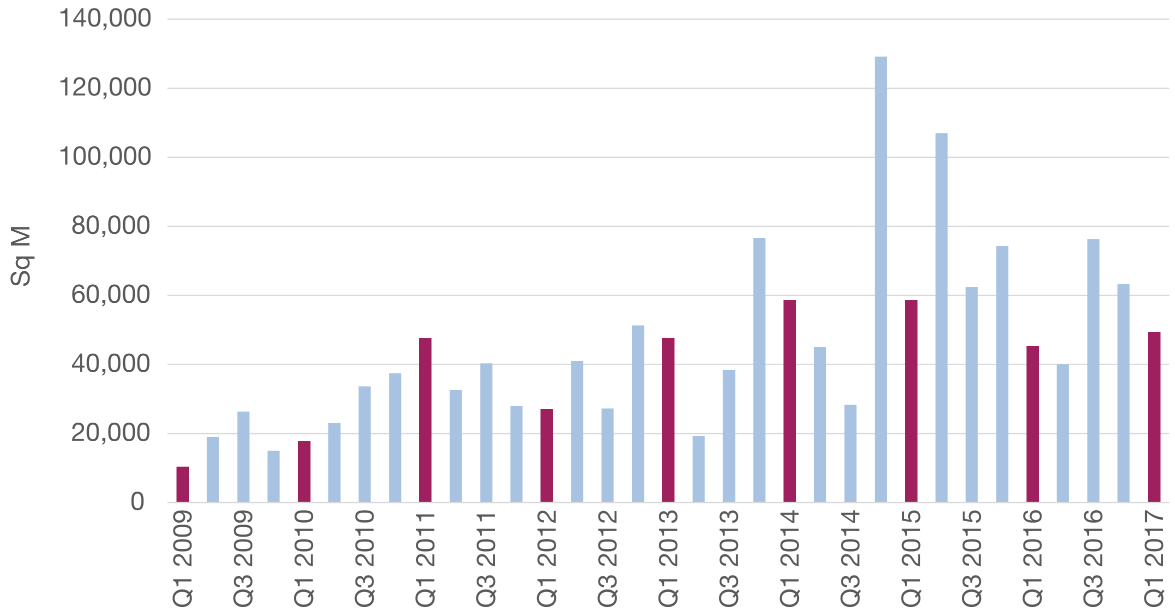


Source: CSO

Lettings

Given the natural push to conclude transactions by year-end, Q1 lettings often appear weak by comparison with Q4. Indeed in half of the last eight years Q1 has been the slowest quarter for office lettings. Take-up of 49,315 sq m was recorded in the first three months of 2017. However, although this is 22% down on the Q4 total, it is 9% up on last year's Q1 figure and 26% up on the Q1 average over the last eight years (Figure 2).

FIGURE 2:
Dublin Office Take-Up

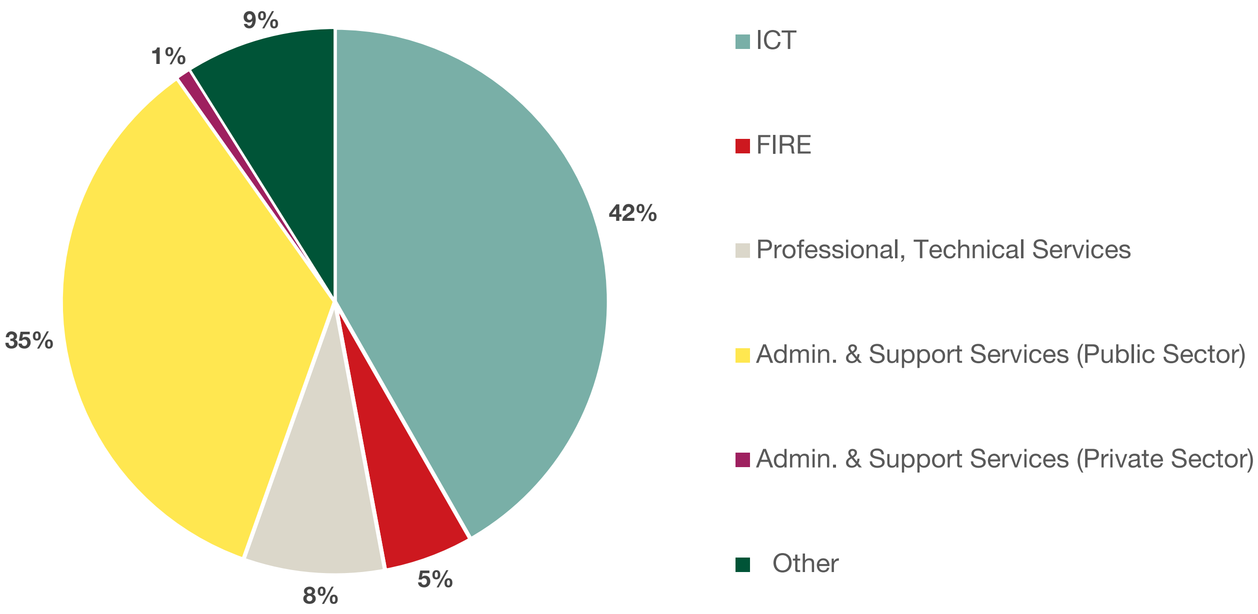


Source: Savills Research

Broadly speaking, the pattern of lettings followed jobs growth in the opening months of 2017 with ICT, Professional Services and FIRE companies accounting for 55% of the transacted space between them (see Figure 3).

32 Molesworth Street. Recently redeveloped and pre-let by Savills.

FIGURE 3:
Dublin Office Lettings by Sector Q1 2017



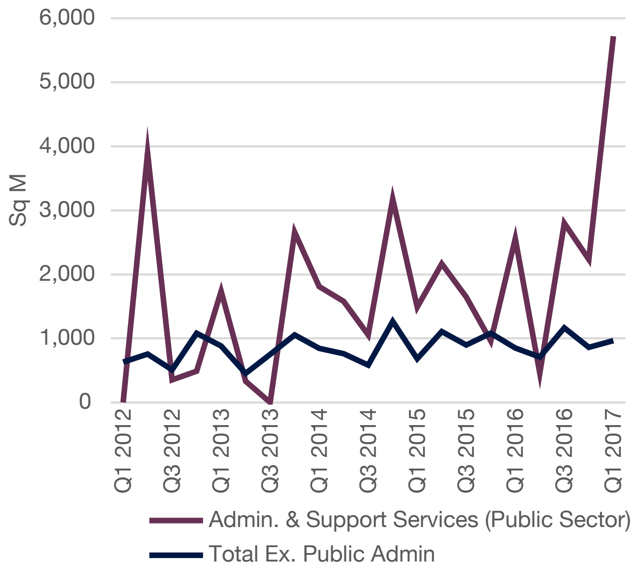
Source: Savills Research

Notably, however, the public sector was also a major taker of space with 17,160 sq m signed in the quarter. This represents 35% of the quarter's take up and makes Q1 2017 the strongest quarter for public sector lettings in the last decade. While Government take up in Q1 was heavily influenced by a large letting of 13,285 sq m in Miesian Plaza to the Department of Health there was also a substantial letting of 3,450 sq m to the Department of Social Protection in Smithfield and a smaller sub-letting to Pobal in the newly refurbished 100 Lower Mount Street. Indeed large Government lettings are becoming something of a trend - over the last year the NTMA, the ESB, the Passport Office and Comreg have all taken substantial quantities of space and a Government body has recently signed a lease for 1,769 sq m in The Exchange Building, Dublin 1. Reflecting this the size of the average Government letting has consistently exceeded the private sector norm (Figure 4a) and the share of take-up accounted for by the public sector has been on a sustained upward trajectory (Figure 4b).

100 Lower Mount Street was extensively refurbished and fully pre let by Savills.

FIGURE 4 (a) 4 (b) :

Figure 4 (a): Average Letting Size - Public and Private Sector
Figure 4 (b): Public Sector Share of Office Take-Up (4 QMA)



Source: Savills Research

On one hand these trends reflect a resumption of public sector employment growth following the lifting of a recruitment moratorium that was in place between 2009 and 2014. Since then a net 1,800 workers have been added to the public sector payroll in Dublin. In addition, increased public sector activity reflects a programme of active facilities management that the Office of Public Works has implemented to consolidate its accommodation requirements and achieve more efficient utilisation of space. The OPW has also been keen to upgrade the quality of its stock which had become tired or obsolete in many buildings e.g. Hawkins House, Central Bank Dame Street.

TABLE 1:

Top 5 Lettings Q1 2017

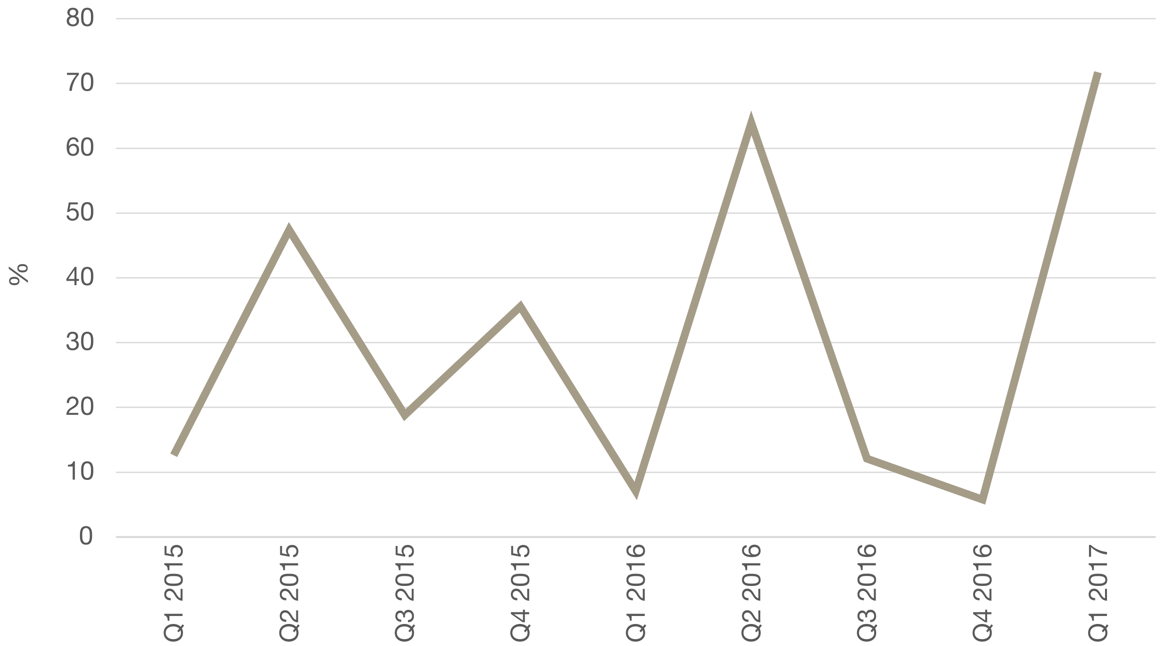
Building	Postcode	Location	Sq M Taken
Miesian Plaza	2	CBD	13,285
124-127 St. Stephen's Green	2	CBD	4,750
Block 2, George's Place, Smithfield	7	City Fringe	3,450
Block 19 Nangor Road Parkwest	12	South West Suburbs	3,406
1 Windmill Lane	2	CBD	3,159

Availability

The overall vacancy rate in the Dublin office market edged up from 9.0% in Q4 2016 to 9.4% in Q1 2017. This represents the first quarterly rise in the vacancy rate for 10 quarters dating back to Q3 2014.

It is instructive to analyse the origins of this upward movement. On the demand side, gross lettings were solid, if unspectacular, at 49,315 sq m in Q1. However, new entrants and expansions accounted for a sizable share of the quarter's lettings. In addition pre-lets fell from 44% of lettings in Q4 to 33% in Q1. As a result of these trends the conversion rate between gross lettings and net absorption was over 70% – see Figure 5.

FIGURE 5:
Net Absorption as % of Gross Take Up



Source: Savills Research

With demand remaining robust the increased vacancy rate has derived entirely from expansion of the total stock. Eleven new office buildings were completed in Q1 2017 – by far the highest number of quarterly completions in the cycle to date.[1] In gross terms these properties comprised 70,116 sq m of space. At the same time three existing blocks, comprising 15,432 sq m of older space, were decommissioned for redevelopment. The net effect of development activity was therefore to raise the total stock by 54,684 sq m in the quarter. In the event, and despite robust demand, net absorption countered at 35,375 sq m, meaning that the overhang of available space rose by the balancing sum of 19,309 sq m. As ever, the vacancy rate is highly variable by location – see Table 2. And, even within these broad districts, there is a high degree of variation in the vacancy rate by micro market and building quality.

[1] Gross development refers to space delivered in the quarter before subtracting any space that was decommissioned for redevelopment in the same period. Please note that all measurements in this report are in terms of sq m NIA.

TABLE 2:
Vacancy Rate by Broad District

Broad District	VR (%)
Central Dublin	6.5
North East Suburbs	11.2
North West Suburbs	16.0
South East Suburbs	12.0
South West Suburbs	21.1
Overall Dublin	9.4

There are currently 10 buildings with more than 5,000 sq m available in standing blocks. Six of these are located in Central Dublin with two each in the South East and South West Suburbs. None of these available large lots are classified as Grade A. There are a further 40 lots available at sizes ranging from 2,000 – 4,999 sq m, six of which are Grade A offerings.

Development

The development pipeline is now starting to roll. Just under 14,000 sq m of new office space was built in 2015, with a further 62,310 sq m completed in 2016. However activity ramped up dramatically with 70,116 sq m of completions in Q1 2017, driven in no insignificant way by Miesian Plaza. This brings the gross development total since the start of 2015 to 146,335 sq m.

Development has been heavily concentrated in the Central Business District (CBD) with just over two thirds of new space being built in Dublin 2, and 12% in Dublin 4. The focus on city centre locations which are already heavily developed has given the current cycle a new dynamic. In contrast to earlier rounds which exploited unused sites in the city centre and which took advantage of new infrastructure to roll out suburban office building, the current development cycle requires the demolition of obsolete older blocks to facilitate new construction. Consequently the distinction between development gross and net of demolitions has become a critical consideration for analysts of the Dublin market. In gross terms, 146,335 sq m of new space has been delivered across 30 schemes since the start of 2015. However, 22 of these projects have involved the replacement of older buildings with new. When demolitions are netted out, and allowing for construction lags, net additions to the total stock in the cycle-to-date fall back to 56,143 sq m.

In gross terms there are currently 340,209 sq m of new office space on-site and under construction across Dublin. The majority of this will have reached practical completion by end-2018. Based on an item-by-item review of ongoing projects we expect total completions for 2017 to be approximately 255,000 sq m. The margin for error widens for our 2018 completions forecast. Some schemes which are scheduled for completion late this year could potentially drift into early 2018. But there is an even greater chance that schemes which are currently scheduled for 2018 completion could drift into 2019. Moreover unexpected refurbishment projects could commence and deliver within an 18 month timeframe. Notwithstanding these caveats, our expectation is that just under 270,000 sq m of new office space will be completed in 2018, a very limited uplift on 2017. While these figures appear substantial in a market that currently comprises 3.6m sq m of stock two points are worth emphasising. Firstly 38% of the gross development that is currently onsite is already pre-let. Secondly, as mentioned above, demolitions mean that gross completions of approximately 523,000 sq m in 2017 and 2018 should net back to just 282,500 sq m being added to Dublin's total stock.

TABLE 3:
Gross and Net Development Pipeline 2017 and 2018

	Gross Completions Sq M	Demolitions Sq M	Net Additions To Stock Sq M
2017	254,911	107,479	147,431
2018	267,814	132,766	135,048
Total	**522,725**	**240,246**	**282,479**

Rents

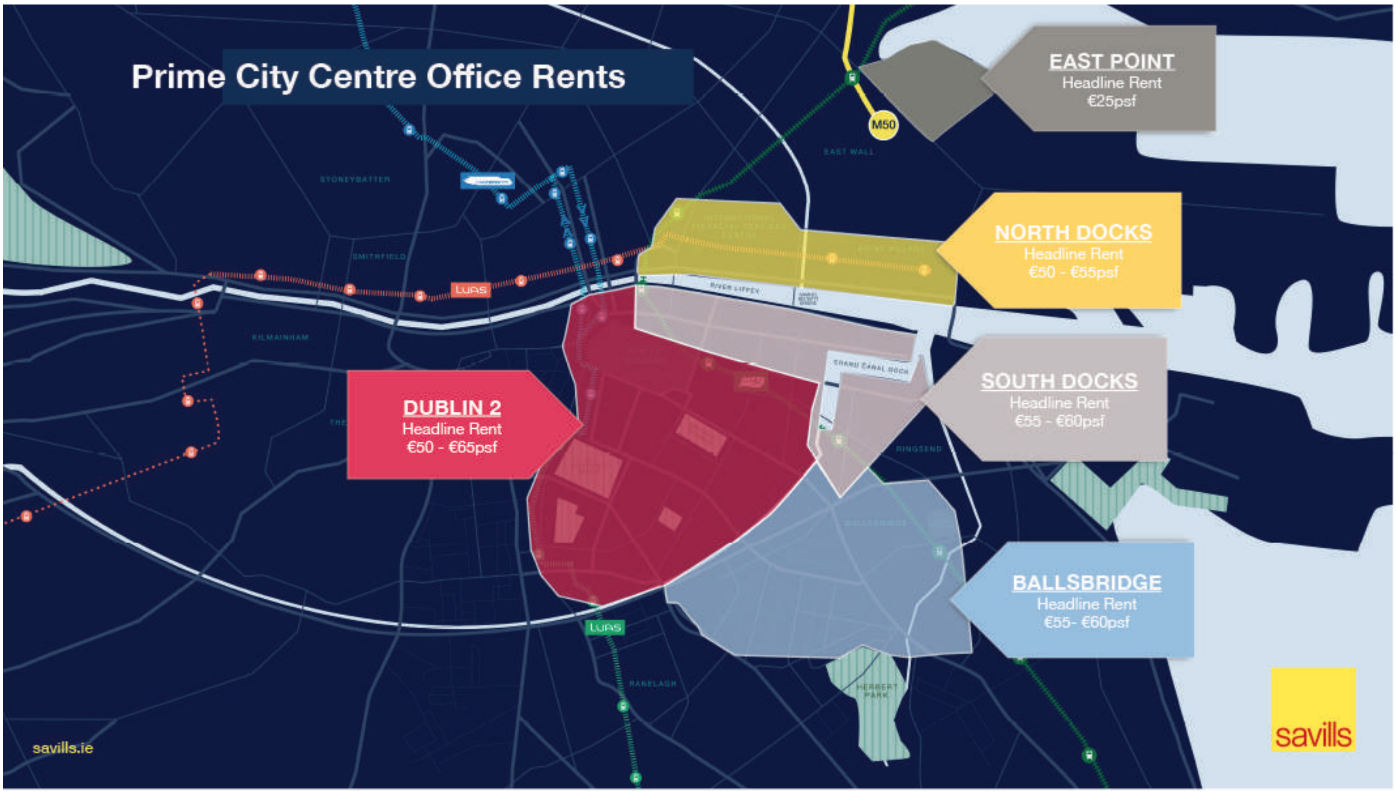
We believe that the tone of rents for good quality office space in Dublin's prime business locations now stands at €673 per sq m per annum. This headline rate is largely unchanged over the last 12 months although, it must be noted, net effective rents have risen somewhat by virtue of tightening tenant incentives. With rent frees having narrowed there is limited scope for tenant incentives to tighten further in the current cycle. While they could of course tend to zero, tenants do favour rent-frees to aid with the cashflowing of their fit-out. In theory, therefore, continued strong demand for Dublin office space could find its way into a resumption of stronger growth in headline rents. However, it remains to be seen whether this dynamic emerges in practice, and the flow of Brexiteers in particular (focused on Q1 2019) could be an important driver of this if it emerges.

Looking ahead, theory and historical experience suggest that vacancy rates will drive future growth in headline rents. The evolution of vacancy rates will reflect two factors;

- Net Absorption – which depends positively on gross lettings and negatively on 'churn'
- Net Completions – which depends positively on the gross development and negatively on demolitions

Combining assumptions about net absorption (which are informed by consensus macro-economic forecasts) with our detailed knowledge of individual office development schemes, we expect vacancy rates will end 2017 at approximately 8% - around a percentage point lower than last December. Thus we view the observed uptick in Q1 vacancy rates as a hiccup caused by the timing of several major completions. Over the remainder of this year net absorption should outstrip net completions causing the vacancy rate to fall again. This expectation reflects the fact that two thirds of the onsite development stock that is due to deliver by year-end is now committed to tenants/occupiers. While the ultimate impact of Brexit on Dublin office demand is still to be determined, if JP Morgan's pre-purchase of a large block in Capital Dock sets a precedent which others follow, net absorption could be even stronger than expected, resulting in a sharper decline in vacancy. Looking further ahead, we expect the vacancy rate to edge back up after this year, ending 2018 at approximately 9% - similar to where it was in December 2016.

Feeding these assumptions into our forecasting model suggests further modest growth in prime headline rents through the remainder of this year and into 2018.



The Reflector. Up to 11,427 sq m of Grade A space in Dublin's Docklands, ready for occupation in August 2018.

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