Savills Research – Market Review and Outlook 2023

MARKET IN MINUTES

Savills Research

Dublin Industrial and Logistics Market

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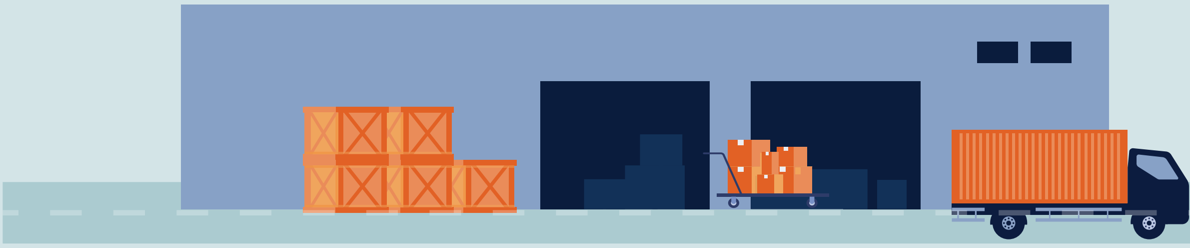
Macro view • Market activity • Outlook

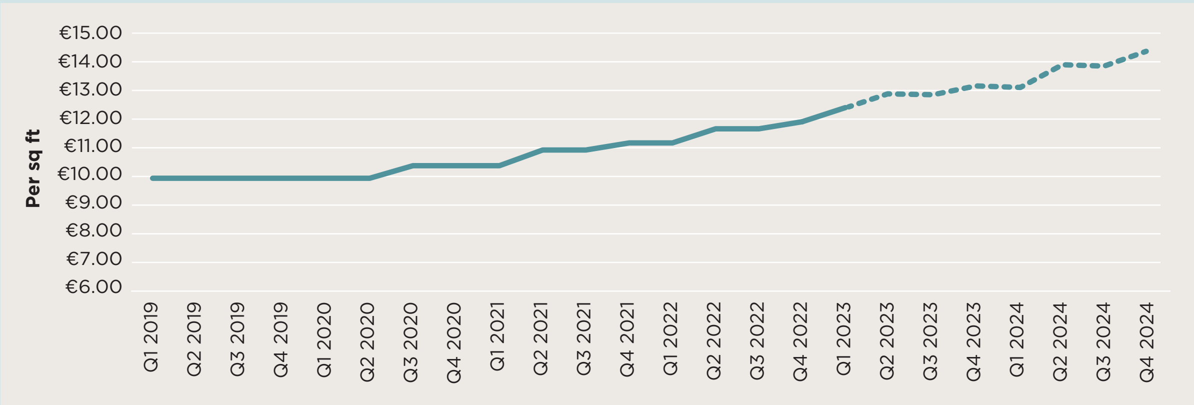
Outlook for 2023



New benchmark rental terms being quoted and agreed

Competition for limited modern stock has not only resulted in a higher portion of take-up being composed of pre-lets, but a favourable market towards landlords. Tenants are willing to accept longer term leases to secure these units as part of their strategic and long-term operations within Ireland. Essentially a landlord's market, prime rents increased by 6.7% in 2022, going from €11.25 psf to €12.00 psf. Our econometric model forecasts prime rent reaching €13.00 psf by the end of 2023 and €14.50 psf by the end of 2024. Vacant legacy stock in the short-term will provide far more favourable terms for tenants. However, if the trend in pre-letting persists among new stock, some firms will eventually be willing to take on legacy stock to redevelop or retrofit in the absence of modern units. This trend has already begun to reveal itself in the form of secondary rental growth of 12.5% over the past 12 months, going from €8.00 psf to €9.00 psf.

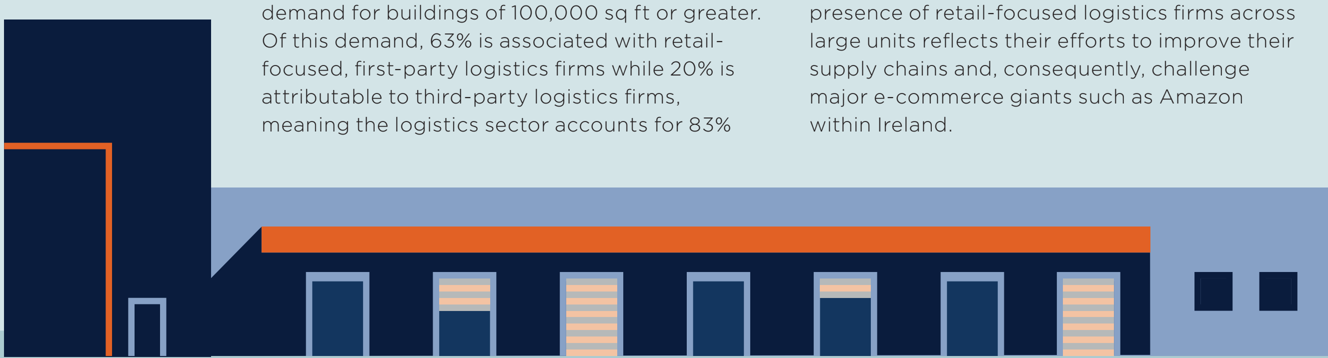
Figure 1: Prime rents forecast



Source: Savills Research

Retail-focused logistics aims for expansion

Currently, there is over two million sq ft of demand for buildings of 100,000 sq ft or greater. Of this demand, 63% is associated with retail-focused, first-party logistics firms while 20% is attributable to third-party logistics firms, meaning the logistics sector accounts for 83% of this size-specified demand. The growing presence of retail-focused logistics firms across large units reflects their efforts to improve their supply chains and, consequently, challenge major e-commerce giants such as Amazon within Ireland.



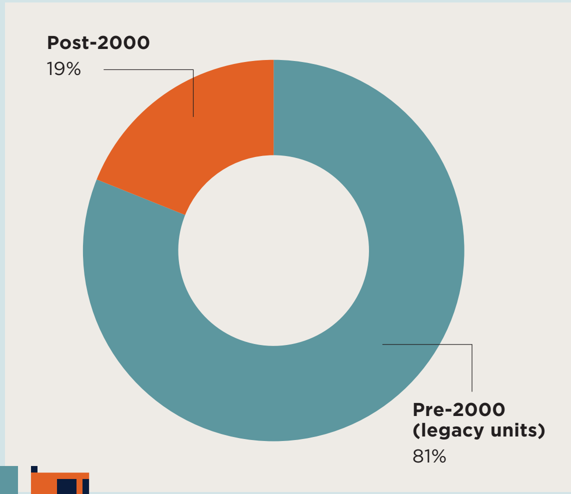
Chinese re-opening raises questions over supply chain strategies

Chinese manufacturers aim to resume production and operations to pre-pandemic levels in 2023, despite activity remaining constrained by ongoing infections in factories. The return of the world's largest exporter to the international fold should act as a stimulus to the global economy as well as freeing up global supply chains. At the same time, foreign firms will be wrestling with the decision whether to retain their China-based supply chains or shift these closer to their consumer bases in order to improve oversight and control. The key question will be whether firms choose to remain with the China centric model of old, or seek to decentralise from their reliance on China.

Vacancy is expected to remain constrained

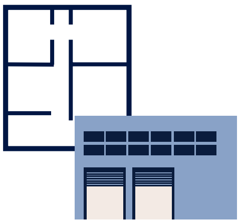
The taking of new stock prior to completion has resulted in the absence of modern stock within vacancy. The vast majority of new builds are over 50,000 sq ft in size, with the demand for these large units preventing the possibility of them being added to vacancy. We do, however, expect the vacancy rate to increase slightly in 2023 as the non-renewal trend among tenants in legacy units continues to bring smaller, legacy stock into vacancy. This is a result of tenants moving into higher-quality stock, combined with weaker demand for tertiary stock that does not meet modern occupiers' specifications.

Figure 2: Vacancy by age



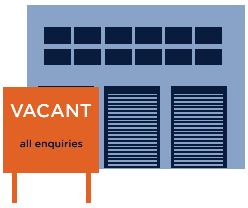
Rising debt costs to impact new supply

Debt costs and the resultant impact on yields have affected end values. On this basis, we may see certain developers require a pre-let to be in place prior to commencing construction. Ultimately, a slight reduction in the delivery of speculative units is expected, although the forecast for completions for 2023 is at an all-time high of 2.6 million sq ft.

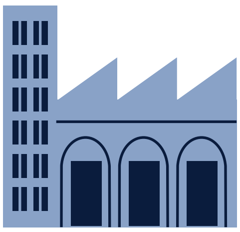


2.9m sq ft
of take-up in 2022

69%
of take-up was by logistics firms



1.6%
vacancy rate in 2022



81%
of vacant units are over 20-years old

Macro view

Navigating a challenging economic landscape

The Irish industrial and logistics sector was impacted by several key challenges in 2022, with supply chain bottlenecks, an energy crisis and exceptionally high inflation eroding consumer and market sentiment alike. These conditions created significant uncertainty for the global and domestic economies. Despite this, multinational companies continued to choose Ireland due to its strategic location within the European Union (EU), after accounting for a significant portion of the 2.9 million sq ft of space taken. Firms have expressed a commitment to continue investing in Ireland, supporting the relatively strong Irish GDP growth forecast of 4.0% for 2023 from the International Monetary Fund. This makes Ireland an exception among advanced economies, with firms recognising the potential to capitalise on this. In 2023, firms will test the resilience of the domestic economy and confront a range of challenges and opportunities in the sector.

Figure 3: Economic growth forecast for 2023

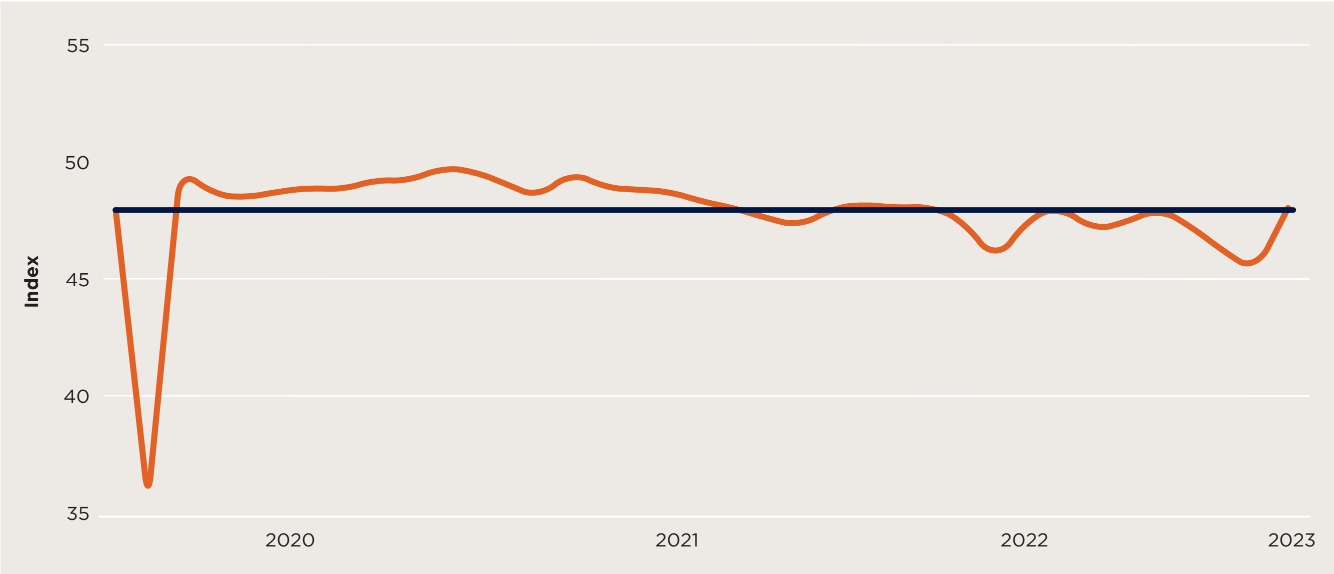
Source: EU Commission

Caution surrounding supply chains

After the debilitating conditions supply chains faced during the pandemic, a recovery is in sight as bottlenecks ease. Export and import firms gained access to cheaper commercial shipping after pandemic measures were lifted, with container prices returning to pre-pandemic price levels of approximately USD$ 1,800 (€1,652) per 40 ft container. This is down from the pandemic high of USD$ 10,360 as shown by the World Container Index. While the drop in shipping costs has benefitted firms and supply chains, it is a symptom of the downturn in the Chinese economy – which threatens a series of new challenges in 2023.

The post-pandemic reopening of China is expected to have a mixed impact on the industrial and logistics sector. This is down to two dynamics arising from the lifting of the zero-Covid policy. Firstly, China now has greater access to foreign-produced goods, placing significant demand on supply chains involved in the exporting of European and Irish goods – particularly luxury and high-end items. Secondly, there is a question over whether Chinese manufacturing can resume the same levels of output as before the pandemic. Chinese manufacturers have suffered numerous Covid outbreaks across their factories, squeezing output and producing the nation's lowest level of manufacturing activity in December since the initial lockdown in 2020. This activity recovered significantly in January, according to the National Bureau of Statistics, but does pose a question regarding the stability of centralised supply chains linked to manufacturing abroad. With additional external demand and a highly volatile supply of cheaper manufactured imports on the horizon, Ireland's industrial and logistics industry must proceed with caution in managing stock levels and remain alert to the stability of supply chains.

Figure 4: China Manufacturing Purchasing Managers Index



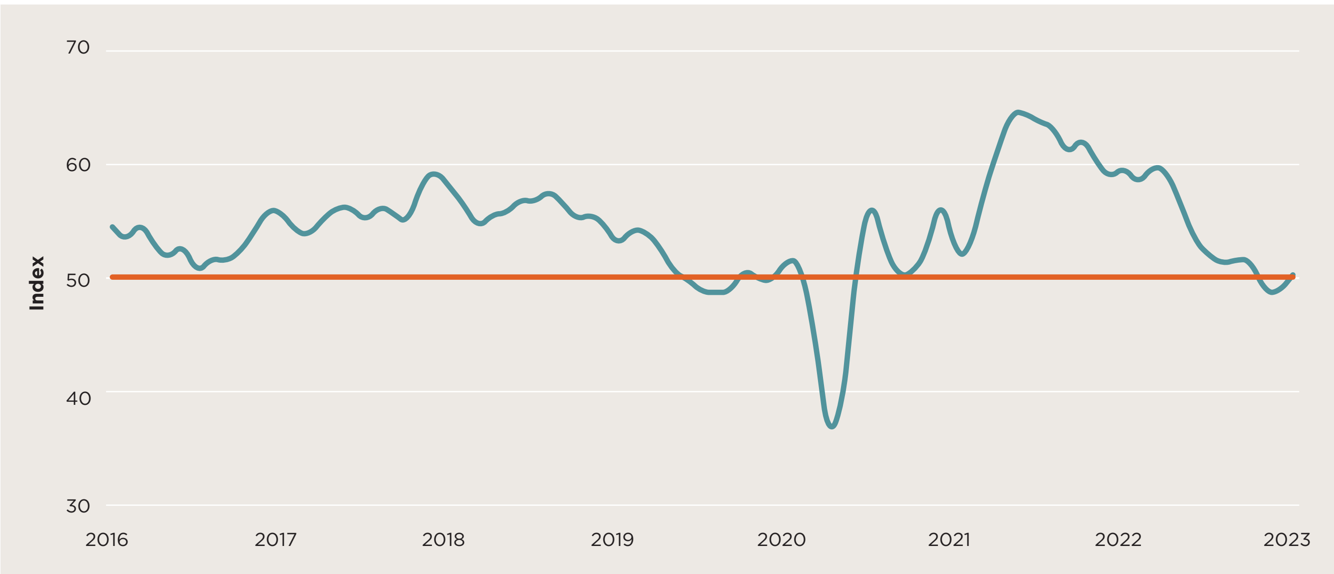
Source: NBOSC

Weakened demand drives stockpiles

Preliminary estimates from the Central Statistics Office suggest economic growth was 12.2% in 2022. Coupled with a low unemployment rate of 4.3%, this indicates a generally positive environment for the industrial and logistics sector. Nevertheless, consumer confidence has been volatile. The Credit Union Consumer Sentiment Index fell from 81.9 to 48.7 between January and December 2022, with any reading below 50 representing a negative opinion. Although the index recovered to 55.2 in January, consumers' real disposable incomes have been squeezed by high inflation, primarily driven by the war in Ukraine. Personal consumption expenditure growth has consequently slowed, with Irish consumers digging into their savings to keep spending. Mixed consumer confidence and the reduction in real disposable incomes have resulted in firms adjusting their relevant stock levels and production patterns. This is particularly evident in the Irish manufacturing sector.

According to AIB Ireland's Manufacturing PMI, the New Orders Index has fallen for an eighth consecutive month amid weak demand. At the same time, the Stock of Finished Goods Index recorded a seventh consecutive month of stock build-up, indicating that firms have a sufficient supply on hand and are actively choosing to further build their inventory levels. The overall Manufacturing PMI recorded a level of 50.1 in January, just above the benchmark of 50 indicating neutral conditions. Ongoing developments in inflation and interest rate movements will create some volatility in consumer discretionary spending, with the PMI likely to remain close to the neutral value of 50 as this volatility feeds through to supply chains.

Figure 5: AIB Ireland Manufacturing PMI

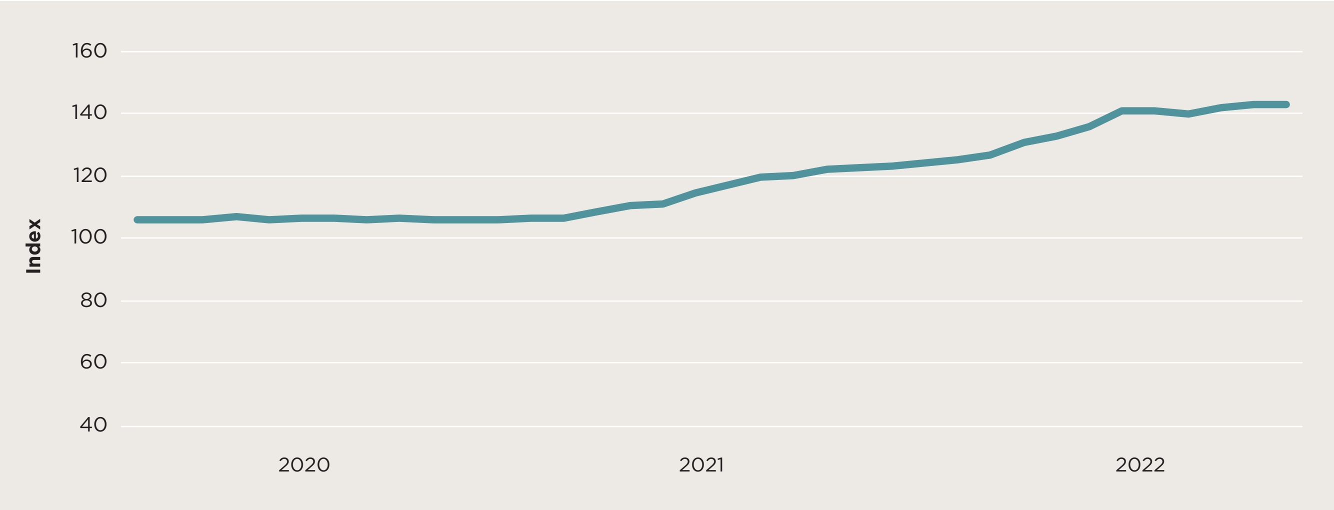


Source: AIB

Construction material prices may hinder development

The impact of rising material costs in 2022 placed significant pressure on developers. According to the CSO, wholesale construction material prices increased by 16.2% y/y in 2022. This was on top of growth of 16.1% y/y a year earlier, although that was primarily due to pandemic-related lockdowns and a shortage of timber. 2022 price growth was produced by the supply shock attributable to the war in Ukraine. With no real indication as to when the conflict may be resolved, the instability in materials supply will likely keep upward pressure on prices. Developers currently considering the development of new sites in 2023 may opt to push out their construction timelines until conditions stabilise.

Figure 6: Wholesale Construction Material Price Index



Source: CSO

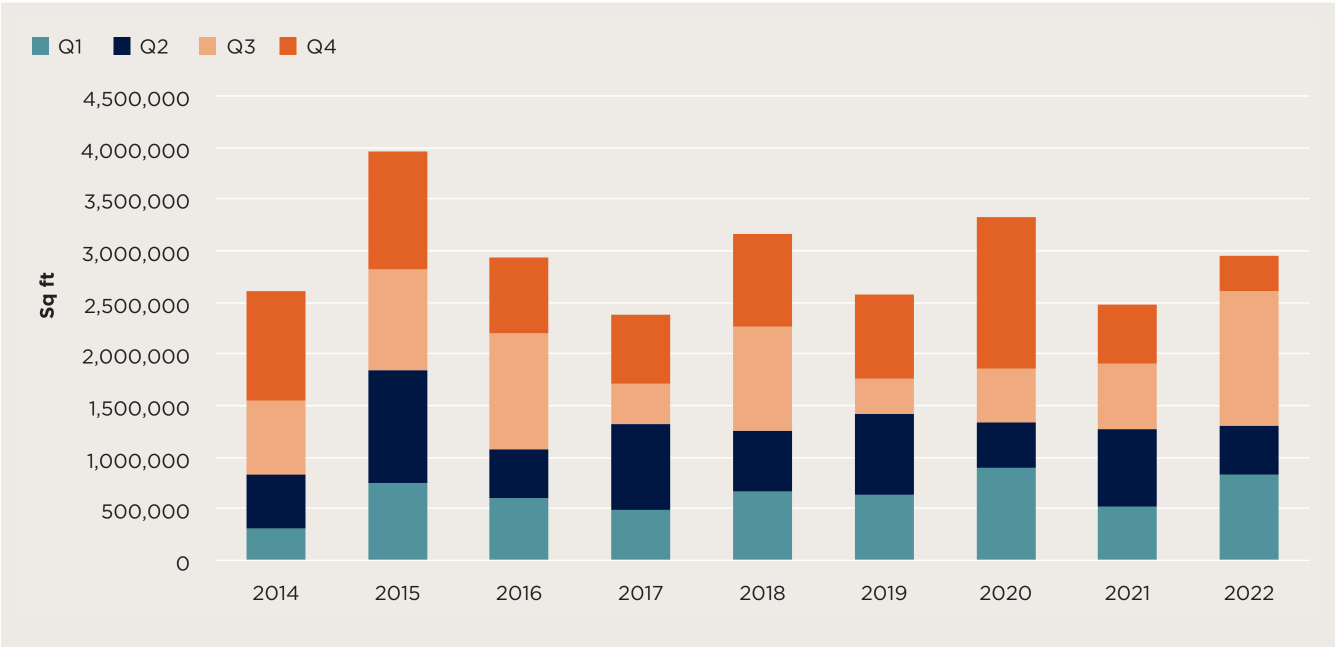
> **Developers currently considering the development of new sites in 2023 may opt to push out their construction timelines until conditions stabilise.**

Unit 628 & 637, Northwest Logistics Park

Market Activity

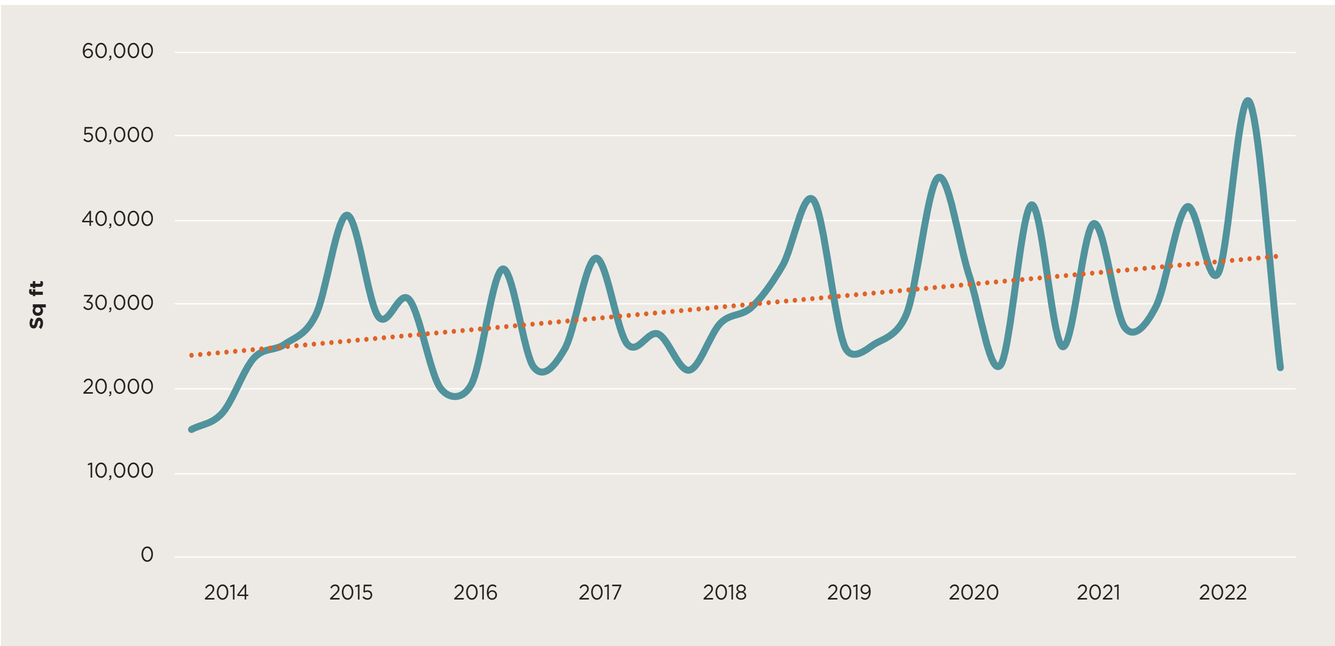
Take-up totalled 338,000 sq ft in Q4, the lowest quarterly figure on record due to the shortage of available units. The average deal size was 22,500 sq ft, a significant decline from the 54,000 sq ft recorded in Q3. Fifteen deals occurred in the quarter, which was also the weakest on record. There were six deals between 20,000 and 50,000 sq ft, making this the largest size segment in Q4 and equating to half of the total take-up. There was only one deal greater than 50,000 sq ft, which was a substantial drop from the 10 recorded in Q3. Nevertheless, annual take-up reached 2.9 million sq ft – just over the five-year average for the sector. The total number of deals was 73, at an average of 40,350 sq ft – making this the largest average annual deal size since we began tracking activity.

Figure 7: Take-up



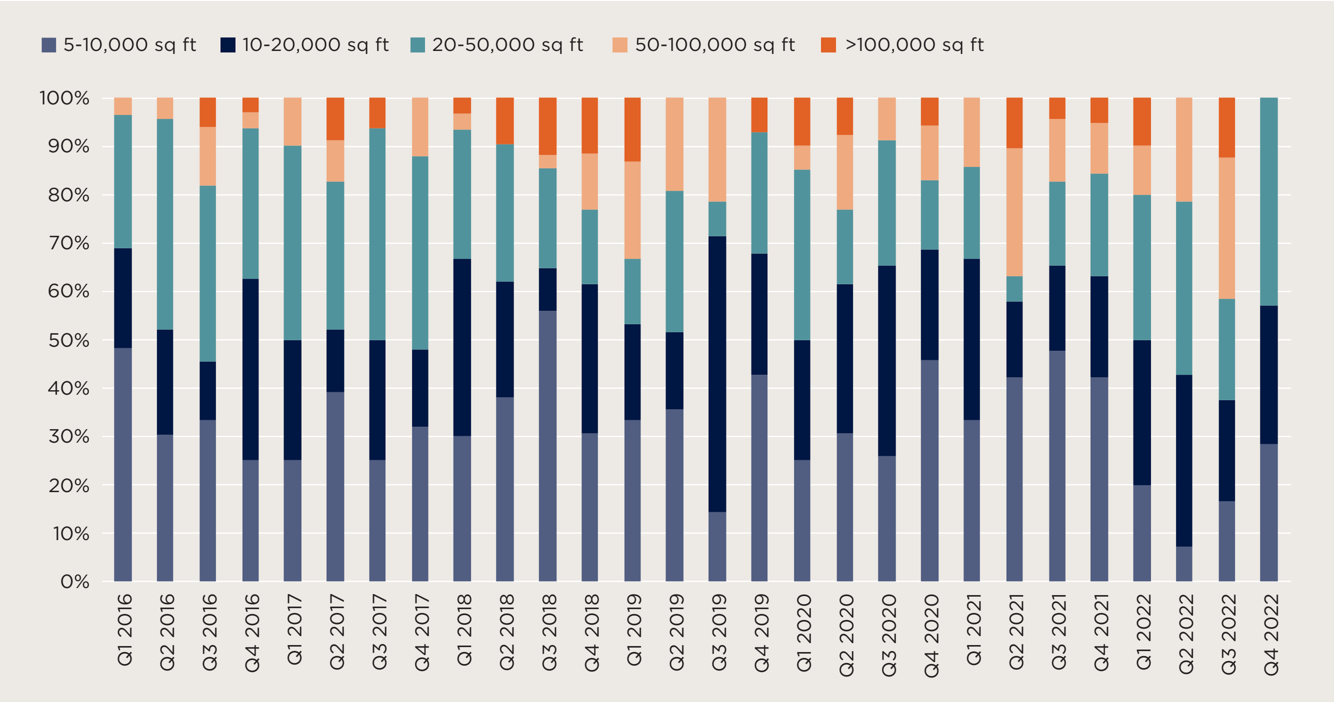
Source: Savills Research

Figure 8: Average deal size



Source: Savills Research

Figure 9: Share of deals by size



Source: Savills Research

Big box units – the main driver of activity

Deals for big-box units of 50,000 sq ft or more accounted for 1.83 million sq ft, or 62%, of take-up in 2022. This compares with a five-year average of 55%, reflecting the gradual increase in the demands of modern occupiers who plan to expand their Irish operations. While only one big-box deal of 86,700 sq ft occurred in Q4, the annual total is the second largest on record at 18 transactions. The largest of these were by logistics firms DHL and Maersk, along with e-commerce giant Amazon. Given the EU Commission's forecasts for Irish economic growth and the projected supply of new stock for the year ahead, we believe big-box units will continue to make up the majority of take-up in 2023.

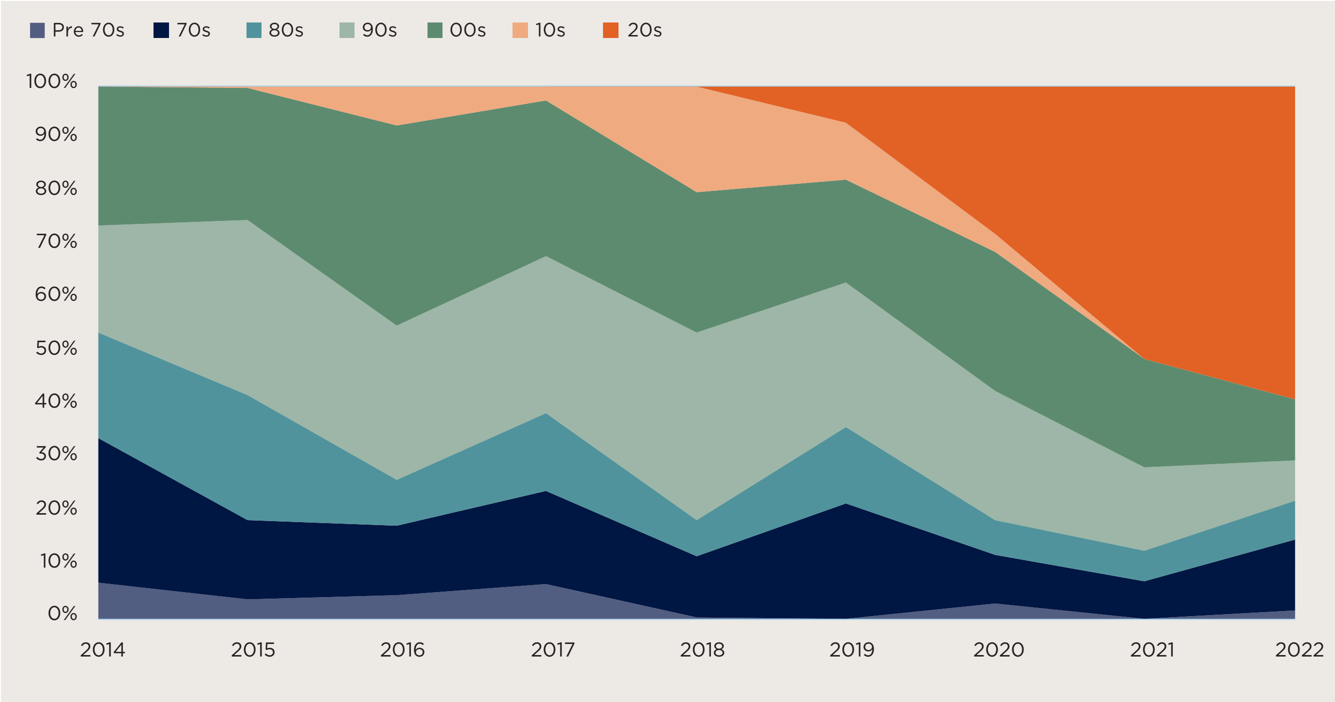
62%
of take-up in 2022 was for big-box units

Table 1: Top deals of 2022

Property	District	Sq ft	Tenant	Type
Unit 1, Quantum Distribution Park	NE	206,000	DHL	New Build
Unit 902, Northwest Logistics Park	NW	200,000	Amazon	New Build
Unit 3, Quantum Distribution Park	NE	178,481	Maersk	New Build
Unit Q, Aerodrome Business Park	SW	161,700	Iron Mountain	New Build
Unit D, Mountpark II, Baldonnell Business Park	SW	133,800	DB Schenker	New Build

Source: Savills Research

Figure 10: Take-up by age

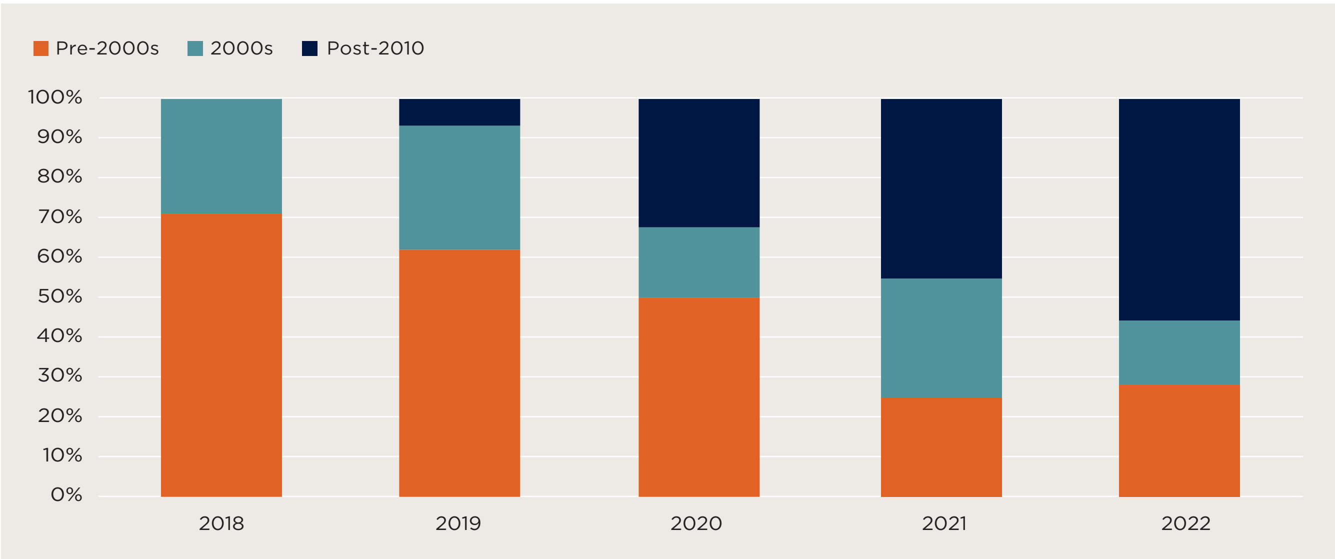


Source: Savills Research

Out with the old, in with the new

Industrial and logistics units built over the past ten years accounted for 59% of take-up in 2022, compared to 51% and 28% in 2021 and 2020, respectively. This reflects a growing demand for large, high-spec units, with 2022 recording 1.75 million sq ft completed, the highest amount of new space delivered annually on record. Thirteen deals were pre-lets, accounting for 46% of annual take-up. Indeed, 2022 was characterised by pre-lets and the subsequent phasing out of long-term tenants from lower-quality stock. Take-up for modern units increased 37% y/y, while the share of take-up for legacy units more than halved from the historical average of 56%. Ironically, high levels of demand for modern stock may drive occupiers towards legacy units as temporary centres of operation while waiting for additional modern builds to come onstream. In the interim, firms may also reconsider the costs of refitting older units to meet their needs. In response, lease terms for legacy stock will continue to be more flexible to attract shorter-term tenants.

Figure 11: Legacy and modern portion of take-up

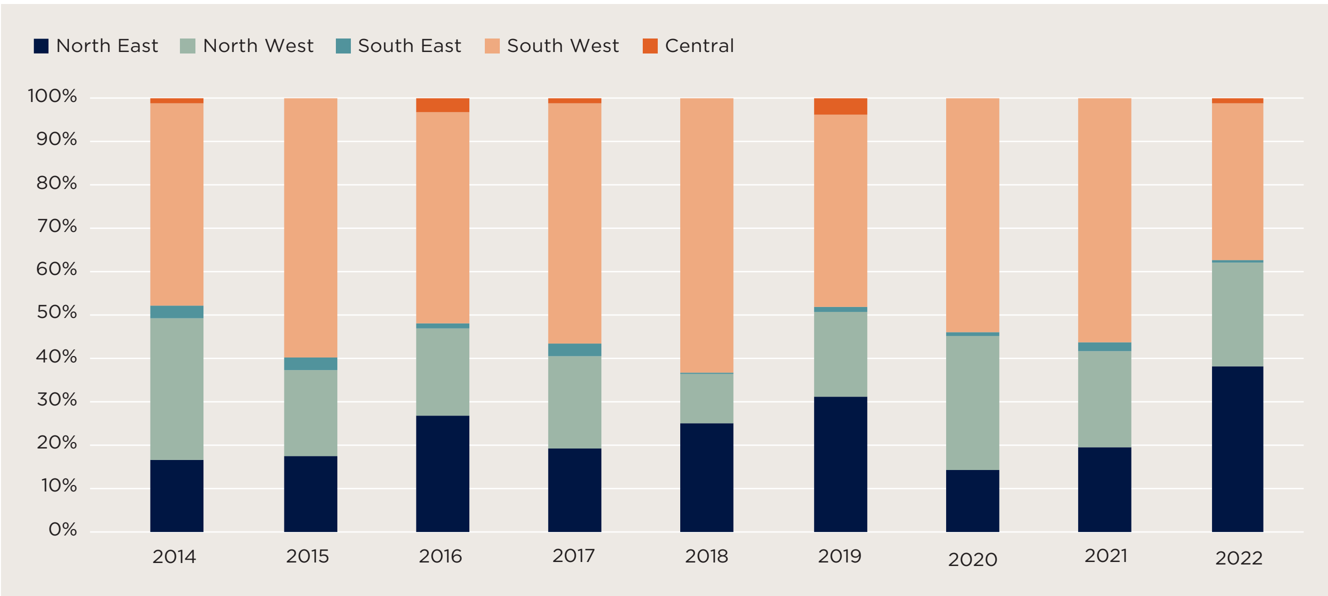


Source: Savills Research

North outpaces South in take-up

The North-east accounted for 45% of take-up in Q4 and 38% of total space taken in 2022. This represented its largest annual share since records began and was well above the five-year average of 23% for the region. Furthermore, the North-east suburbs made up the majority of big-box transactions, with just 10 deals translating into 33% of total take-up for the year. New developments in the region, such as Dublin Airport Logistics Park Quantum Distribution Park and Horizon Logistics Park, combined with the undersupply of modern stock in other parts of the city, explain the North-east's popularity. Meanwhile, the South-west was the second-most popular location, accounting for 36% of annual take-up. This was well below its five-year average of 52% however. Elsewhere, it was a particularly strong year for the northern suburbs as they totalled 62% of take-up where they have historically only averaged 55%.

Figure 12: Take-up by location

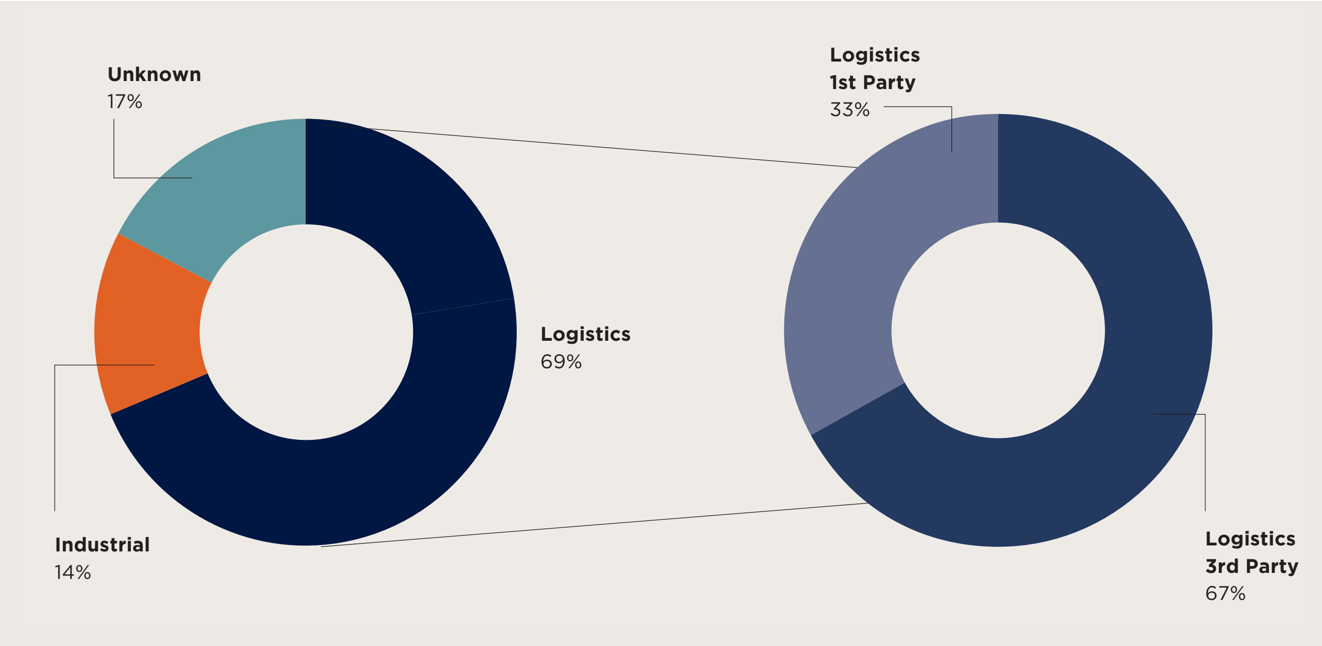


Source: Savills Research

2022 marked by logistics firms' big commitments

The logistics sector took 35% of warehouse space in Q4, which was a substantial decrease from its 81% share in Q3. Despite this, there was a significant number of third-party logistics firms, such as DHL and Maersk, completing deals for big-box units throughout 2022. The majority of these transactions were completed in Q3, with a lower take-up in Q4 a result of a reduction in the delivery of new builds. This trend supports the view that Ireland is an important base for global logistics firms looking to expand their facilities, particularly since Brexit. Annually, the logistics sector made up 69% of take-up at just over two million sq ft, representing an increase of 20% y/y or an additional 809,000 sq ft in total. Separately, the industrial sector also had an underwhelming Q4 with take-up of 28,000 sq ft, or 8% of space taken. This was a significant decline on the 236,600 sq ft taken in Q3. Annually, the industrial sector accounted for 14% of take-up.

Figure 13: Take-up by sector, 2022



Source: Savills Research

Building 1 & 2 Brownsbarn, Citywest Business Park

Supply

Completions nearly double in 2022

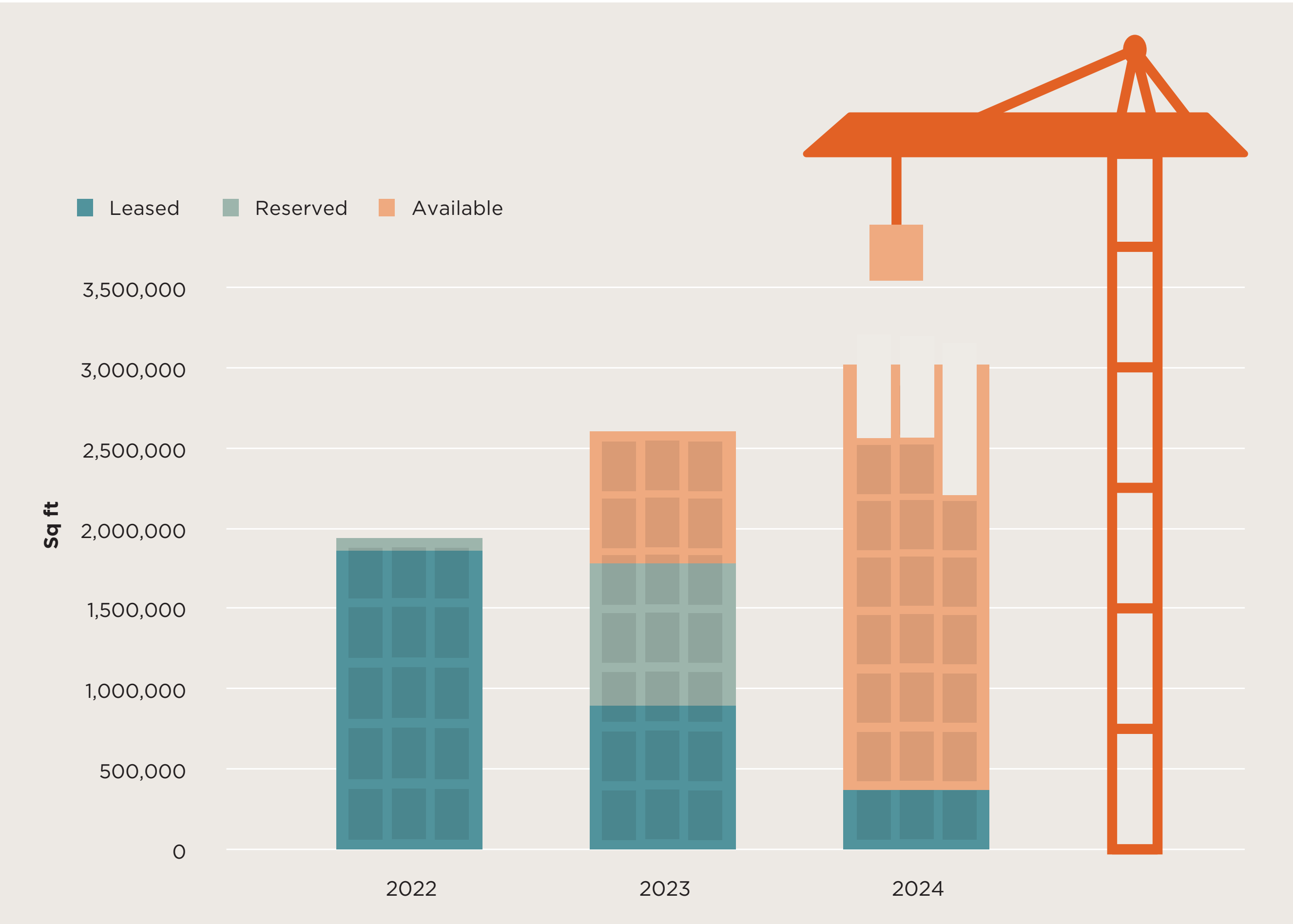
Seven units totalling 429,100 sq ft reached practical completion in Q4 2022. The largest of these was IPUT's Unit 2, Quantum Distribution Park, totalling 95,700 sq ft and pre-let to Harvey Norman. The second largest was Sandymark's Unit F, Greenogue Logistics Park, totalling 95,000 sq ft and pre-let to Zeus Logistics.

New supply in 2022 reached 1.9 million sq ft, which was below the 2.1 million sq ft estimated in Q3. Approximately 370,000 of the 534,000 sq ft due to be delivered by year-end was completed on schedule. Total new supply was 97% higher than the 982,000 sq ft delivered in 2021, and the largest annual addition of space on record.

In addition, all of this space was either reserved or pre-let on completion, meaning none of the new supply translated into vacancy – underscoring strong demand for high-calibre, modern units.

We expect completions of 2.6 million sq ft in 2023, with 2.5 million sq ft already under construction, of which 68% is either pre-let or reserved. Notwithstanding this, construction cost instability and tighter credit conditions arising from higher interest rates present serious challenges to developers. These headwinds may delay construction projects, with the tougher lending environment potentially preventing some developers from breaking ground.

Figure 14: Pipeline forecast



Source: Savills Research

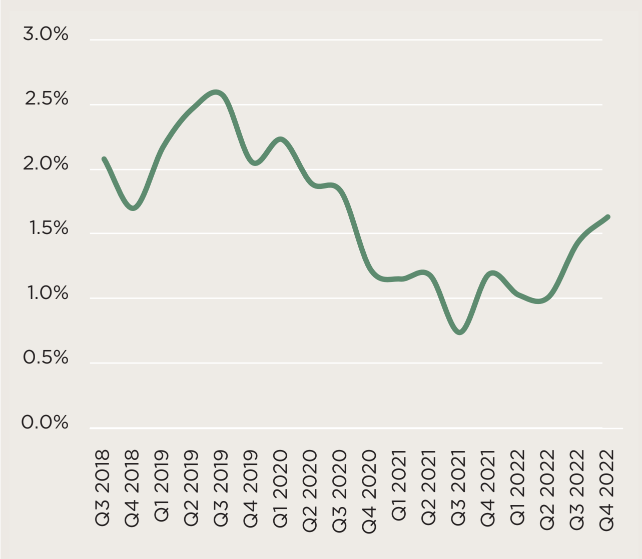
> Total new supply was 97% higher than the 982,000 sq ft delivered in 2021, and the largest annual addition of space on record.

Vacancy rate reflects weak demand for older units

None of the three units which were added to vacancy in Q4 were modern stock. In fact, the increase in the vacancy rate was primarily due to a large legacy unit of 200,330 sq ft, namely Unit 3, Harris Truck Centre, Naas Road. The other significant addition was the 19,250 sq ft Block 538, Greenogue Business Park, though this unit is reserved as of the time of writing. The increase in the vacancy rate throughout the year was mainly driven by the growing number of occupiers exiting legacy units. Tenants are looking for larger, modern, ready-for-use stock. Additionally, the costs involved in refitting and updating older units are difficult to estimate given the uncertainty surrounding construction and materials prices.

As such, we anticipate that existing tenants will choose not to renew their leases on many of these older buildings. Of the 39 vacant units at the end of 2022, only one was built over the past decade. Demand for large stock drove the majority of annual take-up, although potential occupiers are struggling to source both large and modern units. For units greater than 50,000 sq ft, only one out of the six available was built this decade. The completion of a substantial amount of new stock this year will raise the vacancy rate, albeit only slightly as tenants switch to larger, modern stock where they can.

Figure 15: Vacancy rate

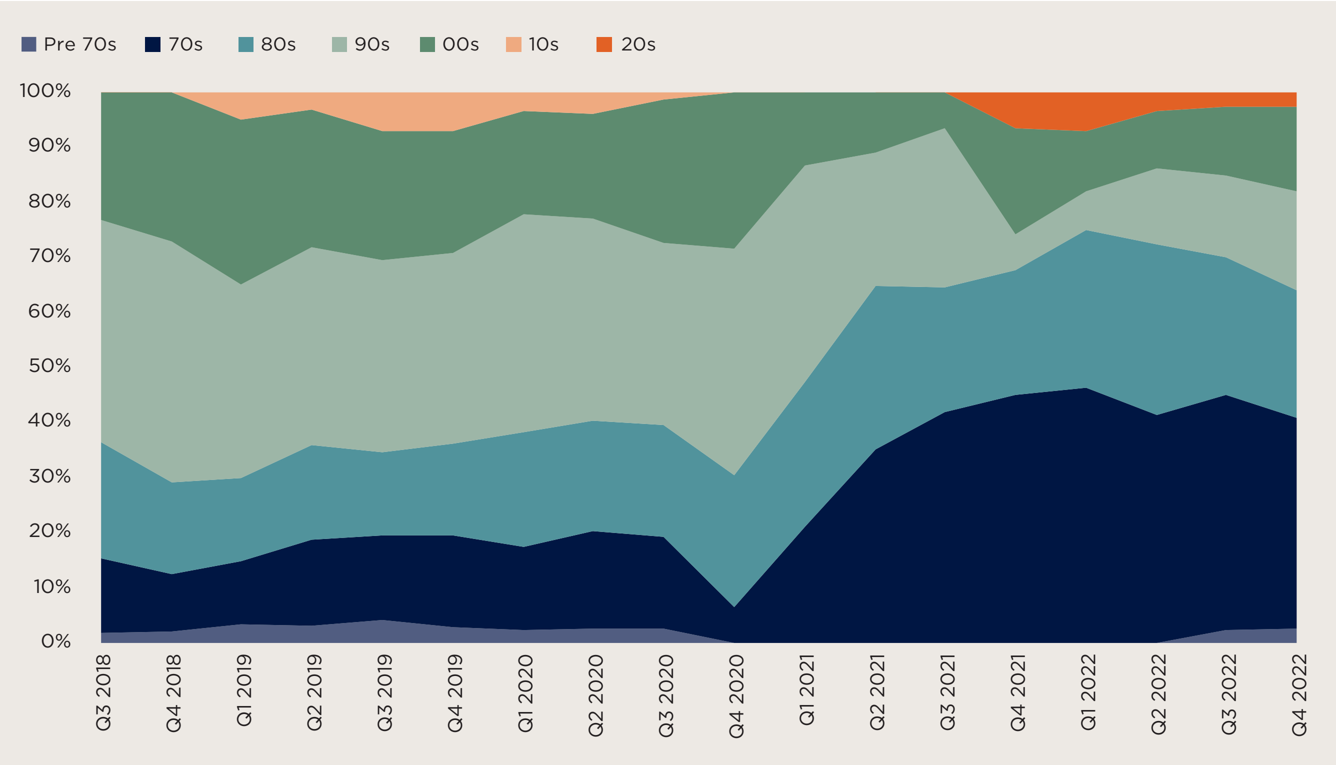


Source: Savills Research

The Vacancy rate edged up from

1.4% in Q3 to 1.6% in Q4

Figure 16: Vacant space by age

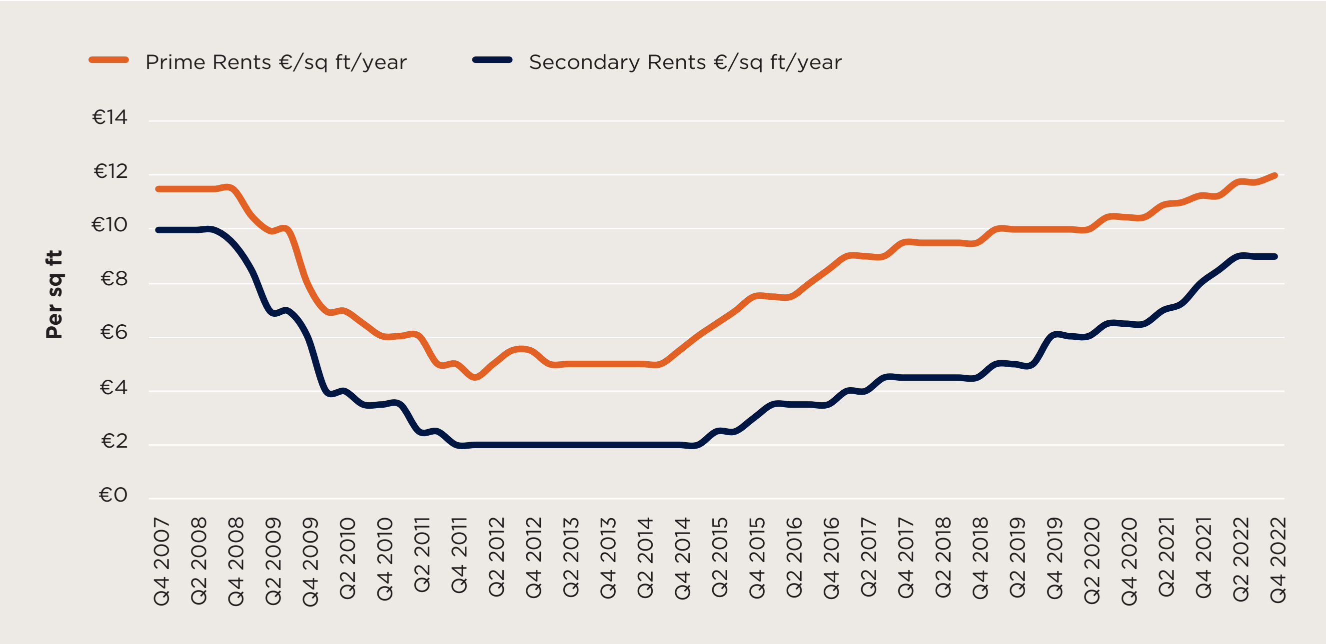


Source: Savills Research

Rents

Rents for the Dublin industrial and logistics sector grew in 2022 and are likely to continue to increase in 2023. The International Monetary Fund has forecast small economic expansions for the US and Europe. Combined with the positive growth expectations for Ireland and the structural undersupply of tenant-suitable units, these factors will be supportive of rents in the year ahead. Looking back at last year, it is notable that prime stock rents rose from €11.25 in Q4 2021 to €12.00 psf in Q4 2022, while secondary rents grew at a stronger rate, increasing from €8.00 to €9.00 psf over the same period. This year, we expect the market to favour landlords as tenants commit to longer leases to secure limited high-quality stock. Ten to 15-year term certains are achievable for prime stock, which we believe will continue until stock levels meet current and expected demand.

Figure 17: Prime and secondary rents



Source: Savills Research

Building 2, Greenogue Logistics Park

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