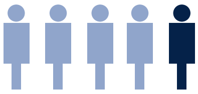
Savills Research – Q1 2021

MARKET IN MINUTES
Savills Research

Dublin Office Market

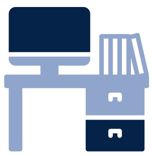
With Shadow Market Study

Macro View • Market Activity • Outlook



+3.6%
Growth in Dublin private sector office-based employment (ex. Admin) in 2020

€57.50 psf
prime headline rents



750,000 sq ft
of space is reserved

816,000 sq ft
of vacant shadow space available at end of Q1, representing 1.9% of total stock

Macro View

Dublin's private sector office-based employment grew through the pandemic

Examining the CSO's employment data by sector for 2020 yields some interesting insights into the impact of the pandemic on (normally) office-based employment. Our traditional reference for office-based employment sectors are set out in Table 1 and show an overall annual decline of 7,100 office jobs in Dublin in 2020 – a decrease of 2.6% y/y. However, the fall in office-based employment was driven almost entirely by the loss of 13,000 administrative and support service roles during the period, with Public Administration jobs accounting for the balance of the contraction (1,100). When we isolate the Professional Services, ICT and FIRE sectors, we can see that high-skilled private sector office-based employment expanded last year, with 7,000 jobs added in these categories in 2020 – an increase of 3.6% y/y. Furthermore, one can expect that these Administrative and Support Service jobs will recover quickly when firms return to the office later this year. This is a remarkable performance given the economic challenges posed by the pandemic and puts the Dublin office market in a position of strength as society reopens.

Table 1: Dublin office-based employment

Sector	Annual Change	
ICT	3,000	4.1%
Professional Services	2,800	4.5%
FIRE	1,200	2.0%
Public Admin	-1,100	-2.7%
Admin and Support Services	-13,000	-32.3%
Total	**-7,100**	**-2.6%** ▼
Total private sector ex Admin and Support Services	**7,000**	**3.6%** ▲

Source: CSO

New job announcements

Looking ahead, there have been several recent positive job announcements. Stripe, who currently employs around 300 people in Dublin, announced that they would be creating at least 1,000 additional jobs here over the next five years. Meanwhile, Workday announced that they would create an additional 400 jobs while Deloitte and ServiceNow both announced the creation of 300 jobs each. Finally, Microsoft announced that they would be expanding their digital sales team in Ireland with an additional 200 jobs expected to be filled by the Summer.

Tech pivots back to the office

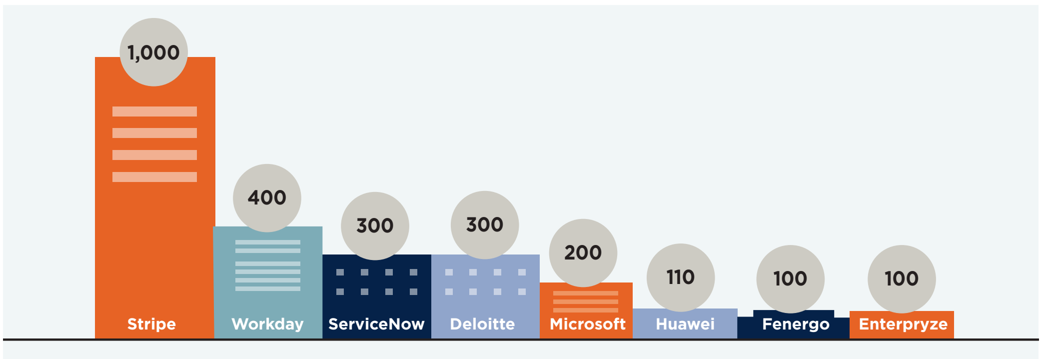
With the underlying employment base of normally office resident workers growing, it is noteworthy that there have been several high-profile pronouncements made in relation to the pivot back to the office from remote working. For example, while Google led the way in implementing working from home policies at the start of the pandemic, the company has reportedly told employees that those who wish to work from home for more than 14 days per year will have to formally apply for it. Elsewhere, Amazon said in a note that their plan is to 'return to an office-centric culture' as their baseline while JP Morgan stated that the way they work will look just like it did before the pandemic by October.

Amazon
plan a return to an 'office centric work culture'

But banks accelerate flexible plans

One notable change to the status quo are the domestic banks, who have stated that they will shed office space to reduce costs. For example, Bank of Ireland have announced a hybrid strategy that will allow staff to work from a combination of home and office, with an additional 11 remote working hubs expected to be operational by the end of 2021. This transition to hub and spoke models was in train before the pandemic, with a similar model being operated by AIB with their HQ in Molesworth Street and suburban locations in Swords, HSQ and Central Park being used along with their bank branches.

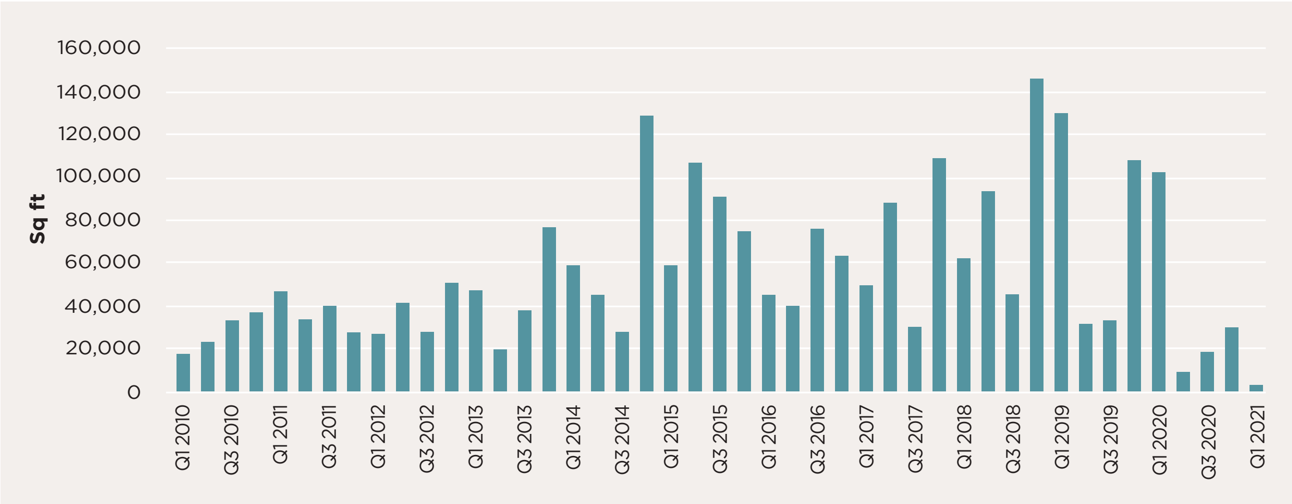
Recently announced new jobs



[1] This consists of the Information and communication (ICT), Professional, scientific, and technical activities (), Administrative and support service activities (N), Public administration and defence, compulsory social security (O), Financial, insurance and real estate activities (K,L) NACE economic sectors.

Market Activity

Figure 1: Take-up



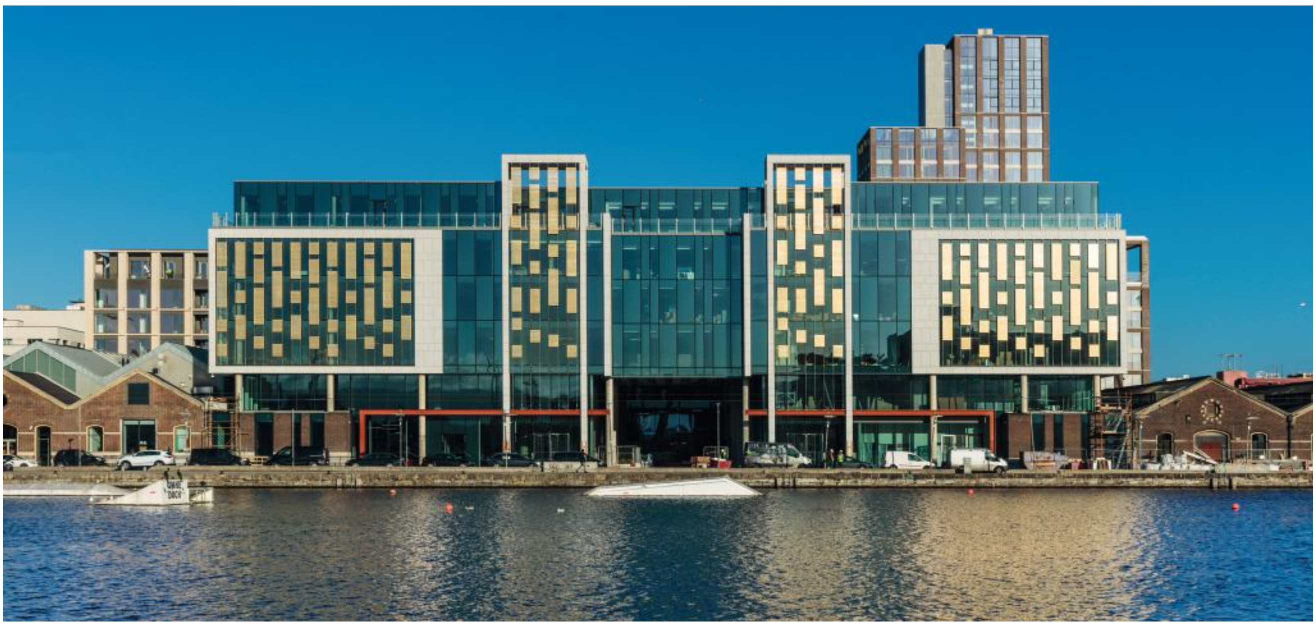
Source: Savills Research

Take-up in Q1 totalled just 23,000 sq ft, making it the lowest level on record. The obvious explanation for this fall is the imposition of a level five lockdown introduced at the beginning of January, which restricted the movement of people for in-person deal activity.

23,000 sq ft

of take-up transacted in Q1, the lowest level on record

Despite the sharp drop in activity, the number of active requirements has continued to grow in recent months, increasing from 3.5 million sq ft at the end of Q4 2020 to 4.1 million sq ft in Q1 2021. Occupier interest remains focused on the CBD with 90% of all enquiries focused there. If anything, this position has hardened since the pandemic which goes against the 'hub and spoke' narrative, as we would expect to see an increase in suburban office requirements in Dublin to complement existing CBD headquarters. While we may see this model emerge in larger cities such as New York, London and Paris, Dublin could be too small geographically and lack the density required to warrant implementing this approach to flexible working. Anecdotally, companies we are talking to are waiting until there is a general return to the office before making any drastic changes to work policies and location strategies. This reflects the feeling that embarking on a new strategic real estate direction will be better judged from the post-pandemic perspective.



Supply

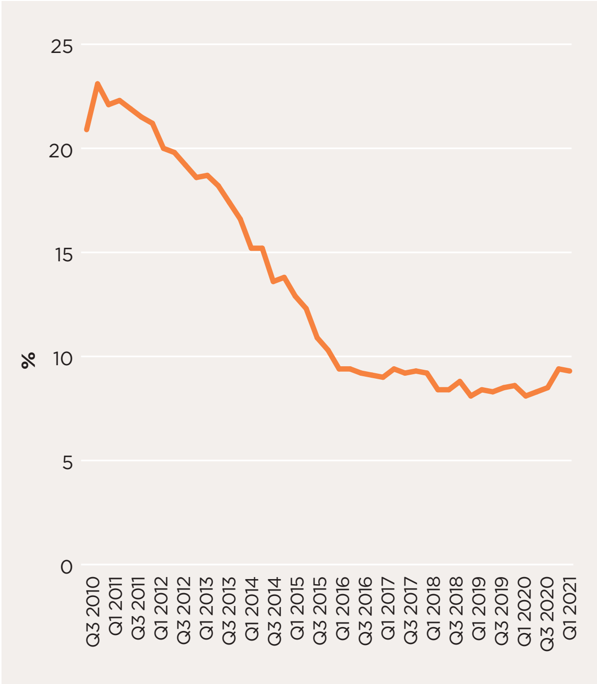
As part of the level five lockdown, the Government ceased all non-essential construction so there were no completions in Q1. The vacancy rate stood at 9.4%, with lower rates of 8.0% and 8.7% in the CBD and City Fringe respectively, while the Suburbs was higher at 11.8%. The vacancy rate is being driven by speculative space delivered in 2020 remaining unlet, with 880,000 sq ft of the 1.3m sq ft delivered last year available (68%). Many units like the Sorting Office, 45 Mespil and 76 Sir John Rogersons Quay had been at legals when the pandemic began with deals falling through as a result of the pandemic. Looking ahead, we estimate that approximately 2.0m sq ft of stock will be delivered in both 2021 and 2022, of which 73% and 54% is already taken respectively. As the economy reopens, we expect competition amongst occupiers will see this newer, more energy efficient space absorbed relatively quickly in the context of a constrained pipeline.

> **Looking ahead, we estimate that approximately 2.0m sq ft of stock will be delivered in both 2021 and 2022, of which 73% and 54% is already taken respectively.**

Rents

With only one deal for Grade A space this quarter there is very limited transactional evidence to use in the analysis of prime rents. Landlords have, where possible, tried to maintain headline rents at higher levels in favour of adjusting term lengths and offering longer rent-free periods. This helps to protect income yield and effective rents at the cost of a shorter WAULT. Indeed, downward pressure on prime rents was inevitable and we have seen the tone of prime rents continue to decline, falling from €60.00 psf in Q4 2020 to €57.50 psf in Q1 2021. Prime rents outside of the CBD have also declined this quarter, falling from €29 psf to €28 psf, and we would expect continued pressure on secondary locations and stock for the foreseeable future.

Figure 2: Vacancy rate



Source: Savills Research

Outlook

As we enter the reopening phase of the economy, we expect to see a pick-up in demand as occupiers start to return to the office and formulate long-term occupational strategies. We have seen viewing volumes on our own stock rise notably in recent weeks, albeit travel restrictions will continue to hinder international decision makers coming to inspect. Property is a physical product and key decision milestones can require inspections in person.

Some occupiers may even now be pressed into action by fixed-date lease events on their current leases which they stalled action upon during covid. Elsewhere, opportunistic occupiers may try to make deals when they will get the best choice of stock and indeed, we have already seen some of the new stock that has driven vacancy over the last year seeing significant interest or entering into legals. Our tally of reserved space has risen to almost 750,000 sq ft and could soon hit one million sq ft, in-line with where the market was when the pandemic began.

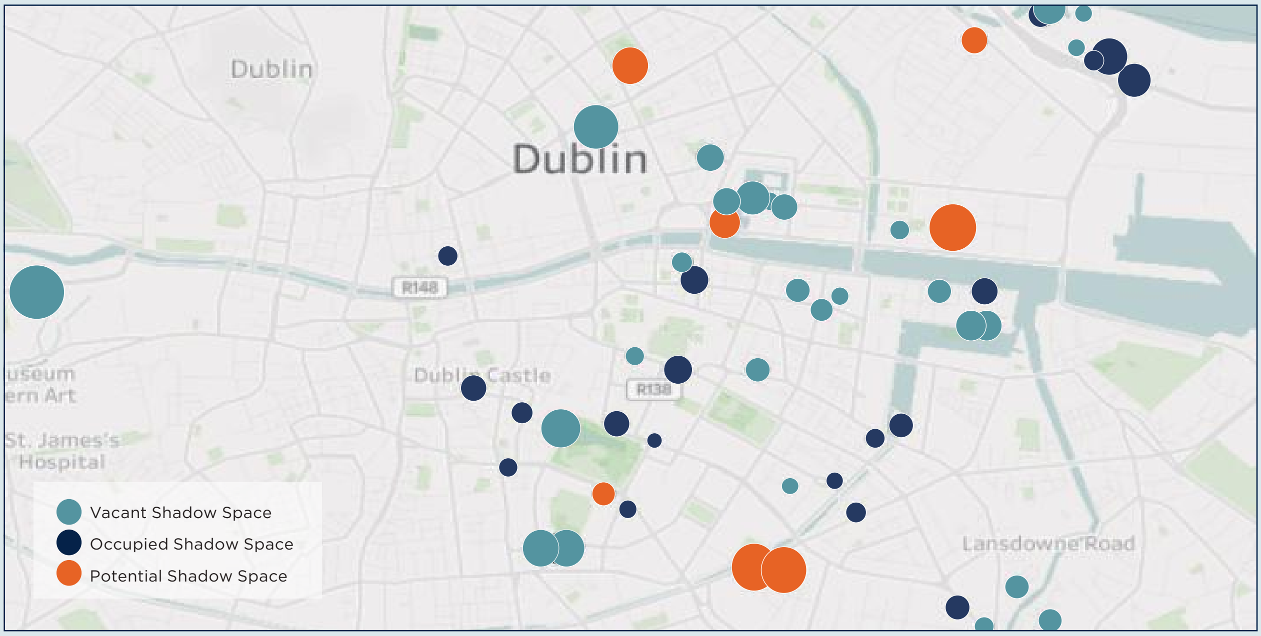
While no major shift to a long-term work-from-home paradigm seems likely to take place, a return to five days a week in the office also looks unlikely. If workers are working remotely for one to two days a week, we do not expect to see a significant reduction in occupiers' footprint in order to cater for surge capacity on the popular mid-week days.

As we have previously argued, some astute landlords may respond to the demand for greater flexibility. In addition to continuing to offer conventional CAT A space on longer leases at standard rents, more flexible – and perhaps fitted – space at higher rents may also become part of the offering.

Shadow Market Study

The shadow market – where space is offered by a tenant for sub-lease or assignment rather than direct by a landlord – is watched as an important indicator of the strength of an office market. Shadow space creates additional competition for vacant landlord stock as it is a de facto increase in supply. Unlike landlord vacancy, which can be slow to feed through to the market as lease terms expire, a tenant has much greater flexibility to dispose of space that is deemed surplus to requirement. As such, it is much more responsive to changing occupier sentiment and can act as a harbinger of market weakness.

Shadow market by type



Notwithstanding, it is important to understand the drivers of changes to the shadow market because an increase in the shadow market does not necessarily mean that there is an excess supply of space in the market. For example, in the context of fast-growing workforces and a fall in the supply of available office space witnessed in recent years, we have seen companies take on more space than they need to give them the flexibility to grow, often referred to as swing space. In this respect, an increase in the amount of shadow space can also be seen as an indicator of a shortage in the market rather than an oversupply. Nevertheless, the recent increased focus in the dynamics of the shadow market has been to gauge the strength of occupational markets as a result of the pandemic, especially from the perspective of assessing the potential impact for greater flexible working adoption.

Pros and cons of shadow space for sub-tenant

Shadow space usually is cheaper for a sub-tenant than if they leased directly from a landlord and in many cases, the space is already semi-fitted out, allowing them to avoid capex. Another advantage is the flexibility afforded by shadow space, with many firms facing greater uncertainty, a long-term lease may not be in their strategic interest making the shorter commitment of a sub-lease more attractive.

On the other hand, lease lengths are generally shorter than would be available directly from the landlord, meaning that the short-term increase in flexibility is at the cost of less longer-term certainty over their occupational portfolio. Furthermore, firms that release shadow space back into the market will typically keep the higher quality parts of the office for themselves which means that it may not be of optimal quality and may require capex to adapt to the incoming tenant needs. Many employers may find themselves having to coax employees back into the office and high-quality office space could be one of the arrows in their quiver when dealing with this problem.

Vacant Shadow Space

As at the end of Q1, the total space available to sub-let or assign that was vacant was 816,000 sq ft, representing an increase of 44% on the 566,000 sq ft available at the end of Q1 2020. While the percentage change is relatively large, it is not uncommon for this figure to change significantly on an ongoing basis. For example, the 566,000 sq ft available in Q1 2020 represented a 67% increase on the 340,000 sq ft that was on the shadow market in Q1 2019, even though this was during a time of market strength.

816,000 sq ft

total vacant space available to sub-let or assignment at the end of Q1

Looking at the largest vacant shadow market listings, we can see that the two largest and four of the top 10 shadow listings were on the market before the pandemic. It is also worth noting that Aviva – one of the largest vacant shadow spaces to come on since the pandemic – were disposing of space before the pandemic, having sub-let the fourth floor of the same building to Dropbox in Q1 2020. Also, Indeed's marketing of 48,000 sq ft is in the context of having taken on a new ten-year lease of 127,000 sq ft in the building in Q1 2020. Furthermore, it follows-on from the 216,000 sq ft the tech company pre-leased at Capital Dock in 2017. In fact, the most significant of all the space in the shadow market that could potentially be attributed to remote working is LogMeIn, who are seeking to sub-let 23,000 sq ft at the Reflector. LogMeIn have stated that they intend to move to a remote centric model and fulfil their mission as 'a work from anywhere in the world' company. Notably, there is no shadow space offered by the mega cap FAMG tech companies.

> **"Looking at the largest vacant shadow market listings, we can see that the two largest and four of the top 10 shadow listings were on the market before the pandemic."**

Table 2: Top 10 vacant shadow space

Name	Sublessor	Sublessor sector	Available sq ft	Brought on since Covid?
1 Heuston South Quarter, Dublin 8	Eir	Telecoms	110,000	No
Telephone House, Dublin 1	HCL	Tech	83,000	No
One Park Place, Dublin 2	Dropbox	Tech	58,000	Yes
One Park Place, Dublin 2	Aviva	Finance	54,000	Yes
124-127 St. Stephens Green, Dublin 2	Indeed	Tech	48,000	Yes
1 George's Dock, Dublin 1	JP Morgan	Finance	44,000	No
Block I, Eastpoint, Dublin 3	Oracle	Tech	42,000	No
5 Hanover Quay, Dublin 2	DocuSign	Tech	24,000	Yes
The Reflector, Dublin 2	LogMeIn	Tech	23,000	Yes
Joyce Court, Dublin 1	Smartbox	Leisure	23,000	Yes

Source: Savills Research

Availability by size

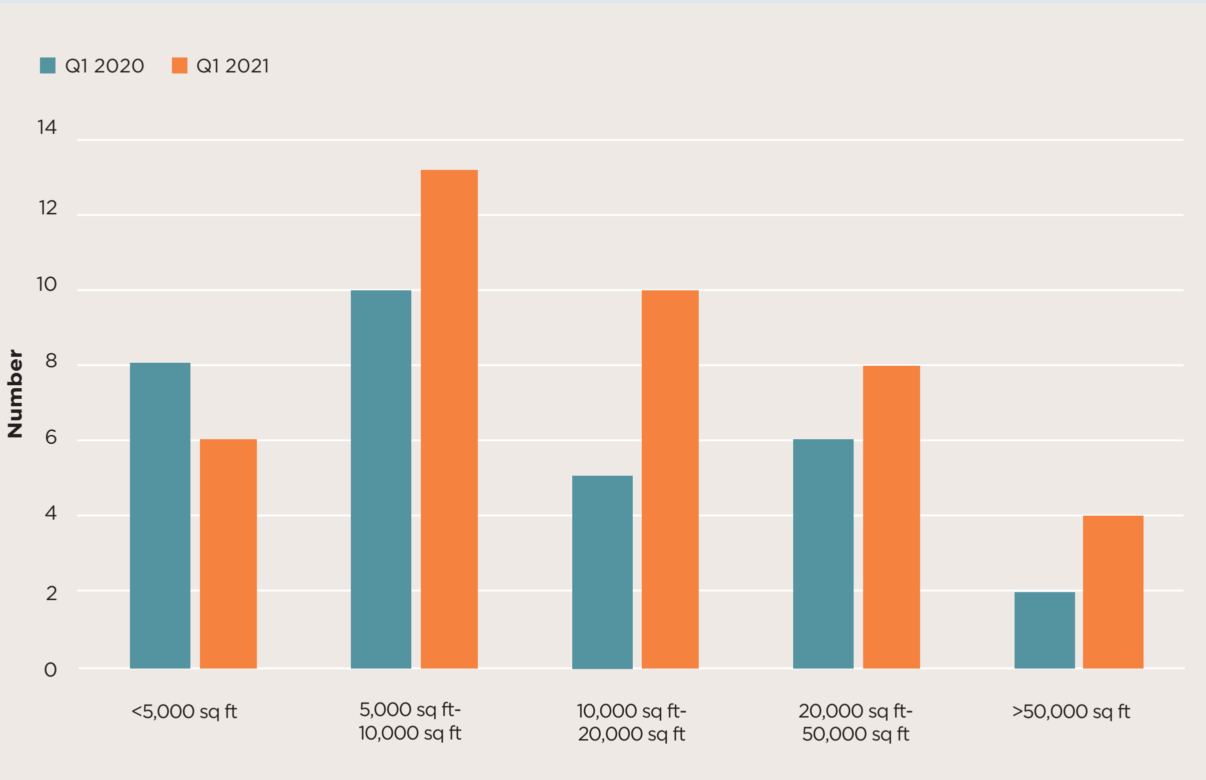
Apart from deals under 5,000 sq ft, the availability of vacant shadow space has increased across all other size categories. The largest growth in listings was the doubling of the 10,000 sq ft to 20,000 sq ft category from five to 10, while the listings in the 50,000 sq ft category also doubled from two to four. Overall, however, there was not the large-scale increase that many had feared with 1HSQ remaining the only availability above 100,000 sq ft. Furthermore, in the context of the growing emphasis on ESG, it is significant that the average age of the space available is 19-years old with space in just seven buildings delivered post-2010 available, offering a combined total of 132,000 sq ft. Finally, it is also worth noting that the total amount of vacant shadow space accounted for 1.9% of total stock in Q1 2021, up from 1.3% in Q1 2020.

1.9%

total stock in Q1 2021, up from 1.3% in Q1 2020

> **There was not the large-scale increase that many had feared with 1HSQ remaining the only availability above 100,000 sq ft.**

Figure 3: Vacant shadow space by size



Source: Savills Research

Occupied shadow space

The second part of the analysis looks at space that is currently occupied but is also being marketed for sub-letting or assignment. It is important to also analyse this segment of the shadow market to assess whether there is a large overhang of space coming down the line. The analysis of currently occupied shadow space is especially relevant in the context of the pandemic, with the recent restrictions limiting access to the office.

At present, there is 415,000 sq ft being marketed for sub-letting that is not vacant, adding another 51% potential of shadow space to the 816,000 sq ft that is immediately available. If this space were brought onto the market today, it would only raise the shadow market contribution of vacancy from 1.9% to 2.8%, a relatively minor potential impact.

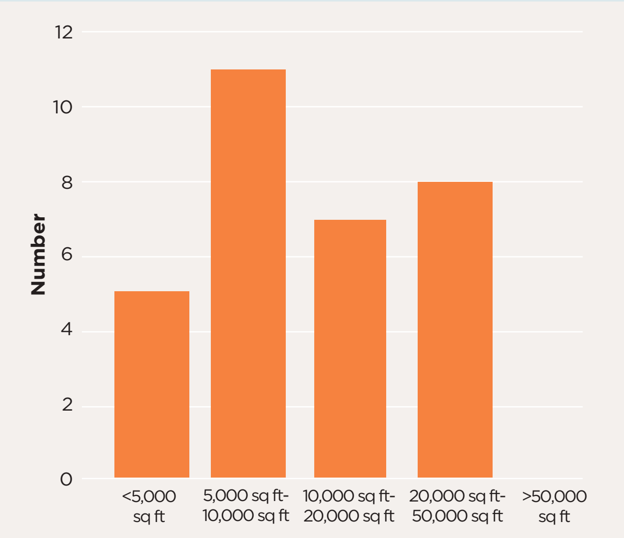
Once again, there was a lack of large office space available with the majority of space being available in the 5,000 sq ft to 10,000 sq ft category and no availability above 50,000 sq ft.

The average age of available stock is 20-years old, with just 36,000 sq ft available across five properties of stock delivered post-2010. Finally, looking at the location of the stock, while Dublin 2 accounts for 34% of the space, a large proportion is in Dublin 3 (27%), in particular Eastpoint, with the remaining 39% spread out evenly in Dublin (no single remaining postcode accounts for more than 9%).

415,000 sq ft
is being marketed for sub-letting that is not currently vacant

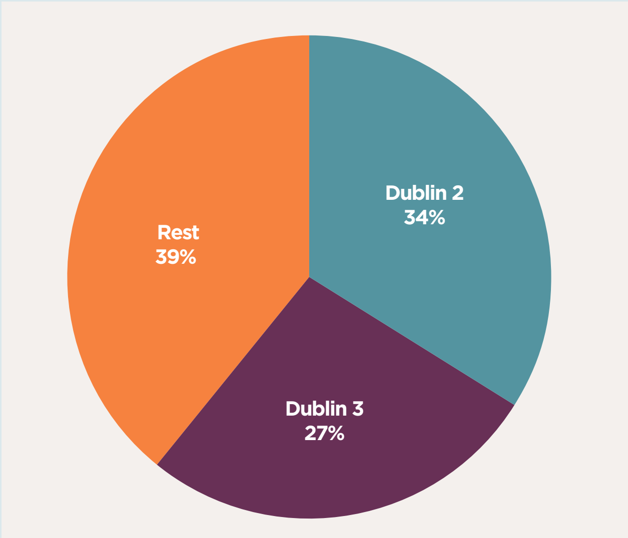
In addition to the above, we have identified a further 478,000 sq ft upcoming in Q2 and beyond for sub-letting or assignment, mainly driven by disposals by the domestic Irish Banks (AIB and Bank of Ireland) who are shedding office space to cut costs. This process was ongoing pre-covid but has perhaps accelerated on foot of it. Furthermore, there is a further combined 100,000 sq ft expected to come to the market in two buildings under construction, from occupiers who took more space than they required in the short-term, but which allows them to grow in the long-term. This latter behaviour is very much a reflection of securing long-term space needs rather than a reflection of space shedding behaviour.

Figure 4: Occupied shadow space by size



Source: Savills Research

Figure 5: Occupied shadow space by location



Source: Savills Research

Conclusion

Many companies are waiting to re-open before making decisions on occupational strategy and, paradoxically, we may yet see an increase in the shadow market stock as we transition back to the office. Nevertheless, we would have expected to see greater evidence in the market at this point if a substantial increase in the shadow market were to become a major trend.

Our analysis has found no evidence of any major shift away from the office for cyclical economic causes or structural reasons relating to remote working. In the main, the shadow market largely comprises of small average sizes in older buildings in non-central locations – the stock is not of the quantum or quality that will compete with newly delivered landlord vacant stock.

One tech company we are aware of were seeking to sub-let their entire current building with the view to operating with greater remote working and a smaller office post-pandemic. However, when this company saw the scarcity of available options in the market, they have decided to stay in their current premises and seek to sub-let one floor.

The growth in the (normally) office-based employment over the pandemic period combined with the constrained office pipeline means that office space, especially low carbon CBD stock, will be a valuably held scarce resource for most occupiers, even if greater flexible working is adopted post-pandemic.

Savills team

Please contact us for further information

Andrew Cunningham
Director, Head of Offices
+353 (0) 1 618 1720
andrew.cunningham@savills.ie

Roland O'Connell
Director
+353 (0) 1 618 1315
roland.oconnell@savills.ie

Shane Duffy
Director
+353 (0) 618 1351
shane.duffy@savills.ie

Michael Healy
Director
+353 (0) 1 618 1367
michael.healy@savills.ie

John Ring
Director, Research
+353 (0) 1 618 1431
john.ring@savills.ie