Savills Research – Q4 2020

MARKET IN MINUTES
Savills Research

Dublin Office Market

Market activity • Rents • Outlook

> **Throughout the pandemic, the share of office-based employment has stayed relatively steady.**

Figure 1: Central Bank Estimates for Annual GDP Growth - 2020

Source: Savills Research, Various European Central Banks

Introduction

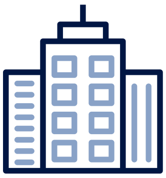
Ireland's economy performed strongly in 2020, despite the Covid-19 pandemic. The Central Bank of Ireland now estimates that economic growth reached 2.5% in 2020, with this positive economic growth the exception at a European level as illustrated in Figure 1. The ESRI has also adjusted their 2020 estimate to 3.4% in their Winter Quarterly Economic Commentary which is, incredibly, higher than their forecast of 3.3% made at the start of 2020 and before the pandemic was on the radar.

Even with overall GDP improving, office-based employment has not escaped the fallout from the pandemic. According to the CSO, total employment in the ICT sector experienced an annual decline of -1.5% in Q3 2020 and Administrative, Support and Public Admin jobs fell by 4.5% over the same period. Firms reducing their workforce will decrease the amount of space they need in the long run if jobs growth does not recover in 2021, before allowing for dispersed or remote working.

Despite the fall in employment, the office sector has proven more resilient to the Covid-19 shock than other sectors of the economy. Throughout the pandemic, the share of office-based employment has stayed relatively steady. Looking at the statistics from the Pandemic Unemployment Payment we can see that, despite accounting for more than one-quarter of Ireland's jobs, the office-based sectors accounted for just 15% of those on the PUP. Looking ahead, the vaccination program represents a light at the end of the tunnel. If successful, the path back to the office in a significant way could be underway by the second half of the year.

In terms of Brexit, the EU/UK trade deal avoids tariffs that would have stymied any economic recovery this year. Indeed, the failings of the final deal may benefit the Dublin office market. While dealing adequately with the details of goods trade, many within the UK have criticised the provisions for financial services. Financial Services firms will no longer be able to access the EU market through passporting and will instead need to request and maintain 'equivalence' by complying with regulatory requirements for market access set at the level of individual member states. Legal Services firm McCann Fitzgerald went as far as to say that the deal is in all practicality a no-deal for services firms. While we have always been conservative concerning the quantum of occupier relocations arising from Brexit, this constraint will likely increase transitions to Dublin. So far, while most firms have only made a foothold presence in Dublin - many in coworking locations such as WeWork - as they awaited the result of the Brexit negotiations, we may now see a scaling-up of operations from this base over the coming quarters.

161,322 sq m
was taken-up in 2020

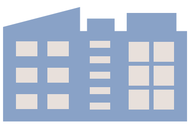


62%
of pipeline stock due in 2021 is already taken

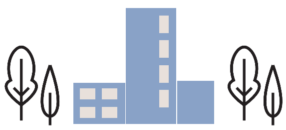
70%
of take-up in 2020 was by tech firms

Vacancy Rates

8.0%
CBD



8.7%
City Fringe

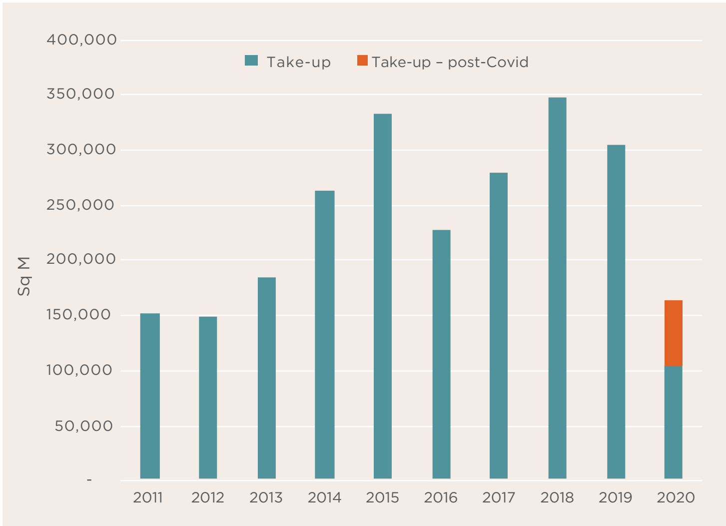


11.8%
Suburbs

Market Activity - Take-up

Take-up in Q4 totalled 30,010 sq m, bringing total take-up for the full-year 2020 to 161,322 sq m, just over half of the 302,902 sq m recorded in 2019. Looking at the year as a whole, the overall numbers do not accurately demonstrate the true impact of Covid on the occupational market. Nine of the top ten deals in 2020 transacted in the first quarter of the year which also accounted for 63% of the take-up this year. If we compare the sum of Q2, Q3 and Q4 against the same quarters in the past five years, 2020 is 74% lower than the 5-year average from 2015 to 2019.

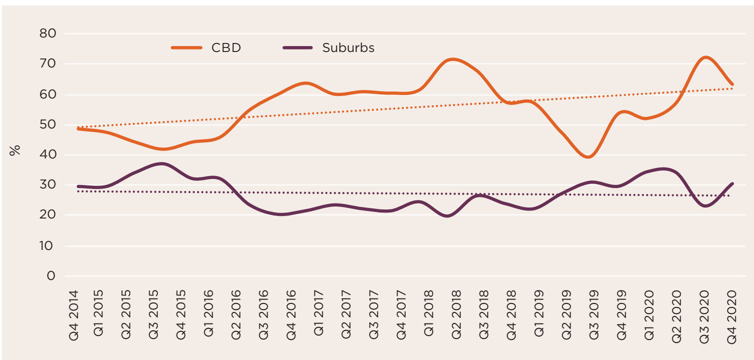
Figure 2: Annual Take-up



Source: Savills Research

The largest deal in Q4 was Amazon's letting of 6,938 sq m at Burlington Plaza 2. It represented an expansion on their current footprint of 15,922 sq m on the same road at the Shannon Building. The letting also follows on from the 15,805 sq m pre-letting at Charlemont Square in 2019. The DAA plc took 4,100 sq m of space in Three Airport Central in the second largest deal of the quarter, representing an expansion of the DAA's footprint in Dublin. The HSE subleased 4,057 sq m of space in HSQ for their track and trace program in a one-year deal with the option to be extended for a further 18 months. Finally, Rabobank leased 2,183 sqm in the newly completed 76 Sir John Rogersons Quay on a long-term lease. Notably, our agency team have traded the highest amount of office space in Dublin between Q2 and Q4 2020.

Figure 3: Take-up by location - 4QMA



Source: Savills Research

One media narrative that has dominated this year has been a possible shift away from the CBD towards suburban offices. There is no evidence of this, with the CBD's 4QMA share of take-up standing at 63% in Q4 2020. Indeed, if anything take-up was probably hampered by the lower vacancy rate of 8.0% in the CBD compared to 11.8% in the suburbs. This demonstrates that real estate costs are not the driving metric for businesses and that employee preferences drive corporate decisions instead of costs.

Table 1: Top Office Market Deals: Q4 2020

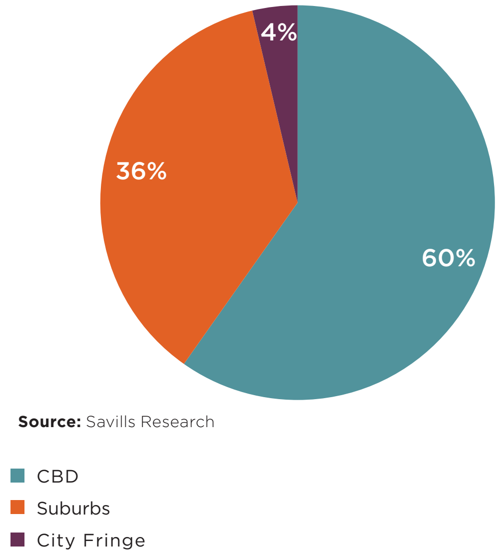
Address	Total Size Sq M	Occupier	Sector
Burlington Plaza 2, Burlington Rd.	6,938	Amazon	ICT
Three Dublin Airport Central	4,100	DAA plc	Other
1HSQ	4,057	HSE	Admin. & Support Services (Public Sector)
Block 230-240, Airside Swords	2,327	P&C	Other
76 Sir John Rogerson's Quay	2,183	Rabobank	Financial Services

In terms of take-up by sector, tech firms were again the most active in 2020 with ICT accounting for the top ten deals in the year and 70% of take-up. This was primarily due to several large lettings in the first quarter of the year. Mastercard's lettings of One and Two South County saw a combined 22,525 sq m of take-up – with One South County being the largest deal of the year. The second and third largest deals were Slack's letting of 12,510 sq m at Fitzwilliam 28 and Google's purchase of the 11,334 sq m former Treasury Building.

Looking ahead, we expect to see ICT continue to account for a sizable share of take-up in 2021. TikTok are reportedly shortlisting options in Dublin that are between 14,000 and 19,000 sq m, for the first phase of their European base. We may also see higher take-up next year from the State who have renewed some space but may need to address the quality of their space from a a sustainability, carbon footprint reduction and energy consumption perspective in the coming years. That said, they may wish to test uptake on their new remote working policy before taking leases on such upgraded buildings, although there might be less interest in remote working if their offices were to a higher standard (including amenities). KPMG is also expected to commit to space in 2021 which will drive professional services share of take-up this year.

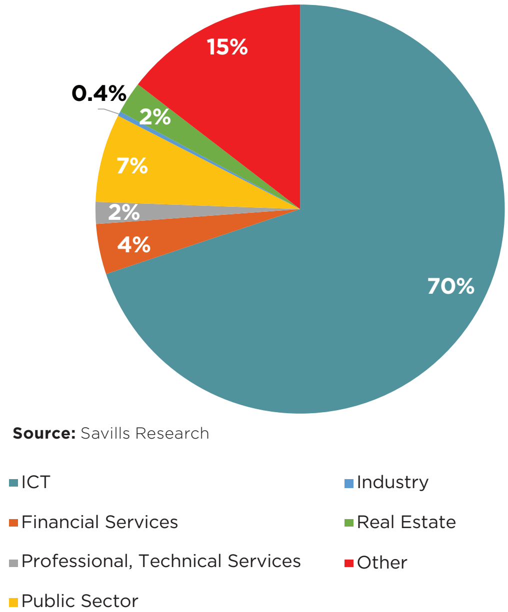

76 SJRQ - Completed Q2 2020, available to let

Figure 4: Take-up by location – 2020



Source: Savills Research

Figure 5: Take-up by sector – 2020



Source: Savills Research

There were five pre-lets in the year, totalling 35,223 sq m or 22% of take-up. This is a sharp fall compared to 2019 when pre-lets totalled to 157,847 sq m – just over 52% of total take-up. This is unsurprising as remote working and economic uncertainty from Covid has caused greater uncertainty about occupier's future requirements, with many firms taking a shorter-term view on their real estate needs.

This uncertainty was illustrated by the dearth of larger sized deals (5,000 sq m+) with only one large letting occurring after the on-set of Covid-19 compared to eight in Q1 2020 and ten in total in 2019. While the volume of smaller lettings (less than 1,000 sq m) also fell, the reduction was not as dramatic and that size cohorts share of overall deals rose. As a result, the average letting size has fallen to 978 sq m since Covid, just over half of the average of 1,721 sq m in 2019. The overall average letting size for 2020 was 1,772 sq m, however, this was because of an above average proportion of large transactions in Q1. If this trend of smaller lettings continues, we could see some landlords revisit floorplate design, particularly to ensure that they are more flexible in terms of sub-division.

Notably, when we compare Q4 2020 active demand levels with Q4 2019 we see that demand was most impacted in larger size categories with a 57% reduction in the number of parties seeking space larger than 4,645 sq m (50,000 sq ft) compared to a reduction of just 16% in sub 929 sq m (10,000 sq ft) space. Encouragingly overall demand levels appear to have stabilised after a period of decline. The 500,000 sq m of total active demand pre-Covid fell to 330,000 sq m in October 2020 and now stands at 350,000 sq m of active demand in January 2021. We are now seeing a healthy number of new enquiries including some larger requirements which were placed on hold in mid-2020 that have since reactivated with minimal reductions in size.

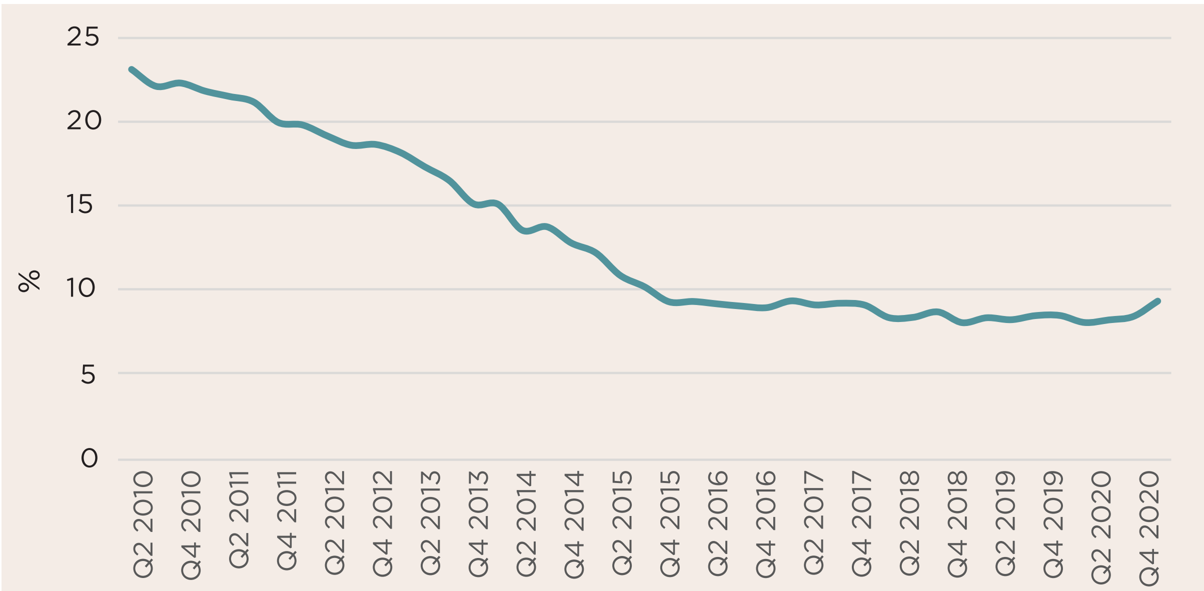
Supply

With several unlet developments completing during Q4, absorption was minus 24,883 sq m for the quarter. Looking at the full-year, absorption totalled 45,472 sq m, driven by strong take-up of standing stock in Q1 and several pre-let offices reaching completion earlier in the year.

On the supply-side, 27,320 sq m of new space was completed in the quarter and demolitions totalled to 15,814 sq m. With net development outstripping net absorption, the amount of vacant space rose in the quarter and the vacancy rate rose from 8.5% at the end of Q3 2020 to 9.4% in Q4 2020. Looking at 2020 as a whole 119,306 sq m of space completed in the year, which was offset by 23,613 sq m of demolitions, totalling to 95,693 sqm of net development.

The increased flow of unoccupied tenant space known as grey space has also gained a lot of media attention. Grey space traditionally emerged as a result of companies contracting or leaving space behind when moving. In recent years there has been a trend of tenants taking larger offices than they require to account for future growth and releasing some back to the market as swing space. Savills have responded to this trend by analysing it in-depth and in real-time. Our analysis shows that grey space now accounts for roughly 1.6% of total stock with this proportion rising.

Figure 6: Vacancy Rate, Dublin Office Market



Source: Savills Research

During 2020 on-site supply volumes dropped by almost 15%, from 483,000 sq m at the start of the year to 430,054 sq m by year-end, as a reaction to Covid with some commencements deferred. This reduction in the pipeline will continue in 2021 which will likely have a knock-on impact on supply in 18-30 months, similar to how supply was constrained post-GFC, though likely not as acute. Some developers have chosen to extend existing leases or try to let buildings that were previously earmarked for development, on a short-term basis while they assess the market and try access funding for speculative development which is more challenging if the buildings aren't at least partially pre-let.

Table 2: Largest Office Completions: Q4 2020

Building	District	Sq M	Vacancy
Termini, Sandyford	South East Suburbs	17,716[1]	17,716
The Sorting Office, Cardiff Lane	Central Dublin	18,982	18,982
North Dock Two, 91-94 North Wall Quay	Central Dublin	9,941	5,595
Dublin Landings 5, North Wall Quay	Central Dublin	9,594	-
Airside Green, Airside Business Park, Swords	North East Suburbs	8,833	8,833

Rents

While a lack of like-for-like pre and post-Covid letting evidence is impeding the analysis of prime rents, Savills were involved in a limited number of properties where transactions agreed pre-Covid, subsequently fell through due to Covid but have since been re-agreed with new parties. In one instance, a Grade A CBD building in the 2,000 – 5,000 sq m range saw a headline rent reduction of less than 3% with the rent-free increasing by 25% to reflect the short-term uncertainty for fit-out programmes – something that should perhaps reverse when lockdowns begin to ease. Though one example doesn't prove a trend, it was interesting.

Rising vacancy rates in 2020 led to downwards pressure on headline rents. Prime headline asking rents are estimated to have fallen from €700 to €646 psm per annum in Q4 2020 for the best buildings in the best locations, though most CBD lettings are below this. We expect continued pressure on rents in the short-term, however, landlords have been more willing to adjust term commitment and rent-free periods. Rental pressure is likely to be more severe on secondary/fringe locations and refurbishments compared to new builds in the CBD with strong energy and sustainability credentials.

6 Pembroke Row - 2,482 sq m due for completion in Q2 2021

[1] Savills figure of 17,716 sq m is net area for consistency with the rest of our completions list, Termini is being marketed with gross size of 20,438 sq m.

Outlook

Vaccinations for Covid-19 have now begun although challenges remain regarding supply and delivery. We may see progressively increasing densities in the office as the roll-out of the vaccine progresses through the year, although we are unlikely to see a wholesale return to the office until a sufficient proportion of the population has been inoculated.

With the majority of the working population unlikely to be vaccinated until Q3, we would not expect to see any major return to the office until H2 2021, provided vaccination efforts are successful. This will likely reduce demand for office space in the first half of the year as many occupiers maintain their wait-and-see approach in the face of uncertainties around the final trajectory of the virus. As the dust settles, occupier's choices will become clearer as uncertainty eases. If and when Covid ceases to be a relevant biohazard many firms who would otherwise have leased space over the past 9 months may begin to look for suitable space and pent-up demand could release. As such we would expect to see take-up rise in the second half of the year after a lacklustre first half. We may also see some positive effects for Dublin from the lack of provisions for financial services in the final EU/UK trade deal. Some opportunist occupiers may try to make deals in H1, when they will get the best choice of stock.

Flexibility will be a key factor for tenants in the short term. Smaller office sizes and fitted solutions will be more in demand in the short-term as is typical after a shock, but we expect larger longer-term requirements to resume as the year progresses.

Even as we wait for the post-Covid landscape to emerge, we are confident that a shift to a hybrid model of occupation, where workers do at least some of their work from home, doesn't necessarily translate into a significant footprint reduction once firms allow for surge capacity for the popular midweek days (we spoke to occupiers who had deployed remote working and grappled with this pre-Covid) and office space is adapted to facilitate lower density, collaborative workspaces. The January lockdown has been challenging and, anecdotally, many workers would like to have the option to work from the office and interact with colleagues. The upsides of remote working were immediate, but the downsides have been slower to manifest, with impact from a lack of mentoring (including learning on the job) and constraints on virtual onboarding of new staff now becoming more apparent. Notably, one large professional firm in Dublin only reduced its desired new HQ by less than 10% of their pre-Covid requirement, believing the office to be a key part of their HR and Graduate development strategy. Furthermore, a recent IBEC survey of Irish CEO's found that the ability to collaborate, absenteeism and a drop in productivity are now key issues for their businesses due to work-from-home .

Even within the tech sector, where firms have possibly the greatest ability to facilitate distributed workforces, we have not seen changes to fit-out plans nor applications for consent from large tech occupiers indicating that firms intend to mothball parts of their new on-site buildings. Indeed, for many of the large, mature US and Asian tech companies that are seeking out new markets, the quality of their office space is another string to the HR bow when competing for young talent, most of whom want at least the choice to be in an office.

In the immediate future, the majority of new pipeline space coming onto the market in the next two years is already committed[3] which should provide some support for absorption and reduce the impact of completions on the vacancy rate. The vacancy rate will likely continue to rise in the first half of the year with low levels of take-up, but we may see a recovery begin in the latter half of the year.

2 73 per cent cited the impact of Covid-19 on collaboration and innovation as a challenge for their organisation. Some 72 per cent highlighted challenges they face in bringing employees back into the office following the pandemic. Half of the companies polled said sales decreased throughout the period of coronavirus restrictions last year, before the State went into another lockdown over the Christmas period. While 51 per cent said employee absenteeism from work remained unchanged as much of the workforce switched to working from home, 29 per cent saw an increase.

3 62% of stock on-site scheduled to complete in 2021 is pre-committed (signed or at legals). 63% of the equivalent stock due in 2022 is similarly pre-committed

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