Ireland remains the EU’s fastest growing economy, with GDP now rising by 5.8% per annum. Employment increased by 53,700 in the year to September, with the annual growth rate picking up from 2.0% in June to 2.4%. Following a pattern that has become well-established since the onset of the economic recovery, growth in Dublin office-based employment continues to far outstrip all other jobs growth (Figure 1). Office employment in the capital has risen by 6.4% in the last year and the 16,400 new office jobs account for three quarters of all the new jobs in Dublin (and nearly one third of all those across Ireland). The extra 16,400 jobs should ultimately give rise to around 170,000 sq m of office absorption in the capital.¹

In our last report we touched on the mixed impact of Brexit on Dublin’s office market. However, in practice, the demand for office space in Dublin is more sensitive to developments in the US. The American economy is now on its longest expansion in history. Growth rates may have moderated somewhat since mid-2018 due to trade tensions with China and slower growth in America’s main trading partners. But there was a slight pick-up in output growth this quarter and the jobs market remains very strong. Furthermore, propelled by three interest rate cuts since July, stock markets have continued their bull run. As a result the demand from US corporates for Dublin business space remains very strong.

Looking ahead, the OECD is forecasting 2.3% GDP growth in America this year, followed by 2% in both 2020 and 2021. In Ireland the outlook also remains favourable, with the consensus forecast for growth of 3.5% and 3.1% in 2020 and 2021 respectively.

¹Our Q1 2019 report presented a detailed analysis of occupational density in the Dublin office market which is now estimated at 10.3 sq m per office-based employee. Please see https://pdf.euro.savills.co.uk/ireland-research/offices-mim-q1-2019-web.pdf
Market Demand

Lettings

After a very strong opening quarter, take-up has been lighter in Q2 and Q3 with 30,452 and 34,040 sq m taken respectively. Nonetheless, on a year-to-date basis the market is line-ball with last year and up around 16% on the 2017 figure.

Figure 2: Dublin Office Take-up

Lettings by Sector

A strong theme in all of our recent reports has been the share of Dublin take-up accounted for by technology firms. ICT was behind 41% of the space let in 2017, and 55% of that taken last year. On the face of it, this has continued in 2019 with ICT accounting for 40% of take-up in the year to date. One could argue that this figure is being inflated by some exceptionally large ICT deals in Q1, including Facebook’s letting of 16,165 sq m in Sandyford and the pre-let of 43,664 sq m by Salesforce in Spencer Place. But, over the last 6 months, ICT has taken only 4,841 sq m, and the market has experienced its lowest two quarters of ICT take-up for a decade (Figure 3). Savills’ view is that this is just a quirk of timing; several large ICT lettings have signed since the end of Q3 and, with more likely to sign before year-end, this will restore the ICT share of take-up in Q4. Looking further upstream, Savills is aware of a number of tech firms with active space requirements in Dublin that will translate into take-up over time. There are also signs of a pick-up in professional services demand and we expect increased leasing activity from firms in this sector over the medium term.

Another sector that has attracted significant attention is serviced offices. Flex space providers took 38,115 sq m in 2018, accounting for 11% of the year’s total take up. These players have been less active in 2019, taking 9,485 sq m year-to-date – a 65% drop on last year.
WeWork’s tribulations since August have been well documented, with the failure of its IPO, the removal of its CEO and, most recently, the announcement of a redundancy programme. It remains the biggest flex space player in Dublin and has accounted for nearly half of all lettings by serviced office providers in the first nine months of 2019. This includes two deals in Q3 – 2,137 sq m in the Oval, Ballsbridge, and another 782 sq m in Georges Quay. It should be said that WeWork’s offices in Dublin are highly occupied. Moreover, a recent survey by Savills European Research showed that younger Irish workers are well disposed towards co-working arrangements. Nonetheless, a number of deals involving WeWork have recently run aground, including Clerys, 9-12 Dawson St, The Forum, 78 Sir John Rogerson’s Quay and Central Quay. Moreover it remains to be seen whether rumoured deals on New Century House and Connolly Station progress.

This is unlikely to impact heavily on the Dublin market. Firstly, most of the buildings listed above are yet to commence, so the implications for on-site pre-commitment rates are low. Secondly, the arrival of new entrants such as Knotel to the serviced office sector, along with the expansion of established operators such as Regus, should help to compensate for any adverse WeWork effect. Finally, any reduction in serviced office letting would likely be offset by increased letting of smaller spaces on more conventional lease arrangements. One consequence of WeWork’s expansion in Dublin was a reduction in small direct lettings as conventional landlords found it harder to lease sub-1,000 sq m spaces on long term commitments (see Figure 4). However some traditional operators had begun to respond by offering shorter terms with options to renew, albeit with higher rents, reduced tenant incentives and, in some cases, break penalties. At the margin this trend may now begin to reverse.

Looking ahead, 183,000 sq m of development space has been pre-let in Dublin over the last 12m. As most of this has not yet reached practical completion it cannot be counted as occupied stock. However, when it does complete in the coming quarters it will immediately drive a rapid increase in the occupied stock, in all likelihood causing net absorption to outstrip take-up.

In addition to procuring smaller parcels of accommodation from flex-space specialists and traditional landlords, tenants may be able to access this through the grey market. This market exists because tenants who have leased space through conventional channels occasionally find themselves with a surplus and, rather than carrying this cost, they sub-let it to other tenants. This often happens when the primary tenant is moving or contracting. But lately we have seen some occupiers taking more space than they need in anticipation of future growth, and putting a portion of it back into the market on a short term basis; a phenomenon referred to as ‘swing space’. One consideration is that this grey space provides ‘hidden’ competition for properties that are being marketed through conventional channels. Savills recently did an exercise to quantify the scale of this previously unmeasured source of market supply. In terms of development stock it had an insignificant impact on the on-site pipeline pre-commitment rate. Moreover grey space counted for a relatively modest proportion of standing vacant space.

Net Absorption

Net absorption was actually negative in Q3 2019, indicating a 17,381 sq m decline in the amount of occupied space. This is only the sixth time in ten years that this has happened and it reflects a number of factors; Firstly, overall lettings in the quarter were low. Secondly, pre-lets accounted for 18.5% of the space that was let. This space will not count in absorption until a later period when the building is completed. Thirdly, only one small building was completed in the quarter, and this was unlet upon completion. Therefore there was no boost to absorption in this quarter from early-cycle pre-lets reaching practical completion.

Looking ahead, 183,000 sq m of development space has been pre-let in Dublin over the last 12m. As most of this has not yet reached practical completion it cannot be counted as occupied stock. However, when it does complete in the coming quarters it will immediately drive a rapid increase in the occupied stock, in all likelihood causing net absorption to outstrip take-up.
The modern era of tighter development funding has given the current cycle a more conservative profile than previous office-building rounds. Despite the booming economy, the gross flow of new space completions has not yet reached 200,000 sq m in any year since development recommenced. This compares with completions of c. 300,000 in both 2001 and 2007. As shown in Figure 5, the contrast becomes even starker when we allow for the growing scale of the market; no more than 5% has been added to the stock in any year of the current cycle, compared with over 15% in 2001 and around 10% in 2007.

The sedate pace of development continued in Q3 with just one building of 1,131 sq m completing. Year-to-date just 63,777 sq m have been finished. Notably, developers continue to take-out older space for redevelopment, with 42,318 sq m removed in the nine months to end-September. This reflects market confidence that rents will remain underpinned for at least enough time to clear these sites, redevelop and let-up the replacement buildings.

Taking the gross development figure, netting off decommissioned stock, and allowing for small data revisions, the office stock for Dublin as a whole has grown by a mere 20,275 sq m in the first nine months of 2019.

Although net development has been modest, absorption has been even weaker, as outlined above. Consequently vacant space has risen by almost 18,000 sq m YTD. Notwithstanding a small offsetting denominator effect, this has caused the vacancy rate to edge-up from 8.1% in January to 8.5% in Q3. As ever, we note that vacancy rates vary by location, with lower rates observed in the prime South Docks (5.4%) and wider Dublin 2 markets (5.6%).
Offices

Rents

Despite the vacancy rate remaining well below its traditional ‘natural’ level of 11 – 15%, market participants perceive very limited inflationary pressure on rents, and the Savills rent index has only edged up over the last two years. In our last report we suggested that this paradox could arise for three reasons; Firstly, our traditional focus on prime rents ignores an uptick in some suburban markets. Secondly, our focus on headline rents ignores the role that tightening rent-frees and lengthening terms certain play in pushing up net effective rents.

The third possibility is that weaker than expected inflationary pressure could reflect a downward shift in the natural vacancy rate, in effect narrowing the degree to which the market is undersupplied. As promised in our Q2 report we have undertaken a detailed analysis of this which verifies that the natural vacancy rate shifted down from 14.3% to 11.1% after 2010. We believe this arises from the change to up-and-downward leases in 2010. By making it likely that a rent review to market levels will occur within five years, this removed landlords’ incentive to sit on empty space while searching for a tenant who will pay a higher rent on day one. The practical implication of this is that the market is currently closer to being in equilibrium than was previously thought, hence weaker inflationary pressure on rents. This has been incorporated into the econometric modelling for our annual rent forecasting exercise.

For now the tone of headline rents at the top end of the market remains at around €700 per sq m per annum, with typical rent-frees of 6-12 months depending on minimum lease length and covenant strength, among other factors.

Charlemont Square – 15,800 sq m, pre-let to Amazon

^Until now sufficient time had not elapsed post the introduction of up-and-downward leases to empirically verify this.
^Details are available from Savills by request.
Outlook

Although we have been through a couple of quiet quarters in the leasing market, a number of large deals have already been signed since the end of Q3 and we expect full-year take-up to once again surpass 300,000 sq m.

Looking further ahead, based on consensus macro-economic forecasts and our knowledge of active business space requirements, we believe that demand will continue to be robust – notwithstanding the ongoing macro risks we have alluded to in previous reports.

On the supply side our prediction that new office development in Dublin would be modest in 2019 has come to fruition. However we believe that significantly more space will be rolled out in 2020 and are pencilling in gross completions of just under 260,000 sq m. The net impact of this on stock levels and vacancy rates will depend to some extent on how much older space is decommissioned for redevelopment later in the cycle – something that is always difficult to predict given the deferral rates seen on previous pipeline forecasts. But we expect it to be substantial, especially as demolitions appear to be occurring earlier than they did in the past for several reasons; to speed up build programmes if a pre-let engages, to avoid inflation in demolition services, to eliminate the risk of illegal occupation, and to avoid rates obligations.

Even with significant stock withdrawals net development may slightly exceed absorption next year, raising the possibility of a small uptick in vacancy. Nonetheless, given that vacancy is currently at a 20-year low and given the strength of the economy, rental values should be well underpinned at their current levels over the next two years.

Kildress House - 2,100 sq m completing Q1 2020 and 6 Pembroke Row - 2,500 sq m completing Q3 2020