RESEARCH

Knight Frank

DUBLIN

OFFICE MARKET OVERVIEW

Q3 2015

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

SUMMARY

1. Economic growth of 6% expected for 2015

2. Rental appreciation continues with prime rents currently in the order of €55 psf

3. Q3 take-up was 543,570 sq.ft. with the city fringe and south suburbs witnessing an increase in activity

4. Office investment activity slows due to a lack of available opportunities

5. Analysis of office development pipeline show fears of oversupply are overstated

DUBLIN OFFICE OUTLOOK

Development pipeline insufficient to cater for employment growth.

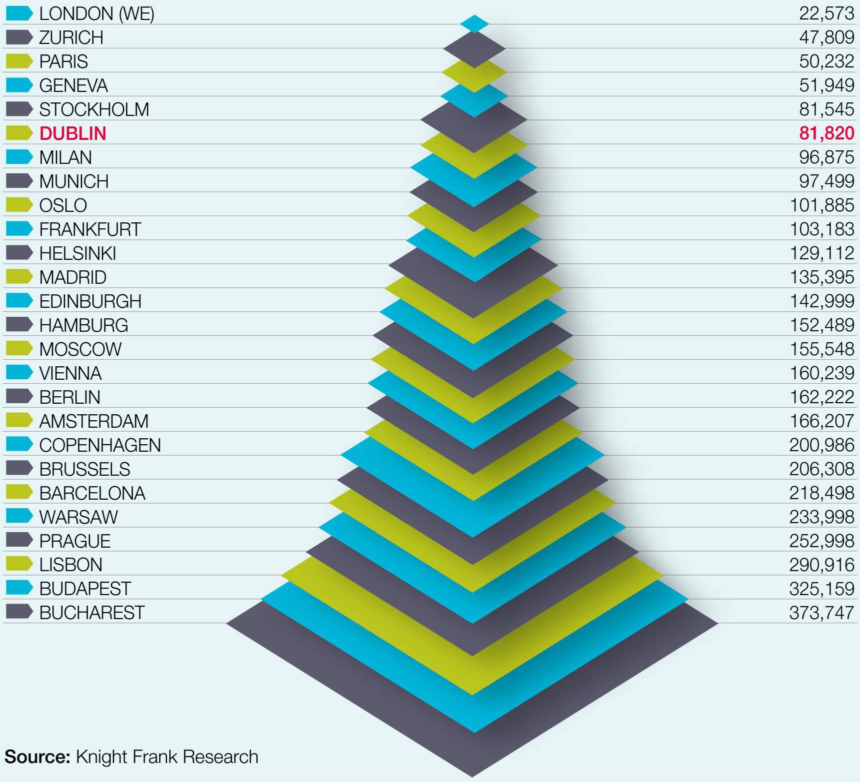
Economy

The pace of economic expansion accelerated in the third quarter with the Economic and Social Research Institute (ESRI) now forecasting GDP growth of 6.0% for 2015, which represents a substantial increase from the 4.4% growth projected earlier in the year. Ireland's GDP has now surpassed the previous peak level achieved in 2007 with next year's forecast putting it comfortably at the top of the European growth league table for a third year in a row. The current rate of expansion is remarkable, being of a level that we more commonly associate with emerging market economies rather than a high-income economy such as Ireland. In the current environment, Ireland effectively offers investors exposure to emerging market growth rates at risk levels commensurate with an advanced European economy.

The growth in employment continues to be the most positive aspect of the economic expansion, with employment up 158,000 from its low point in Q1 2012. While this rate of job creation is impressive, it is the high-value nature of the roles being announced that is most encouraging with IBM, NIIT, SAS and Parexel all recently announcing between 100-200 positions each. Furthermore, Accenture are also to create 200 new jobs in their new Innovation Centre based in Grand Canal Square. The Innovation Centre will feature research jobs in cognitive computing, the internet of things, advanced analytics, security and digital marketing, helping to strengthen Dublin's position as a leading global technology hub.

FIGURE 1

How much prime office space does €100 million buy? sq.ft.



Source: Knight Frank Research

KNIGHT FRANK VIEW ON RISK

Research by Knight Frank shows that €100 million buys approximately 81,820 sq.ft. of prime Dublin office space at the end of the third quarter. This now makes the Dublin the sixth most expensive office location in Europe leading to fears that Dublin may becoming uncompetitive. However, despite the relatively high costs, Dublin is still nearly four times cheaper than London,significantly cheaper than Zurich, Paris or Geneva and approximately in-line with Stockholm. Furthermore, research released in the third quarter by IBM found that Ireland has ranked first in the world for a fourth successive year for average jobs value of investment projects. Entitled '2015 Global Locations Trends', the report states that Ireland "continues to attract investment project in industries characterised by high knowledge intensity and economic value added, such as life sciences and information and communication technology". As the capital city and headquarters for many of these high-value companies in Ireland, it follows that Dublin can sustain a relatively high prime rental level.

The recovery in the economy is increasingly being driven by domestic demand, which is just as well given the anaemic global growth forecast by The International Monetary Fund contained in its latest 'World Economic Outlook' briefing. The IMF is predicting global economic growth of 3.1% for 2015, down from the 3.8% forecast at the start of the year, and represents the lowest rate of growth since 2009 as China's slowdown continues to weigh heavily on sentiment. As one of the few growth markets moving in the opposite direction to the trend, Ireland should attract further international capital market allocations as investors search for growth opportunities.

Occupier Market

A total of 543,570 sq.ft. of office space was let in the third quarter, which represented the highest letting activity for a third quarter in over five years. Total activity for the first nine months of 2015 now stands at 1.73 million sq.ft., which represents a 25% increase on the same period last year. As the market still awaits a significant supply of new office stock to come online, the scarcity of available accommodation continues to drive rental appreciation with prime grade A rents now in the order of €55.00 per sq.ft.

Despite the strong level of activity recorded in the year so far, it remains to be seen whether full-year take-up will exceed market activity achieved in 2014. With 1.1 million sq.ft. let in the final quarter of 2014, over 750,000 sq.ft. worth of activity is required in the fourth quarter of 2015 for volumes to exceed last year's levels. Given the number of deals that are due for completion before the end of year, the sentiment amongst office agents is that 2015 activity will indeed surpass 2014 levels, which would make it the third highest year on record behind 2007 and 2006 respectively.

The largest letting in the third quarter was Twitter's taking of 85,000 sq.ft. at Cumberland House for a term of 20-years and at a rent of €50.00 per sq.ft. As part of the terms of the letting, which equates to three quarters of the building's total floorspace, Hibernia will undertake a €27 million refurbishment of the property, with the social media company expected to take occupation in the second quarter of 2016.

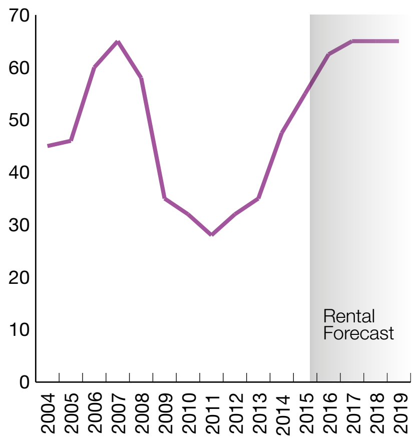
The second largest transaction was Workday's taking of 75,000 sq.ft. at the Kings Building in Smithfield. The deal came as the company announced that it is planning to expand its Dublin workforce to 600 strong, with the Kings Building becoming its European Headquarters. The tech firm became the first tenant to lease space in the Kings Building since its completion in 2008 when it took 85,000 sq.ft. in the third quarter of last year. Workday's expansion is indicative of the aggressive pace with which international technology firms are increasing their footprint in Dublin at the moment.

The lack of available city centre space has led to greater leasing activity in the city fringe and suburban areas. Although the city centre still had the highest take-up in the third quarter with a market share of 36%, the figure represents a substantial decline from the 60% share it held in 2014 as firms searched outside the city core for available space. This is reflected in the fact that the south suburbs and the city fringe accounted for 28% and 20% respectively in quarter three, which compares to 14% and 12% during the full-year 2014. Notable deals completed in the south suburbs include financial software firm Sage's taking of 45,000 sq.ft. at Central Park, APC's taking of 30,000 sq.ft. at Cherrywood and AbbVie taking of 19,986 sq.ft. at Citywest.

Development Market

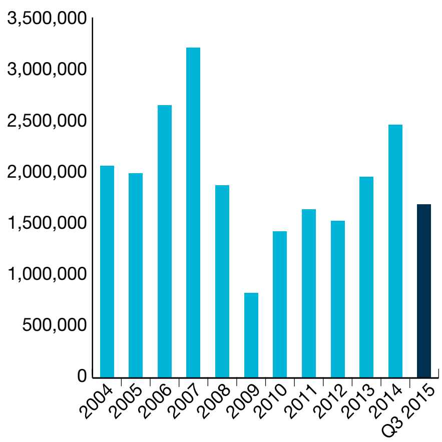
The office development land market built further momentum in the third quarter with a number of schemes proposed. However, with access to development finance remaining an issue, it is likely that many of the projects announced are unlikely to be built within the time frame publicised.

FIGURE 2
Dublin prime office rents
€ per sq.ft. per annum



Source: Knight Frank Research

FIGURE 3
Office take-up sq.ft.



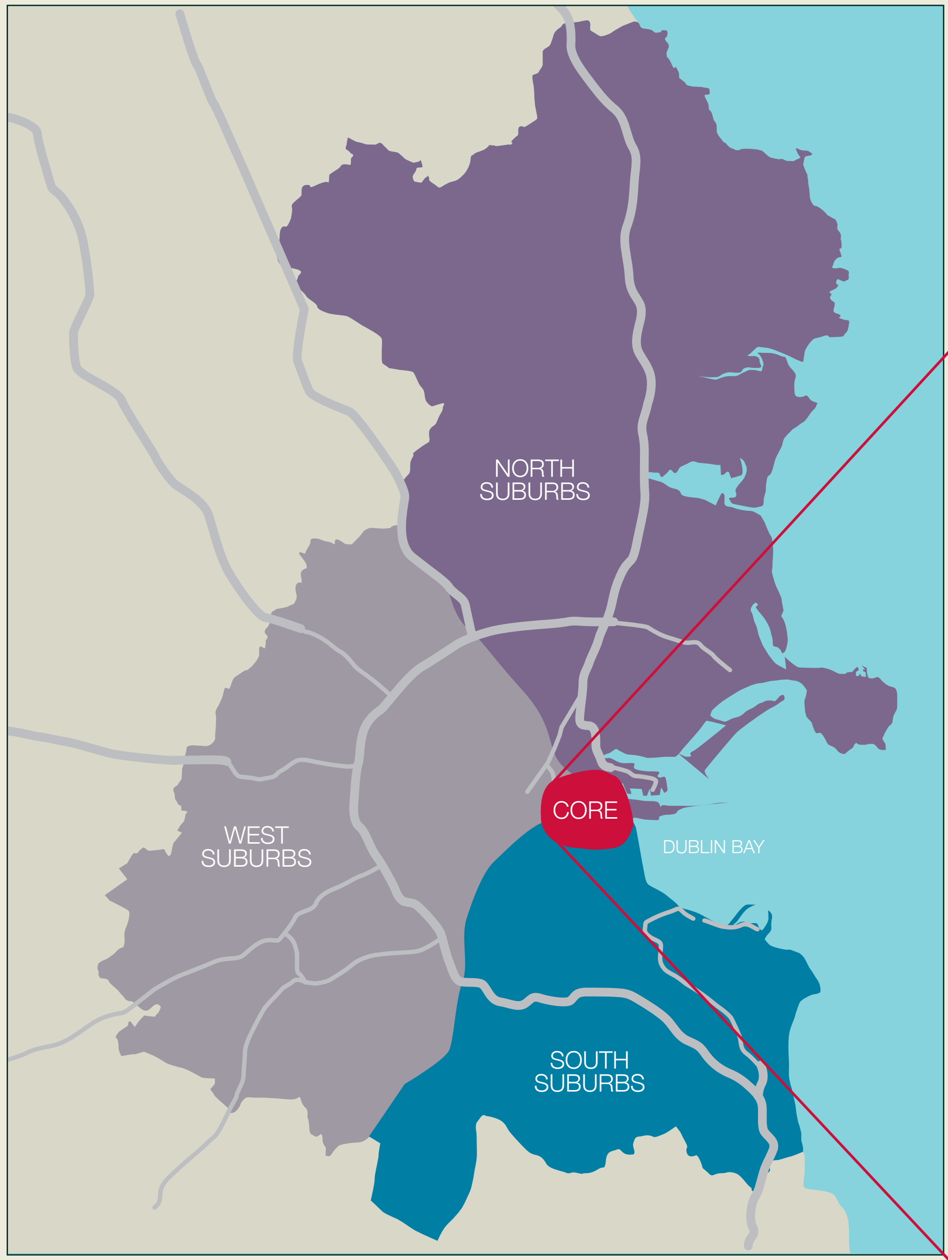
Source: Knight Frank Research

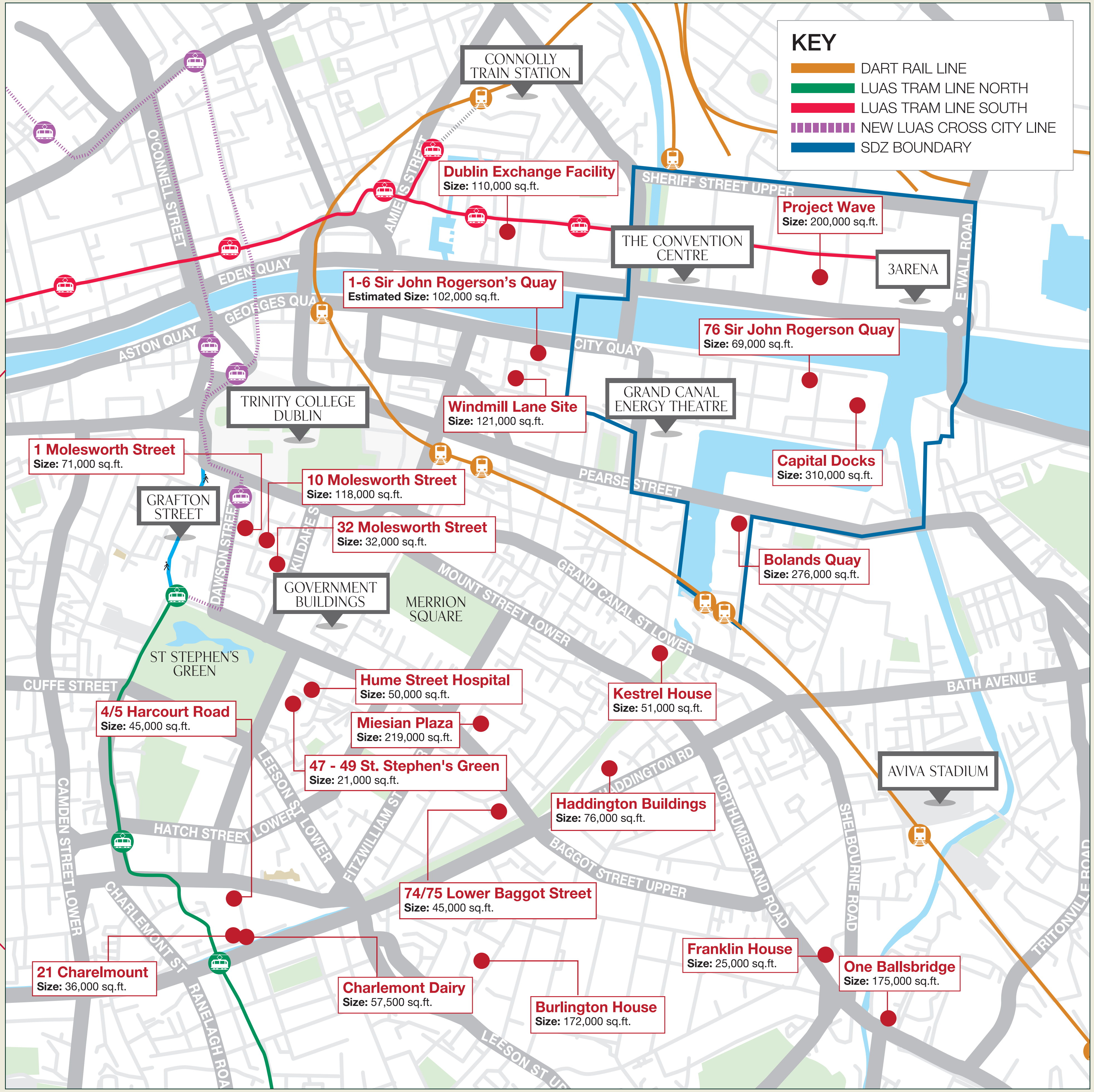
Top 5 office leasing transactions

Property	Tenant	Sector	Size
Cumberland House, Dublin 2	Twitter	TMT	85,000 sq.ft. (7,897 sq m)
Kings Building, Dublin 7	Workday	TMT	75,000 sq.ft. (6,968 sq m)
No.1 Central Park, Dublin 18	Sage	TMT	45,000 sq.ft. (4,181 sq m)
Block G2, Cherrywood	APC	Pharma	30,000 sq.ft. (2,787 sq m)
14 Riverwalk, Citywest, Dublin 24	AbbVie	Pharma	19,986 sq.ft. (1,857 sq m)

Source: Knight Frank Research

POTENTIAL DELIVERY CURRENTLY WITHOUT PRE-LET 2016 -2018





Note: All figures contained above are approximate estimates only and subject to change

Given the risk adverse environment that still persists, capital funders have a strong preference for a substantial portion of any development to be pre-let in order to minimise risk.

The most noteworthy proposal announced in the third quarter was the planning application by Nama for a 224,500 sq.ft. office building at the Point Village on the north docklands. At 73 metres tall, 'THE 'EXO' would be the tallest building in Ireland and form one part of a landmark harbour entrance to Dublin City along with Kennedy Wilson's/ Nama's Capital Dock development on the south side of the river. Green REIT meanwhile have won their appeal against An Taisce to develop 71,000 sq.ft. on the corner of Dawson Street and Molesworth Street with construction due to start before the end of the year with the property to branded as One Molesworth Street.

Investment

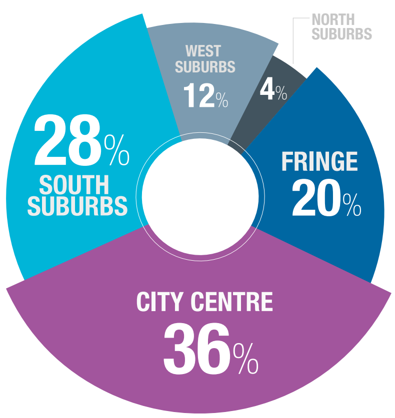
Retail transactions dominated investment activity in the third quarter with a lack of available office investment opportunities rather than a lack of investor demand behind the low volumes. Indeed, the largest investment transaction of the quarter was the purchase of the retail focused Sovereign Portfolio by Irish Life for approximately €150 million. The office element of the portfolio was substantial however, and included significant above ground floor office lots along Merrion Row, Dawson Street and Westmoreland Street as well as including office blocks in Liffey Valley Office Park, Blanchardstown Corporate Park and Eastgate Business Park in Cork.

The largest single office lot sale of 2015 transacted in the third quarter with the Central Bank purchasing the 127,000 sq.ft. Block R in Spencer Dock for €104 million, a property which the authority was letting half of on a twenty-five year lease from 2008. The sale was significantly ahead of the €90 million guide, with the price achieved representing a capital value of €819 per square foot.

With the construction of its new headquarters underway just a stone's throw from Block R, the Central Bank is obviously committed to keeping its long-term footprint in the Spencer Dock area. The next largest sale in quarter three was at a dramatically reduced lot size with Aviva's acquisition of One Grants Row for €8.5 million serving to illustrate what a quiet quarter it was for office investments.

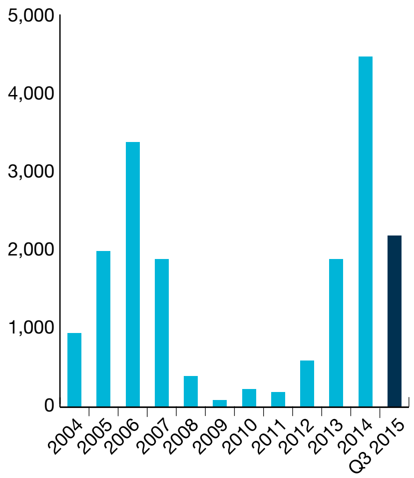
Despite the slowdown, the office market still accounts for the largest share of investment properties transacted this year with approximately 60% of the €2.2 billion worth of deals comprising of office investment sales. Although prime office yields remain unchanged from quarter two at 4.5%, the out-performance of the Irish economy in a European context combined with the continuation of the ECB quantitative easing programme will continue to exert downward pressure on yields in the coming quarters.

FIGURE 4
Q3 take-up by location



Source: Knight Frank Research

FIGURE 5
Irish commercial investment volumes € million



Source: Knight Frank Research

FIGURE 6
Dublin prime office yields

Source: Knight Frank Research

Top 5 office investment transactions

Property	Seller	Buyer	Approx price
Sovereign Portfolio (Retail and Office)	Royal London Asset Management	Irish Life	€150.0 million
Block R Spencer Dock, Dublin 1	Nama	Central Bank of Ireland	€104.0 million
One Grants Row, Dublin 2	Reciever PWC	Aviva	€8.5 million
14-16 Lord Edward Street, Dublin 2	Private	Private	€7.2 million
13 Pembroke Row, Dublin 2	Receiver Grant Thornton	Irish Developers	€5.8 million

Source: Knight Frank Research

SPECIAL FOCUS:
OFFICE CONSTRUCTION PIPELINE 2016-2018

BACKGROUND: THE DEMAND FOR OFFICE SPACE 2016 -2018

As previously mentioned in this report, the rate of jobs growth has been the most positive aspect of the economic recovery. This trend is forecast to continue with the ESRI projecting that 52,000 new jobs will have been created by the end of 2015 with a further 48,000 projected in 2016. The rapid pace of job creation has clearly come with a price however, by creating a severe shortage of grade A office space in Dublin and a consequent rapid appreciation in grade A rents.

While the real estate industry was initially slow to cater to this emerging demand, a significant supply response has since initiated with a number of new construction projects in the pipeline. Indeed, the extent of schemes now planned has led some to question whether there is now too much space coming on-stream which may have an adverse effect on the market in the future. However, based on our analysis of both the office construction pipeline and employment forecasts, these fears are unfounded with the quantum of space due to be delivered insufficient to meet emerging demand.

DEMAND: METHOD AND ASSUMPTIONS

1. METHOD

Our approach follows established methodology of forecasting office need based on the two principal drivers of office demand:

- **1. Employment forecasts** – projected employment growth can be used to estimate the space needed for extra workers in the economy given an assumed space per worker allocation.
- **2. Obsolescence** – In order to account for space that needs to be replaced due to the functional and physical obsolesce of existing office stock due to the passage of time.

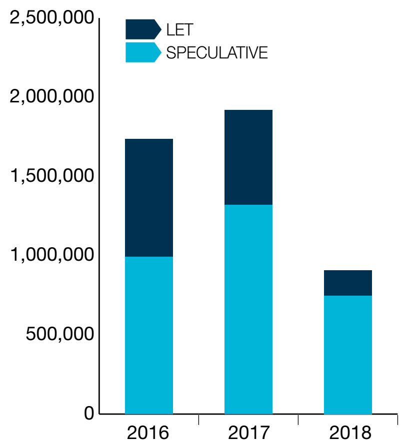
2. ASSUMPTIONS INCOPORATED

- Employment growth in Ireland of 50,000 per annum between 2016 and 2018. This target is in line with current trends with 56,000 jobs having been created in the year to Q3 2015.
- It is assumed that approximately half of the jobs created in Ireland will be located in Dublin. This is based on the fact that 53% of jobs in 2014 were created in Dublin according to the CSO.
- According to the 'Recovery Scenario' contained in the 'Occupational Employment Projections 2020' published by the government agency 'Solas' in 2014, half of new jobs will be in the white collar sector.
- Using the above assumptions and applying an average net density of 130 per sq.ft. gives an annual requirement of 1.625 million square feet based on employment growth.
- Applying a conservative obsolescence rate of 1% to the existing 38 million square feet of office space and combining it with the requirement based on employment growth implies that there is a need for just over 2 million sq.ft. of office space per annum.

SUPPLY: UPCOMING PIPLINE 2016 - 2018

- Based on our analysis of upcoming developments, redevelopments and refurbishments, there is approximately 4.5 million sq.ft. of Grade A office space due to come on stream between 2016 and 2018. This works out as an average of 1.5 million sq.ft. per annum.
- This figure includes owner occupier buildings such as the Central Banking building on the North Lotts and the Microsoft development in Leopardstown. It is also includes pre-lets such as Aer Cap's leasing of LXV on the corner of St. Stephens Green and Bank of Ireland's taking of Baggott Plaza on Upper Baggott Street.
- With 1/3 of the upcoming supply already let, this implies that approximately 1.0 million sq.ft. of the new construction that comes on stream will become available to rent on annual basis for occupation which is just half the ten-year gross take-up average of 2 million sq.ft. per annum.

FIGURE 7
Forecast supply sq.ft.



Source: Knight Frank Research

Demand calculations

Assumptions	Total	Basis
Ireland employment forecast p/a	50,000	Recent trends
Dublin employment forecast p/a	25,000	Half of Ireland jobs created to be Dublin based
Dublin office employment forecast p/a	12,500	Half of Dublin based jobs to be office based
Net density per employee per sq.ft.	130	Knight Frank Research
Annual sq.ft. required to cater for employment growth	1,625,000	
Annual sq.ft. replacement rate of existing stock @ 1%	380,000	
Total requirement per annum sq.ft.	**2,005,000**	

SUMMARY: KEY CONSIDERATIONS

In conclusion, our forecast of the office market has illustrated that fears regarding market oversupply have little basis in reality with the projections showing that the current development pipeline is insufficient to cater for existing and future demand.

The projections suggest that we are facing an annual deficit of 505,000 sq.ft. between 2016 and 2018, or a total of 1,515,000 sq.ft. cumulatively over the period.

Furthermore, the estimate is likely to understate the true deficit as it does not factor in the significant pent-up demand that was likely to have been created in 2015 due to the combined forces of high employment growth, a prevailing low vacancy rate and lack of new space delivered to the market during the year.

Deficit Analysis

	Total
Demand p/a	2,005,000 sq.ft.
Supply p/a	1,500,000 sq.ft.
Deficit p/a	**505,000 sq.ft.**

Source: Knight Frank Research

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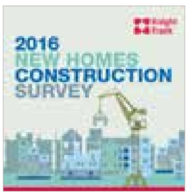

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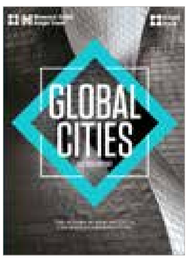

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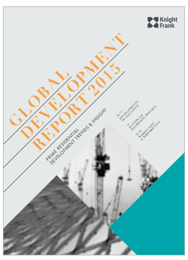

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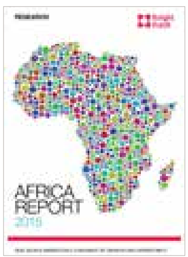

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