

RESEARCH



DUBLIN

OFFICE MARKET OVERVIEW
Q1 2015

OCCUPIER TRENDS

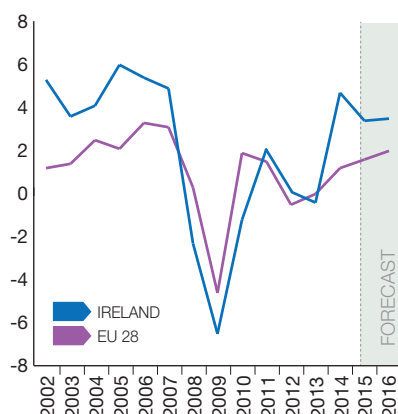
INVESTMENT TRENDS

MARKET OUTLOOK

SUMMARY

1. Economic growth of 4.8% recorded in 2014, with 4.4% projected for 2015
2. Rental appreciation continues with prime rents currently in the order of €50 psf
3. Q1 take-up was 445,920 sq ft with the TMT sector dominating once again
4. €863 million worth of office investment transactions in Q1, accounting for 85% of the investment market
5. IFSC sees heightened leasing and investment activity with a wave of capital expenditure projects ongoing

FIGURE 1
GDP Growth



Source: European Commission

Q1 OUTLOOK

The Dublin office market continues to out-perform, supported by a favourable macroeconomic backdrop.

Economy

Ireland has firmly established itself as the fastest growing economy in the European Union, with GDP growth of 4.8% 2014 easily outshining its European neighbours where growth averaged just 1.3%. Crucially, this growth is set to continue, with the Economic and Social Research Institute (ESRI) forecasting continued robust expansion of 4.4% in 2015 and 3.7% in 2016.

To gauge the strength of this recovery, an examination of two key economic indicators gives real insight to the progress made. Firstly, unemployment has been pushed down to the psychologically important barrier of 10%, down from a peak of 15.2% witnessed just over three years ago. Just as impressive, the latest figures show that the government recorded a budget deficit of 3.1% in 2014, just a nudge above the 3% target mandated at the beginning of the bailout. Achieving this target effectively a year ahead of schedule is a significant milestone for the economy and will be the yardstick against which the recoveries in other European economies will be judged. This sound fiscal platform provides the confidence for private sector investment with the ESRI projecting that investment will grow by 13% in 2015.

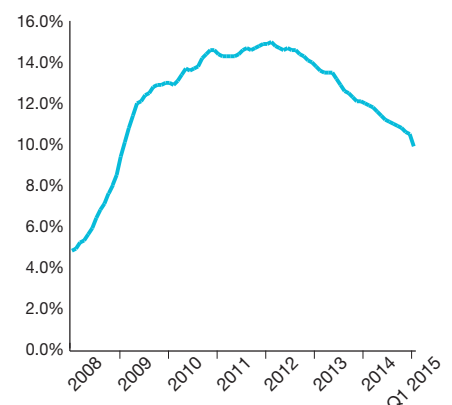
The commencement of the European Central Bank's (ECB) long anticipated 'Quantitative Easing' programme, which began on March 9th, will see the ECB purchase €60 billion of European debt instruments every month until at least September 2016, enabling the State to borrow at a negative yield for the first time in its history in the first quarter. This action by the ECB is being undertaken in order to stoke inflation towards the ECB's mandated target of 2%. With an annual inflation rate of minus 0.6% in the year to March, Ireland is a prime example of the need for this type of unorthodox intervention.

The most immediate effect of this ECB policy has been to further the devaluation of the Euro, which has now declined

by over 10% against the British Pound and over 20% against the US Dollar over the past year. From an office property perspective, we see the ECB action and resulting currency depreciation feeding into the office leasing and investment market in the following ways:

- Lead to an increase in demand for office space as firms expand in the confidence that the economy has the support of ECB intervention. Furthermore, ECB action should increase the availability of financing for firms wishing to expand their operations, with this effect being most beneficial for export orientated companies. Encouragingly, the ECB has already noticed an increase in lending to businesses which is an early sign of success of the policy.
- Currency movements will attract non-euro dominated capital seeking to play the decline in the euro's value. Ireland's position as the fastest growing economy in Europe, combined with the out-performance of the Dublin office market, should also make it a strong candidate as a destination for these flows. At the macro asset allocation level, the measures are designed to stimulate an inflationary response in the economy which should lead to increased portfolio allocations to real estate, as real estate is seen as natural hedge against inflation.

FIGURE 2
Standardised unemployment rate



Source: Central Statistics Office

Occupier Market

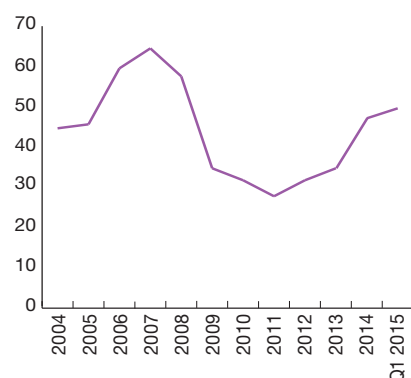
Dublin office take-up in the first quarter was 445,920 sq ft, 30% down on the same quarter of last year but still representing an extremely healthy level of activity. Digging further into the figures reveals that the number of deals was up 25% to 69 from the 55 completed in Q1 2014, with the average deal size reducing to 6,643 sq ft from 11,592 sq ft.

48% of take-up was focused on the city centre, with Dublin 1 seeing the largest amount of activity by postcode with 91,526 sq ft transacted in the first quarter, up from 50,871 sq ft in the same period last year. The chronic lack of available space in Dublin 2 is evidenced by the fall in take-up from 199,031 sq ft in Q1 2014 to just 72,344 sq ft in Q1 2015, with Dropbox's letting of 29,345 sq ft at One Park Place the only deal recorded in Dublin 2 of 10,000 sq ft or more compared to the seven recorded over the same period last year.

With Dublin-wide vacancy at a reasonable 12.1% and a severe shortage of available grade A floorspace in Dublin 2, occupiers are exploring non-core locations with fringe activity rising to 127,077 sq ft across thirteen deals compared to just one letting of under 2,000 sq ft completed during the same period last year. Pharmaceutical company Parexel's taking of 28,128 sq ft of grade A space for €26 psf at the former Amazon European Headquarters at Kilmainham Square is indicative of this activity.

The TMT sector continues to dominate the market accounting for 47% of take-up and three of the largest four deals transacted. In the third largest deal of the quarter, Google has taken further space in the south docklands area, this time

FIGURE 3
Dublin prime office rents
€ per sq ft per annum



Source: Knight Frank Research

KNIGHT FRANK VIEW ON RISK

In our Q1 report, we identified domestic political uncertainty as the greatest source of risk to the Dublin office market. While this continues to be the case, international political factors have increasingly come to the fore in the last few months. While a Grexit looms large, this eventuality appears to have already been priced into the market and is causing a relatively sanguine response from the markets.

With the Conservative party promising to hold a referendum on European Union membership in 2017 if they are returned to power in May's general elections, the potential for a United Kingdom exit from the EU is of far greater concern to Ireland's economy. While such an outcome is likely to have uniformly

negative consequences for the Irish economy as a whole, the implications are more complex for the Dublin office market, as the outcome holds significant upside, as well as downside, possibilities.

This is especially the case for the financial services sector, as a British exit would lead to Dublin being uniquely positioned as the only English speaking financial centre within the Eurozone. While a mass exodus of front office activities from London to Dublin is non-runner, the relative sizes of the respective markets implies that it would take just a small portion of these activities to be transferred from London to Dublin to have a potentially transformative effect on the office market here.

26,673 sq ft at Rohan Holding's recently refurbished 2 Grand Canal Plaza.

The combined forces of robust occupier demand and lack of city centre availability ensures that rents will continue to appreciate through the year from their current level of €50 per sq ft.

Development Market

Kennedy Wilson and Nama have submitted a planning application for a 313,000 sq ft prime grade A floorspace development named Capital Docks. Situated at the entrance of the Liffey along Sir John Rogerson's Quay, the project will feature a nineteen story tower and include a public park spread over 4.8 acres, providing the city with a new landmark development. Should the project receive the required backing, it is expected that the first building could be ready for occupation in 2017.

Bidding is expected to be strong for Tara House, the CIÉ owned development site with potential for 90,000 sq ft in a high-density tower on the south docklands. While the tender is based on a new planning application, permission for the construction of a twenty two storey office tower had previously been granted on the site.

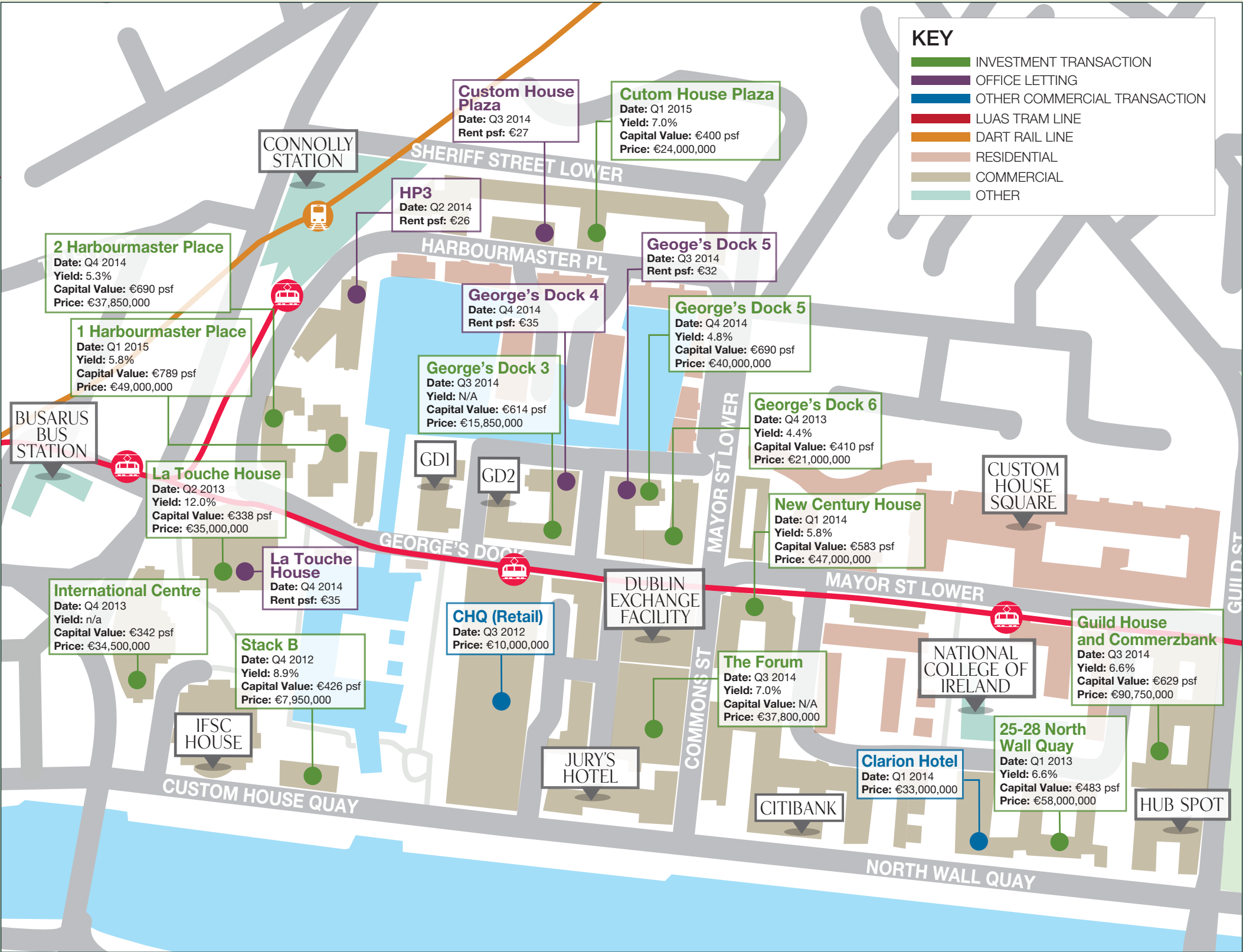
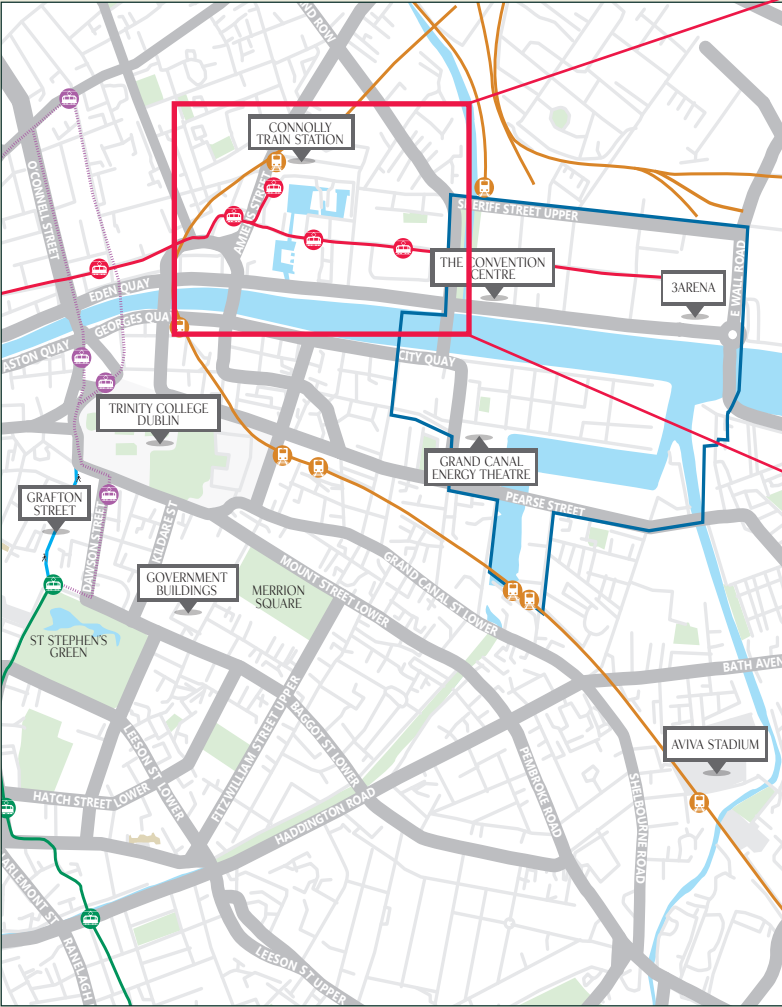
Outside of the city centre, the redevelopment of the old Aer Lingus headquarters at Dublin Airport is underway which represents the first phase of a seventy acre business park that aims to challenge the supremacy of the south and west suburban office markets'. The €10 million project, branded as One Dublin Airport Central, will provide for 89,400 sq ft of grade A floorspace and is expected to be ready for tenant fit-out by November of this year.

Top 5 office leasing transactions

Quarter	Property	Tenant	Sector	Size
Q1 2015	One Park Place, Dublin 2	Dropbox	TMT	29,345 sq ft (2,726 sq m)
Q1 2015	One Kilmainham Square, Dublin 8	Parexel	Pharma	28,178 sq ft (2,618 sq m)
Q1 2015	2 Grand Canal Plaza, Dublin 4	Google	TMT	26,673 sq ft (2,478 sq m)
Q1 2015	Elm Park, Dublin 4	Wipro	TMT	22,000 sq ft (2,044 sq m)
Q1 2015	5 Custom House Plaza, IFSC, Dublin 1	Citico	Finance	20,000 sq ft (1,858 sq m)

Source: Knight Frank Research

FOCUS ON THE
INTERNATIONAL
FINANCIAL SERVICES
CENTRE



Note: All figures noted above are approximate estimates only and may be subject to change.

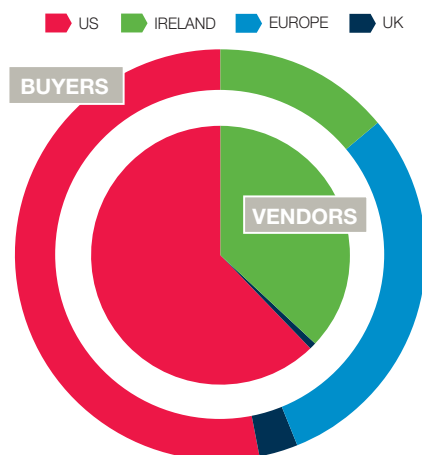
Investment

Office sales dominated the investment market in the first quarter of the year with €863 million worth of transactions accounting for 85% of the investment market. Office investment activity continues to be heavily concentrated in Dublin, with 96% of transactions occurring in the capital.

The United States accounted for the largest share of both sides of the market, representing 53% of buyers and 62% of sellers who transacted in the first quarter. The dominance of the United States funds in Dublin is reflected in the largest deal transacted, namely Lone Star's sale of Project Molly to Starwood Capital for €350 million, representing a yield of 5.6%. Morgan Stanley reputedly provided the finance, with a 5-year senior loan at a rate of 190 basis points above 3-month Euribor. The portfolio comprises four stabilised core office buildings from Project Holly, a forty strong portfolio sold to Lone Star in early 2014 for €220 million, for which Starwood were reportedly one of the underbidders.

The purchase by Starwood marks a major point in the evolution of the Dublin investment market as it demonstrates that US private equity players who had previously bid on distressed portfolios are now willing to acquire core holdings of real estate here, representing a significant boost to the market. King Street's sale of Bishop's Square to Hines for €92 million at a yield of 5.85%, having previously been purchased by King Street in 2013

FIGURE 4 Buyer and vendor source



Source: Knight Frank Research

for €65 million at a yield of 9.87%, is another example this activity. Starwood were also active sellers in the first quarter with the sale of the current Garda Headquarters on Harcourt Street to Hibernia REIT at a yield of 6.7%.

Another development of importance in the first quarter was the entrance of European buyers for the first time since the crisis on a significant scale, accounting for 30% of acquisitions. The largest European investment in the first quarter was Union Investment's purchase of the Facebook tenanted 4 and 5 Grand Canal Square for €233 million, representing a yield of 4.3%.

German funds in particular have been widely known to be exploring opportunities in Dublin for the last year and were unsuccessful underbidders on a number of properties leading to concerns that they may become frustrated by the lack of appropriate opportunities that fit with their investment mandate. Their successful entrance into the market along with the continued activity of American funds is an excellent structural change to the market that adds to the depth and diversification of the capital base that is active here.

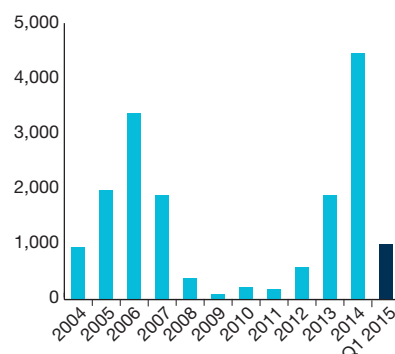
The greater the number of firms that make investments here spreads the available stock of knowledge of the Dublin market internationally, increasing the long-term international buyer universe for Irish property. This helps alleviate previous market concerns regarding the potential liquidity challenges faced by US private equity players seeking to exit their accumulated positions to a limited domestic capital base. Despite the yield compression, Dublin obviously still represents an excellent opportunity for international capital to achieve their target return on a risk-adjusted basis

Top 5 office investment transactions

Quarter	Property	Seller	Buyer	Approx price
Q1 2015	Project Molly, Dublin	Lone Star	Starwood Capital	€350.0 million
Q1 2015	4 & 5 Grand Canal Square, Dublin 4	NAMA	Union Investment	€233.0 million
Q1 2015	Bishops Square, Dublin 2	King Street	Hines	€92.0 million
Q1 2015	Harcourt Square, Harcourt Street, Dublin 2	Gangkhar plc (Starwood Capital)	Hibernia REIT	€70.0 million
Q1 2015	Alexandra House, Sweepstakes, Ballsbridge, Dublin 4	NAMA	Irish Life	€34.5 million

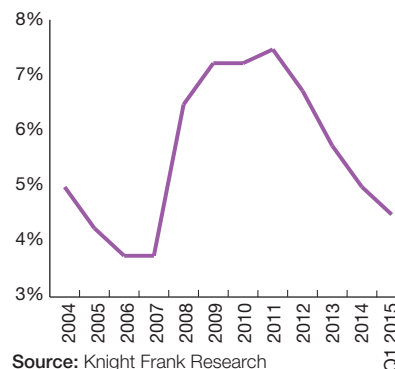
Source: Knight Frank Research

FIGURE 5 Irish commercial investment volumes € million



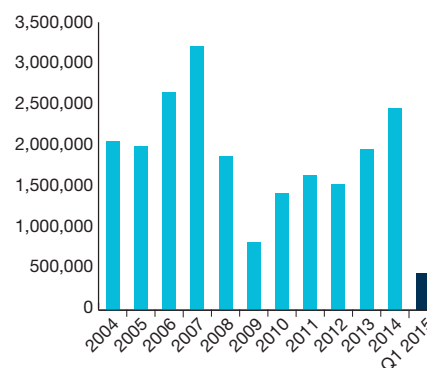
Source: Knight Frank Research

FIGURE 6 Dublin prime office yields



Source: Knight Frank Research

FIGURE 7 Office take-up sq ft



Source: Knight Frank Research

SPECIAL AREA FOCUS: THE INTERNATIONAL FINANCIAL SERVICES CENTRE

With the recent release of 'IFS 2020', the Government's new strategy for the financial services industry in Ireland, we undertake a timely analysis of the IFSC office market.

BACKGROUND: IFSC BOUNDARIES

The IFSC was constructed in two phases. Phase one began in 1988 and started with the construction of The International Centre, IFSC House and La Touche House – three statement buildings which announced the arrival of Dublin as an international financial services hub. In total, 1.3 million square feet of office space was constructed during phase one which extended as far as Common Street when completed. Phase two increased the office footprint of the IFSC by a further 2 million sq ft and was concluded with the opening of Guild House in 2000, by which time the IFSC was home to 14,000 workers.

CURRENT ACTIVITY: OFFICE LEASING AND INVESTMENT

The IFSC witnessed its strongest activity in years in the first quarter of 2015 with 72,975 sq ft let during the period, with Citco's taking of 20,000 sq ft in Custom House Plaza the largest deal completed. The IFSC represented 34% of city centre take-up compared to an average of 7% over the preceding five years and a 16% share of the total floorspace let in Dublin compared to an average of 6% over the same period.

The chronic shortage of grade A space in the city centre has prompted a wave of capital expenditure in the IFSC with with George's Dock 3 and Commerzbank examples of current expenditure projects while 2 Harbourmaster Place and International Centre were amongst others to have undergone recent extensive refurbishment. Meanwhile, The Cosgrave Group's planned redevelopment of The Dublin Facility is likely to be the first redevelopment in the IFSC, although it is uncertain when this will commence.

With a couple of the IFSC deals recorded in the first quarter already achieving €37.50 psf, Commerzbank House and George's Dock 3 refurbishments will set new benchmarks for the IFSC in this cycle, with rents in the late forties expected before the end of the year.

Anticipating this pick-up in tenant activity, investors have been piling into the IFSC. The acquisition of 1 Harbourmaster Place by Irish Life for €49 million in the first quarter, representing a yield of 5.8% and capital value of €789, is one of the largest individual building sales in the area over the past number of years. The 62,000 sq ft block is let with eleven years remaining to KMPG at €49 psf and represents a good yardstick for gauging where IFSC valuations are right now.

Hibernia REIT has been particularly active and now holds four buildings in the area, namely New Century House, Commerzbank House, Guild House and The Forum. It is a measure of how far the market has come when one considers The Forum was sold to Hibernia REIT by Atlas Capital in Q3 2014 for an estimated €37.8 million, having been purchased by Atlas in Q4 2013 for €27.3 million, while Hibernia REIT's purchase of New Century House from CMP Investment Partners in Q1 2014 for €47.0 million also represented a significant premium to the €27.5 million the latter previously paid in Q3 2013.

Recent trading in the IFSC has led to a transitioning of the ownership profile in the area. While previous owners in the IFSC were predominantly Irish high-net-worth individuals who came together in consortiums, the owners are now much more institutionally based with Irish Life, Standard Life, Ardstone, IPUT and State Street all making recent significant investments.

OUTLOOK: THREE KEY CONSIDERATIONS

1. FINANCIAL SERVICES SECTOR

Unsurprisingly, the IFSC is highly dependent on the performance of the financial services industry, an industry that has faced significant challenges globally, although the pain inflicted in Ireland has been particularly acute. Reflective of this turmoil, Dublin's ranking fell to 70th in last years' Global Financial Centres Index (GFCI) produced by Z/Yen Group, having previously ranked as high as 10th in 2009. The decline is also evident in the fall in tax revenues received from former IFSC companies, which fell to €545 million in 2014, from a peak of over €1.1 billion in 2006. However, there are signs of recovery with Ireland rising to 52nd in the latest GFCI index released in March while the tax revenue figure for 2014 actually represented a 10% increase on 2013.

Furthermore, while banking has witnessed a decline in employment in Ireland, growth in other financial specialities such as fund administration have more than offset this decline. Moreover, it can be reasonably stated that banking employment is at a cyclical low and can be expected to grow again in the coming years as bank balance sheets heal with the IFSC expected to be a prime beneficiary of this uptick as it develops. It should also be remembered that despite the recent growth in Dublin's rents, it is still competitively priced as a financial centre when compared to London, where a



new office rent record of £185 psf was set in the first quarter (approximately €255 psf based on prevalent exchange rates).

2. COMPETING AS A LOCATION IN THE ABSENCE OF FINANCIAL INCENTIVES

Financial incentives were a key initial feature of the IFSC strategy in attracting occupiers and included a reduced rate of corporation tax rate, capital expenditure allowances and double rent allowances. In addition to these inducements, there was a rigorous screening process to ensure that the area had a high-quality tenant mix. These measures conferred extra value to holders of the underlying real estate and their expiry compels the area to compete with other locations in Dublin on a level playing field.

As a result, financial occupiers no longer automatically choose the IFSC as their default location anymore as evidenced by HSBC and Capita locating in Grand Canal Square. Furthermore, competition is not only restricted to other locations in Dublin, as illustrated by fund administration company Northern Trust's recent announcement of its intention to expand its Limerick workforce to 1,000 by 2017.

While the competition from alternative locations that can offer newer accommodation is increasing, this effect is being mitigated by the wave of refurbishment works that are sweeping across the IFSC. This, together with its excellent city centre location and its history as the home of financial services in Ireland will see it sustain its position as a favoured destination for financial firms. Lastly, the construction in 2017 and beyond of 646,000 sq ft of office space and 200 apartments at 72-80 North Wall Quay as part of Project Wave will help further gravitate the economic centre of the city down towards the docklands and will be of enormous benefit to the IFSC.

3. TECH SECTOR AND FINANCIAL TECHNOLOGY

While there are undoubted benefits of marketing itself as a financial hub, the IFSC is seen as largely off-limits by tech firms which view it as being overly corporate. Given that the TMT sector has overtaken the financial services as the major driver of office take-up in Dublin, an important consideration for IFSC real estate owners is whether the benefits derived from this financial centre positioning more than offsets the opportunity costs of not appealing to the tech sector, which accounts for approximately half of take-up.

There are, however, signs of an increased tech presence, as indicated by Hub Spot's successful move to the AIG Building while the recent establishment of co-working space for tech-start-ups at Dogpatch Labs in the CHQ Building is another developing innovation that could lead an increased transitioning towards a greater presence of tech occupiers.

As identified in IFS 2020, Dublin has the potential to become a financial technology hub. Combining Dublin's existing strengths in the financial and TMT sectors appears to be a logical next step, with the potential for cross pollination of ideas driving both sectors to new heights. Citi, the largest employer in the IFSC, is an early leader in this field having invested \$24 USD million in 2009 in a Global Research, Development, Innovation and Learning Centre in the IFSC, its only dedicated R&D research facility worldwide. Crucially, 'fintech' is a high-value industry whose presence here on large-scale would certainly boost real estate values.

Conclusion

The experience of the IFSC has shown that the successful execution of blue sky strategic thinking can be richly rewarded. As the IFSC enters a new chapter in its story, these visionary qualities must be encouraged and fostered to ensure that the IFSC's future is as successful as its past.

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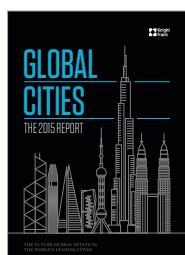
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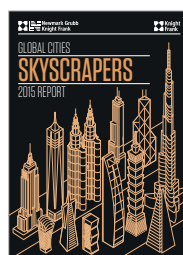
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