DUBLIN
OFFICE MARKET OVERVIEW
Q3 2017
Q3 OVERVIEW

Rents rise for the first time in a year while yields contract for the first time in two and a half years.

Economy

The momentum behind the domestic economy has prompted a number of significant upgrades to Ireland’s end-of-year economic growth forecasts. Of particular note, the Economic and Social Research Institute (ESRI) upgraded their GDP forecast from 3.8% in the summer bulletin to 5.0% in their autumn note. If they are proven correct, growth should be of a level to make Ireland the fastest growing economy in the EU for the fourth consecutive year. Driving the expansion has been the continued contraction in the unemployment rate which is on course to hit 5.4% next year according to the ESRI’s source.

FIGURE 1
Standardised unemployment rate

Source: Central Statistics Office

FIGURE 2
Dublin vs London volatility

Source: Knight Frank Research

KNIGHT FRANK VIEW ON RISK

Too often in real estate we focus on quantifying return while neglecting risk, when in reality, they are just differing sides of the same coin. Dublin has often been characterised as a volatile market, a view supported by the fluctuation in take-up figures transacted between Q3 and Q2. While the 1.05 million sq ft of take-up that transacted in Q2 was the highest level recorded this cycle, Q3 saw the lowest level of take-up since Q3 2014 with just 382,000 sq ft worth of deals transacting. To put this volatility in context, we decided to benchmark Dublin’s take-up against London, perhaps the broadest and deepest office market in the world.

Using quarterly data dating from 2010, we see that take-up volatility in Dublin is 2.5X that of the Central London market. Breaking Central London into its constituent parts, we see the West End is the least volatile of the sub-markets followed by the City and then the Docklands. Despite being over three times larger in terms of take-up, Dublin exhibits volatility of 1.5X that of the City and one fifth of the volatility of London’s Docklands. Finally, you will note how the volatility of the overall London market is lower than any of its sub-markets, thus illustrating the benefits of location diversification at a city level. We will complete volatility calculations for other markets internationally to see which cities Dublin is most comparable with, please email us if you would like to receive this analysis.
forecasts – a level which many consider full employment. As the labour market tightens, increased migration flows will be important to offset any inflationary pressures that emerge. CSO data released in September indicates that we are starting to see this response, with Ireland experiencing net annual inward migration of 19,800 in the year to April 2017, up from 3,100 the previous year.

In a further boost to the office market, the steady stream of Brexit-related relocations continued in Q3 with XL Insurance, Toronto Dominion and Standard Life among those making announcements. Furthermore, with the second and third round of EU-UK negotiations concluding without any substantial progress on the key issues of the Irish Border, the UK “Divorce Bill” or the rights of EU citizens, the chances of a disorderly Brexit are increasing, a prospect which may prompt a further acceleration of relocations to Ireland.

**Occupier market**

382,000 sq ft transacted in Q3 – which represented a two-third reduction compared to Q2 – bringing take-up to 1.9 million sq ft for the year so far. Prime rents increased from €60.00 to €62.50 psf, the first increase in a year. While some have forecast a rise in vacancy this year due to the level of new stock that is coming online, this analysis misses the point that the majority of this new stock is already let. Thus, the vacancy rate fell to 7.4% from 7.9% in Q2 as new let stock was added.

The largest deal of the quarter was Green REIT’s leasing of 37,000 sq ft at One Molesworth Street with 12-years term certain at a rent of €62.00 psf with 12 months rent free. While Barclays have an existing base in Dublin of approximately 20,000 sq ft, the letting is believed to have a substantial Brexit related element. Coworking firm Iconic Offices have taken 30,752 sq ft at the newly refurbished Ardilaun Court on St Stephen’s Green for €45.00 psf, in what is another marker of the rapid expansion of this industry segment in Dublin. The space has been branded as ‘The Greenway’ by the firm with the rent per work space ranging from €249 to €1,000 per month depending on whether the space is private or shared, and the time commitment one is willing to make upront. Another coworking firm, Connect Serviced Offices, were also active, letting 16,615 sq ft at 51 Bracken Road in Sandyford. The city centre accounted for 61% of take-up followed by the west suburbs which was buoyed by the occupation of 30,411 sq ft by the OPW at the Liberty Building and by eBay’s letting of 22,800 sq ft at Aroura House, both of which are located in Blanchardstown. TMT accounted for the largest share of take-up with 28% of the market although it was just marginally ahead of Finance which had a 27% market share. The State had the third highest with 13% followed by Coworking with 12%. We have decided to carve Coworking out of the Professional Services sector and give it its own distinct designation in light of the aforementioned growing importance of the industry.

888,000 sq ft of office space was completed in Q3 in what was the largest quarterly quantum of space to be delivered yet this cycle. Some prominent buildings that were completed included Microsoft’s new 300,000 sq ft campus in Leopardstown and the 172,000 sq ft Vertium which was pre-let to Amazon last year. Having recently let the entirety of Block H at its Central Park development, Green REIT embarked on the construction of Building I during Q3 which will extend to 100,000 sq ft with completion due in Q4 2018. Among some of the developments to be granted planning permission in Q3 was 74/75 Lower Baggot Street. The building, which was previously occupied by Bord Failte, will be redeveloped by its owners Irish Life and will extend to approximately 75,000 sq ft.

**Top 5 office leasing transactions**

<table>
<thead>
<tr>
<th>Property</th>
<th>Tenant</th>
<th>Sector</th>
<th>Size (sq ft)</th>
</tr>
</thead>
<tbody>
<tr>
<td>One Molesworth Street, Dublin 2</td>
<td>Barclays Bank</td>
<td>Finance</td>
<td>37,000</td>
</tr>
<tr>
<td>Ardilaun Court, St Stephen’s Green, Dublin 2</td>
<td>Iconic Offices</td>
<td>Coworking</td>
<td>30,752</td>
</tr>
<tr>
<td>The Liberty Building, Blanchardstown, Dublin 15</td>
<td>OPW – Dept of Education</td>
<td>State</td>
<td>30,411</td>
</tr>
<tr>
<td>One Windmill Lane, Dublin 2</td>
<td>Core Media</td>
<td>TMT</td>
<td>23,767</td>
</tr>
<tr>
<td>Aroura House, Blanchardstown, Dublin 15</td>
<td>eBay</td>
<td>TMT</td>
<td>22,800</td>
</tr>
</tbody>
</table>

**Development market**

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**Figure 3**

Office take-up sq ft

**Figure 4**

Dublin prime office rents € per sq ft per annum

Source: Knight Frank Research

Source: Knight Frank Research
Investment

€530.9 million worth of investment transactions changed hands in Q3, making it the strongest quarter of the year and 72% ahead of Q3 2016, although the year-to-date spend of €1.3 billion is 58% behind the corresponding period last year. Of this, the office sector amounted to €215.6 million or 41% of total spend in Q3, of which 93% was concentrated in Dublin. Given the number of large assets presently on the market that are likely to close by year-end, the overall investment market in 2017 should exceed its ten-year average of €1.8 billion. Prime yields have fallen to 4.25% in Q3, the first reduction in 10 quarters.

While Dublin continues to dominate the geographical distribution of office activity, this is the third consecutive quarter that the regional share of the market has accounted for at least 20% of activity. In contrast to recent quarters, the city core dominated suburban locations with all of the top four office transactions located in Dublin 2 and Dublin 4, with IPUT’s purchase of Gardiner House for €60.0 million representing the largest office transaction of the quarter. Irish Life’s purchase of 3046-3050 Lake Drive, Citywest for €10.2 million was the only large suburban office asset that traded during the quarter.

Irish buyers accounted for the lion’s share of transactions with 40% of the Dublin office market in Q3, followed by European and US investors with 25% and 23% respectively. Looking at the sell side of the market, Irish vendors accounted for 62% and the US for the remaining 38%. In what represented their first entry into the Irish market, French investor La Francaise purchased 21 Charlemont from Rohan Holdings for €45.0 million which equated to a net initial yield of 4.00%. Meanwhile, US buyer ARES – which already has substantial holdings in Ireland – purchased Blocks 4 and 5 of the Harcourt Centre for €47.0 million from the Clancourt Group for a net initial yield of 4.42%.
SPECIAL FOCUS: THE DOCKLANDS

BACKGROUND

The modern form of Dublin’s Docklands can be traced to the 18th Century with the construction of the North Wall and Sir John Rogerson Quays. Their construction was undertaken in order to control and deepen the flow of the River Liffey and facilitate maritime trade upon which Dublin’s economy depended. Today, commerce in Dublin’s Docklands is focused on intangible rather than tangible commodities. The tech and financial innovation that takes place there – along with the legal and accounting firms that support them – are at the heart of not only the local but national economy. The area has become particularly associated with the tech industry which as earned it the moniker of ‘Silicon Docks’ in reference to the giants of Silicon Valley that have established their European Headquarters there. Google were the first major company to do so in 2003 – a year before the company’s IPO – while Facebook moved in 2008 – the same year in which the company took over from Myspace as the world’s most popular social networking site. While an attractive tax regime may have been a primary motivator behind their initial decision to locate there, they now have established deep roots within the Docklands with Google employing over 6,000 staff and Facebook on course to employ approximately 3,000 staff, making it by far its largest footprint outside of their Silicon Valley headquarters.

LEASING, INVESTMENT AND DEVELOPMENT ACTIVITY

Since the market started to recover in 2012, the Docklands has accounted for approximately 3.0 million sq ft or 22% of the total market. The South Docklands accounted for 56% of the Dockland’s take-up followed by the IFSC and the North Docklands which comprised of 24% and 21% respectively, with the latter’s low share a reflection that it is still in the early stages of development. The Docklands reputation as a prime occupier location within Dublin is evidenced by the fact that the highest share of take-up occurred in the Docklands as the economy exited the recession, accounting for 31% of the market in 2012.

Early deals of particular note included Facebook’s letting of 121,000 sq ft at Grand Canal Square for €35.00 psf in 2013, €5.00 ahead of the €30.00 psf achieved by Capita who took 43,000 sq ft at 2 Grand Canal Square during the
tough of the market a year earlier. Since then, rents have appreciated strongly with €60.00 psf being achieved in Q3 2016 with Citadel’s taking of 18,250 sq ft at 1 Grand Canal Square. Take-up in the Docklands has been constrained by a lack of supply in recent times, dropping to a low of 13% market share in 2015, although activity is picking-up once again as new supply unlocks pent-up tenant demand.

The Docklands have the greatest investment liquidity in the Dublin market with no other area rivalling it for the quantum of large sales. Since 2013, there have been five office transactions in excess of €90 million, including the largest ever office deal in Dublin with the sale of One Spencer Dock to Middle Eastern fund AGC Equity Partners for €240.0 million in Q2 2016, representing a price per sq ft of €1,059. This compares to a price per sq ft of €770 achieved for 1 Grand Canal Square when it sold for €93.0 million in Q4 2013. The current marketing for sale of No.1 Dublin Landings by Oxley/Ballymore at a price of €150.0 million or €1,034 psf is believed to be attracting strong international investor interest. This appetite is not only a function of the quality of this state tenanted scheme but also a reflection of Dublin’s transition from recovery to core market status which has occurred over the past year.

Turning to new supply, there is 1.4 million sq ft under construction in the Docklands, with a further 2.1 million sq ft delivery potential from the area’s remaining brownfield sites. In addition to the aforementioned Dublin Landings scheme, significant developments include Ronan Group’s Spencer Place, Hibernia REIT’s SOBO District and Kennedy Wilson’s Capital Docks.

OUTLOOK

While the North Docklands has historically lagged equivalent South Docklands properties in terms of rents and yields achieved, this gap is closing fast as the developments that are coming on stream on the North Docklands will be the best and the most modern in the city. Meanwhile, just as the South Docklands benefited from the planning experience of the IFSC, the North Docklands is benefiting from the planning experience of the South Docklands – for example, schemes in the North Docklands are being designed with greater permeability than their South Docklands counterparts. Crucially, the construction of the pedestrian bridge near New Wapping Street will facilitate ease of access to the amenities of the South Docklands to North Docklands occupiers.

It will be interesting to see how the evolution of the occupier make-up of the North Docklands unfolds, as the early occupiers – namely the Central Bank, the NTMA and PwC – are very much in line with the prevailing finance dominated tenant profile of the IFSC. However, this is more likely a reflection of the limited number of tenants that have located there so far with the area set to become heavily influenced by tech given the high share of Dublin take-up that the sector accounts for. Furthermore, we are likely to see a much altered tenant mix in the IFSC in the coming years as the leases of finance companies who benefited from incentives to locate there expire. The occupation of HubSpot at One and Two Dockland Central and the Food Safety Authority at The Exchange is a sign of things to come.

A mark of the current cycle is that debt and equity funders are more location sensitive than in times past, a reflection of the liquidity needs of international money in managing market cycle risk. Already known as a prime location, the building-out of the remaining schemes will see Dublin’s Docklands cement this reputation and further enhance the relative appeal of the area to core investors going forward.