Knight Frank

Dublin Office Market Overview

Research, Q2 2020

With Special Focus: The Office: Still the Future of the Workplace

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Summary

1. Knowledge workers have been the least impacted segment of the labour market so far

2. Just 83,000 sq ft transacted in Q2, the largest deal being 3M's letting of 23,900 sq ft at 2 Cumberland Place

3. 127,000 sq ft of newly completed office stock was added in Q2 as lockdown hit new supply

4. €257.5 million worth of investments transacted in Q2, driven by the purchase of Bishop's Square by GLL from Hines for €183.0 million

5. While functioning better than many expected, working from home is a poor substitute for the office workplace

Q2 OVERVIEW

While investment volumes remained resilient in Q2, Covid-19 had a large negative impact on take-up levels with just 83,000 sq ft transacting

ECONOMY

The Covid-19 pandemic had an unprecedented impact on the domestic and international economy in Q2, as extraordinary public health measures severely curtailed economic activity. With the economy now opening up on a phased basis, the path of economic growth will largely depend on the timeline to a vaccine and how close to capacity the economy can operate under social distancing restrictions until that goal is achieved. Regarding the timeline for the former, expectations are highly optimistic in this respect with 177 vaccines currently in development – of which 37 are already in human trials – with capital markets pricing-in the development of one by Q1 2021.

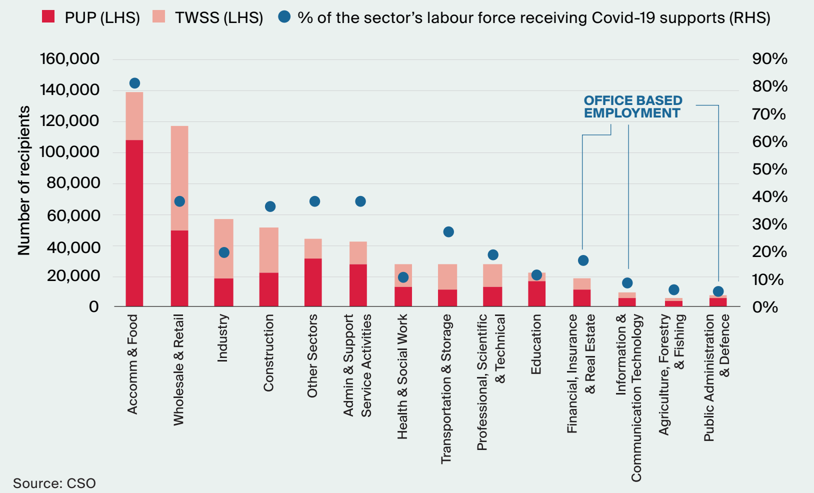
The labour market impact of the pandemic has been considerable so far, with the European Commission's Summer Economic Forecast projecting Ireland's unemployment rate to rise to 7.5% this year, before reverting to pre-Covid levels by the end of 2021. The worst affected sector so far has been the Accommodation and Food Services sector, with 83% of those employed receiving income support compared to just 10% for the Information and Communication Technology sector. This suggests that knowledge workers have been the least affected by the pandemic which bodes well for the resilience of the office market. The virus of course represents a more existential challenge to the office sector through a potential structural shift to greater working from home and this topic is addressed in the Special Focus section of this report.

OCCUPIER MARKET

Just 83,000 sq ft of office space was let in Q2, bringing take-up for the first half of the year to 900,000 sq ft, which is just over half the level witnessed during the same period in 2019. The vacancy rate stood at 7.3% at the end of Q2, up from 6.5% in Q1 and from 6.4% in Q2 2019. TMT accounted for 60% of activity, with the pre-letting of 23,900 sq ft at 2 Cumberland Place by 3M Digital Science Community being the largest deal of the quarter, while Unity Technologies sub-let 7,600 sq ft from Dillion Eustace at 33 Sir John Rogerson's Quay. Finance and Professional Services accounted for the next highest sector shares with 19% and 10% respectively as Vanguard took 6,200 sq ft at Georges Quay Plaza, while Dentons sub-let 4,200 sq ft from Nuritas at Joshua House. The letting of 8,200 sq ft to Amryt Pharma at 45 Mespil Road also brought Pharma's share of the market to 10%. Occupier activity was focused on the City Centre which accounted for 88% of take-up followed by the Fringe and the West Suburbs with 7% and 5% respectively.

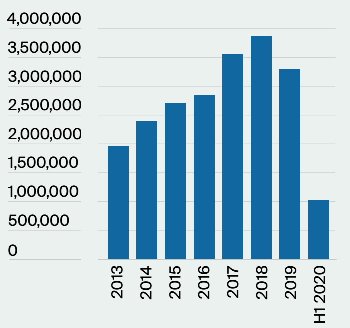
The main factor constraining take-up in Q2 was the logistical challenge of getting deals completed during the lockdown with a number of deals that would have otherwise completed in Q2 now due to sign in Q3. Beyond the expected completion of these deals, take-up for the remainder of the year will depend on economic confidence going forward. In total, there is over 700,000 sq ft reserved but it remains to be seen how much of this will translate into take-up. Looking at rents, there is likely to be a softening of incentives rather than headline rents in the short-term which reflects the tight supply landscape with 45% and 59% of this year's and next year's development pipeline already pre-let.

Fig 1. Sectoral distribution of Covid-19 supports



Source: CSO

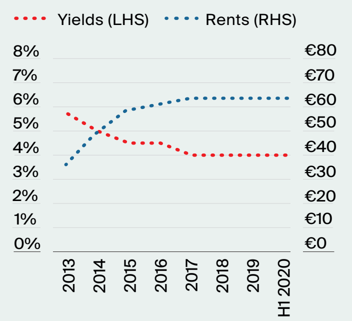
Fig 2. Office take-up
Sq ft



Source: Knight Frank Research

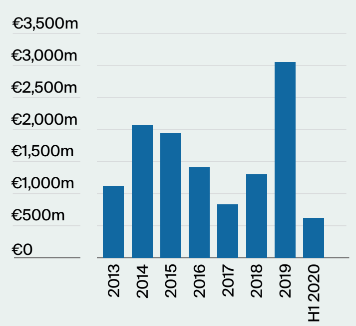
DUBLIN OFFICE MARKET OVERVIEW Q2 2020

Fig 3. Dublin prime office yields and rents



Source: Knight Frank Research

Fig 4. Dublin office investment volumes



Source: Knight Frank Research

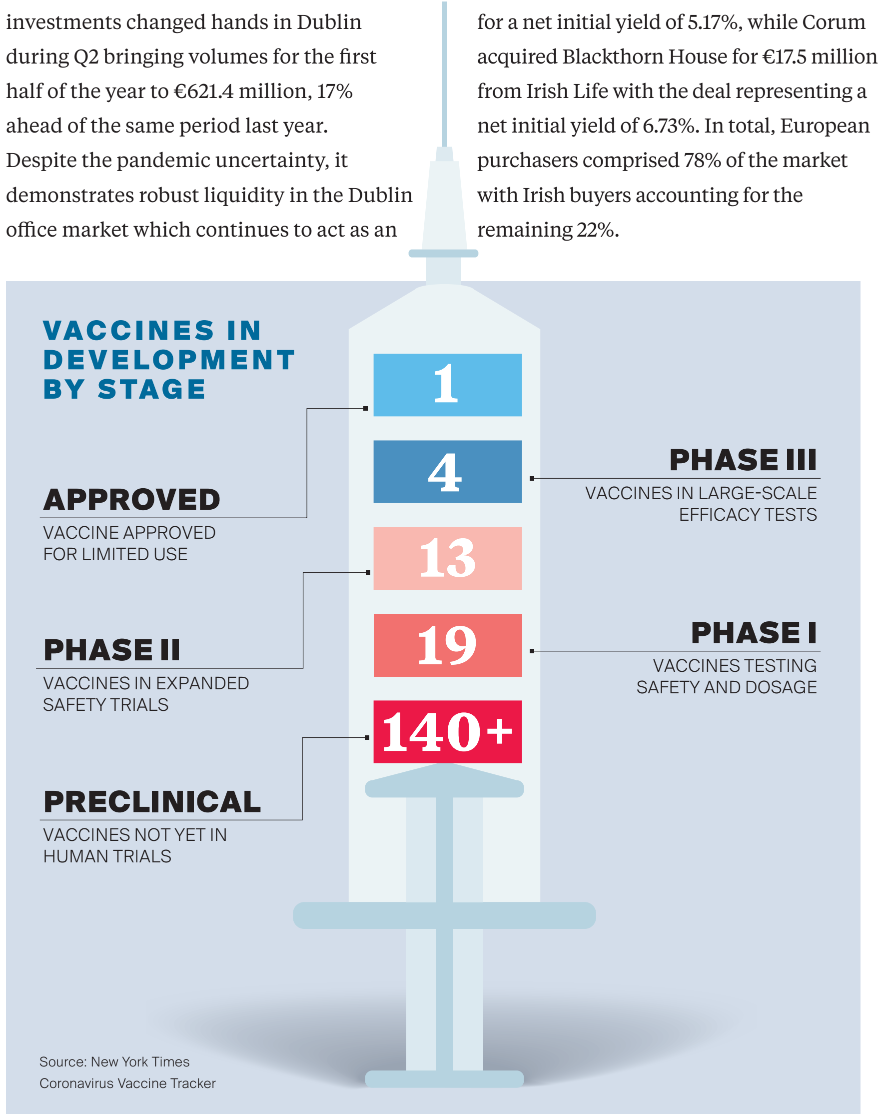
DEVELOPMENT MARKET

With sites closed for much of Q2, just 127,000 sq ft was delivered while upcoming delivery timelines are likely to be stretched as measures introduced to mitigate the spread of Covid-19 will slow construction. Completed buildings consisted of Two Dublin Airport Central (117,000 sq ft) and Block B, Dublin Airport Business Park (10,000 sq ft). Among the few projects to start in Q2 were Two Grand Parade (115,000 sq ft) which was purchased by Union Investment from Hines, while Deutsche Bank commenced their refurbishment of One Haddington Buildings (42,000 sq ft).

INVESTMENT MARKET

€257.5 million worth of office investments changed hands in Dublin during Q2 bringing volumes for the first half of the year to €621.4 million, 17% ahead of the same period last year. Despite the pandemic uncertainty, it demonstrates robust liquidity in the Dublin office market which continues to act as an attractive destination for equity-driven institutional capital.

In what was the largest investment of Q2, GLL purchased Bishop's Square from Hines for €183.0 million with the transaction representing a net initial yield of 3.97%. The deal represents a significant premium for Hines who acquired Bishop's Square for €92.0 million from King Street Capital in 2015. Elsewhere, IPUT achieved sole ownership of Riverside One by purchasing Aviva's 29.2% share of the building for €37.5 million at a net initial yield of 4.03%. IPUT already owned a 70.8% share of Riverside One which they purchased from Harcourt Life for €80.5 million in 2015. Some notable transactions still completed in fringe and suburban locations as Blocks C and D, Parkgate Business Park were purchased by a private Irish investor for €19.5 million for a net initial yield of 5.17%, while Corum acquired Blackthorn House for €17.5 million from Irish Life with the deal representing a net initial yield of 6.73%. In total, European purchasers comprised 78% of the market with Irish buyers accounting for the remaining 22%.



Source: New York Times Coronavirus Vaccine Tracker

SPECIAL FOCUS: THE OFFICE: STILL THE FUTURE OF THE WORKPLACE

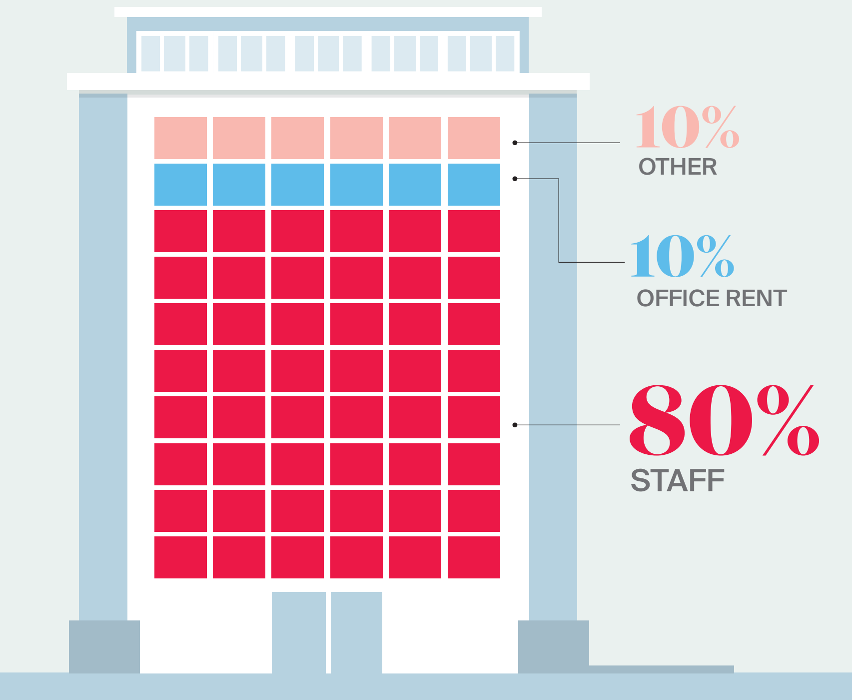
INTRODUCTION

The Covid-19 pandemic has raised a number of interesting questions as to the virus' longer-term structural impact on society, perhaps none more so than those relating to the future of work. Many have predicted that the pandemic will result in the death of the office, to be replaced by Working From Home (WFH) on a permanent basis, even after a vaccine has been produced. However, proclamations heralding the demise of the office have been made as far back as the 1970's and were proved wrong each time. We believe this time will be no different and explore why the modern office is an integral asset to a company's success in today's knowledge economy. To understand why office working out-performs WFH, we examine the pros and cons of each mode of working.

WORKING FROM HOME

Despite initial reservations from companies, WFH has been a largely effective way for office-based businesses to keep going through lockdown. Borne out of necessity, it worked better than many anticipated with digital collaboration tools such as Slack, Teams and Zoom helping to streamline the transition. While it has been a success in the short-term, the majority of occupiers we talk to do not see it as a long-term solution to their business needs.

TYPICAL COST BREAKDOWN FOR AN OFFICE OCCUPIER



CTRIP STUDY

Perhaps the most widely cited study on WFH was undertaken by the National Bureau of Economic Research in the United States. Call center workers from CTrip – a €14 billion NASDAQ listed Chinese travel service company – who volunteered to WFH were randomly assigned to either WFH or from the office over a nine-month period. The results found that performance increased by 13% amongst the WFH group, with 9% of this attributable to more time spent WFH than in the office, while 4% was attributed to greater productivity due to a quieter working environment.

Despite these initial positive implications for WFH, there are a number of other factors to consider. The call centre work at CTrip was particularly suited to WFH as it required neither teamwork nor face-to-face interactions. In addition, the company had robust systems for monitoring performance remotely which allowed them to supervise employees even at a distance. Crucially, those who volunteered to WFH were only allowed to do so if they had a home office – no working from bedrooms or kitchen tables for example – while employees were required to be in the office once every five days so that some in-person engagement was maintained. At the end of the nine months of the study, just half of the WFH volunteers requested to stay WFH, citing feelings of isolation, loneliness and depression arising from the extended period of working remotely.

Notwithstanding, WFH is a potential avenue for those whose jobs are largely independent, such as sales, or for completing specific tasks that require sustained periods of quiet concentration, such as report writing. Leading organisational psychologist Adam Grant argues that periods of intense and focused concentration on a specific task can yield the highest productivity benefits. If some employees find they can achieve deep focus WFH, it may prove an efficient way for them to complete certain tasks.

WHY COMPANIES INVEST IN OFFICES

To understand why companies invest in offices one must first examine the cost-benefit trade-off that an employer faces. A common rule of thumb used in the real estate industry is that salaries generally account for 80% of a company's cost base with the remaining 20% split evenly between real estate and other costs. Human capital is therefore easily the most expensive resource for a company, and explains why companies focus on maximising the return on the 80% staff outlay rather than on cutting the 10% real estate costs, by implementing WFH for example.

The role of the office in maximising labour productivity is well established, albeit the research findings are continually evolving. Knowledge workers add-value in the way they collect, analyse and disseminate information, with the office environment

FACEBOOK'S PLANS FOR WORKING FROM HOME

A number of tech companies have announced that they will be keeping WFH practises beyond the pandemic period. Facebook have even given an initial overview of their plans for WFH via a recent employee virtual town hall event hosted by Mark Zuckerberg. The talk provided some interesting insights into what shape WFH practises may take for big companies such as Facebook, of which up to 95% of staff have been WFH during the pandemic.

Employees at Facebook will be able to apply to WFH if they meet the below four minimum criteria:

1. **Need to be an experienced, relatively senior member of staff**
2. **High ratings on recent performance reviews**
3. **Need to be on a team that supports remote working**
4. **Need to have their team leader's approval**

So, far from being an option for everyone, Facebook are initially limiting WFH to its best employees, presumably because they can trust them to work independently and also because they're already embedded in the company's culture from working in Facebook's office environment.

All going well, Facebook aims to attract new staff for WFH who wouldn't otherwise want to work in a big city but are close enough to be within a four-hour drive of an existing company office – a qualification that would certainly encompass the majority of Ireland if Dublin were to be included as being the centre of such a hub. The catch for employees looking to WFH is that their salaries would be adjusted to reflect the cheaper cost of living outside of major cities – whether potential WFH employees would be willing to accept this trade-off remains to be seen.

Crucially, Zuckerberg said Facebook remains committed to retaining its existing office footprint, which makes sense for a company that recently spent over $1 billion developing its headquarters in Menlo Park in California and includes the largest open floor plan in the world. Facebook say their plans for exploring greater WFH comes not from a cost saving motivation, nor is it necessarily an employee-led demand, rather they believe its part of their responsibility to be leading innovation in such areas. A factor not mentioned, but one that may be playing a role in this, is the fact that Facebook stand to benefit from the rise of remote working having developed 'Workplace', a platform they've established that could potentially challenge Slack and Microsoft Teams.

DUBLIN OFFICE MARKET OVERVIEW Q2 2020

The office market trend has been for companies to invest more rather than less on their office space, something which proponents of WFH based on cost savings miss

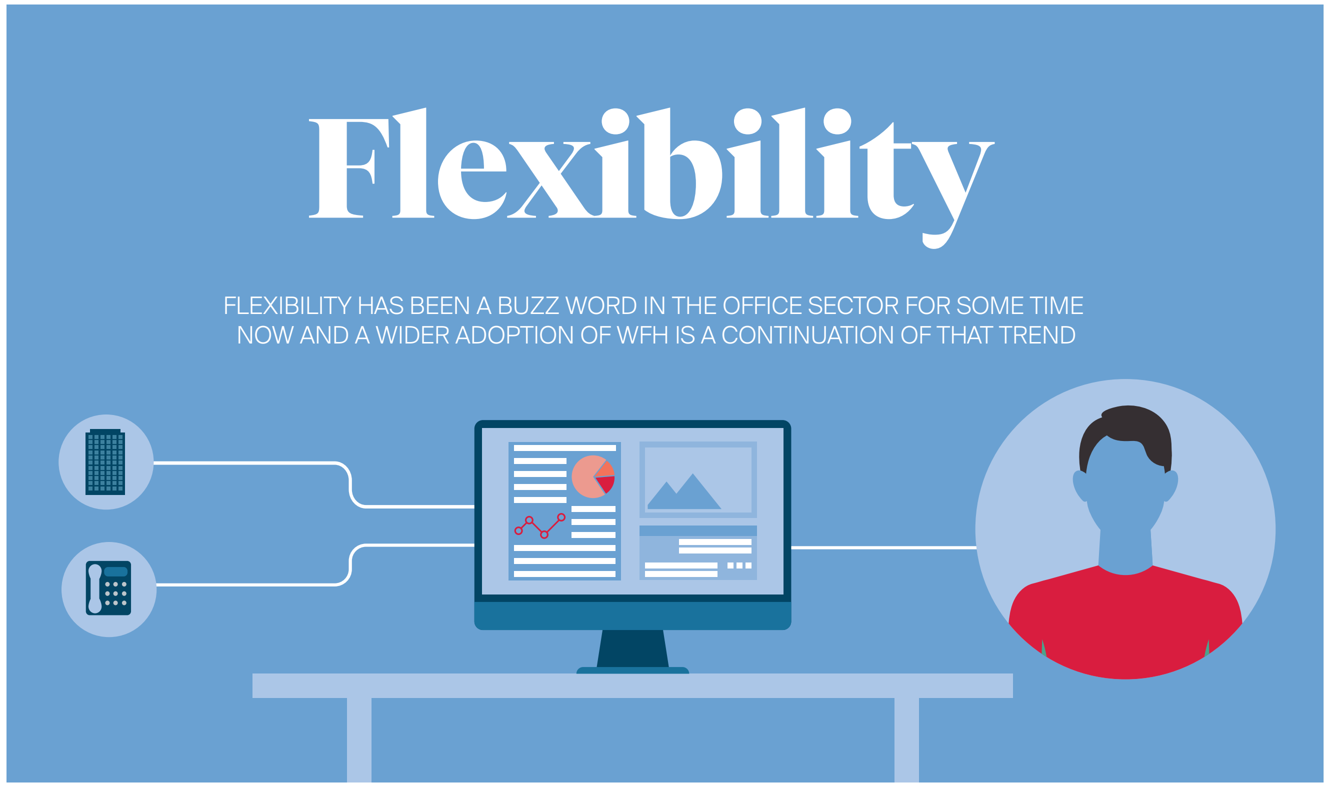
increasing the efficiency of this process by enabling face-to-face collaboration and learning.

The modern open office plan came about as a method of maximising the 'water cooler' effect, a reference to the informal collaboration that took place at the water cooler during which workers shared information and solved problems. The open plan layout was an effort to replicate this effect more widely by getting workers out of their partitioned silos, boosting informal interactions and thus productivity.

Over the last decade, however, there has been some evidence that open plan layouts can hurt productivity, with distractions making it difficult to concentrate depending on the task you are doing. To address this, contemporary office designs increasingly implement the concept of flexibility, which incorporates design features to compliment the open plan structure to include breakout spaces for informal meetings and quiet rooms for focused individual work, while also abolishing fixed desks so as to further increase random knowledge collisions between workers.

The office also plays a role in fulfilling the human desire for socialisation, helping foster a sense of belonging and purpose. As a result, the office has become a key point on which companies compete for talent. This is particularly true of the tech industry, where millennials dominate, with health and wellness benefits such as gyms becoming more common place. Offices are also crucial in transmitting corporate culture so that the aims and values of the corporation are aligned with its employees.

Like many global cities, Dublin has seen a resurgence in city centre office demand over the last decade. As illustrated in Figure 5, the city centre's share of Dublin's office take-up has increased from approximately 50%



DUBLIN OFFICE MARKET OVERVIEW Q2 2020

in 2010 to 70% in 2019, despite rents increasing over the period, while the suburbs saw a corresponding drop from approximately 30% to 20% (the city fringe market accounting for the balance). The office market trend therefore has been for companies to invest more rather than less in their office space, something which proponents of WFH based on cost savings miss. This reflects the relatively small contribution of the office to overall costs (10%) and its crucial role in maximising the return on labour, the chief cost (80%).

It helps explain why companies such as IBM and Yahoo, who previously implemented WFH on a large scale, subsequently rolled back on the practice as their performance lagged their tech peers such as Google and Microsoft, who made the office an integral part of their respective strategies'.

OUTLOOK

Knowledge workers in today's modern economy are hyperconnected, both digitally and physically. While some predicted that technological advancements would result in remote work replacing the office, the importance of physical proximity has only increased as digital collaboration has proliferated. Trends in office design reflect this change as we moved from partitioned silos to open-plan layouts that maximise face-to-face interactions within companies. Inter-company face-to-face interactions have also risen, as evidenced by the growing preference for city centre office locations versus the suburbs. While the Covid-19 pandemic has interrupted this trend towards greater face-to-face interaction, we believe that WFH will prove to have been a temporary workplace solution borne out of necessity rather than a long-term shift.

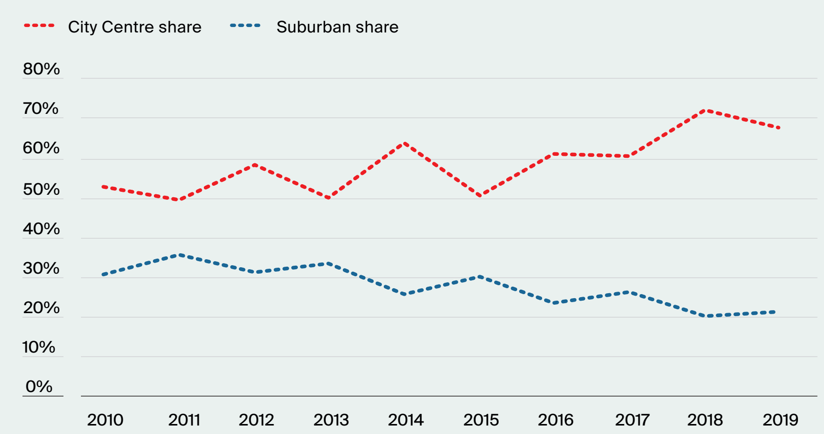
Notwithstanding, going forward an element of WFH will become more prevalent than before the pandemic. The stigma associated with WFH has been removed now that employers and employees have had the chance to experience its benefits for themselves. The type of work one is engaged in is critically important, with work that requires deep concentration – completing a report for example – potentially being more suited to WFH. While quiet spaces have been developed for focused work in the modern office, the WFH option will appeal to those that can avoid the commute and perhaps improve their work-life balance. 'Flexibility' has been a buzz word in the office sector for some time now and a wider adoption of WFH is a natural continuation of that trend.

However, it is worth considering that employee demand for WFH may drop when offices are back running as normal again. This is because staff who WFH can be overlooked when it comes to promotions, suffering from the out of sight, out of mind effect. This doesn't come into consideration in the current environment with the majority of staff WFH, but will return as a factor post-Covid.

Ultimately, the office – as venues for face-to-face collaboration – will retain its position as the place where workers are most efficient and thus remain a cornerstone of the modern knowledge based economy. Commenting on the WFH phenomenon in the context of the Covid-19 pandemic, Nicolas Bloom – one of the authors of the CTrip study cited earlier in this research – concluded that current Covid-19 WFH arrangements will create 'a productivity disaster for firms' and fears that the 'collapse in office face-time will lead to a slump in innovation'. Overall, therefore, WFH will be a poor substitute for work that requires collaboration – which comprises the majority of work undertaken in an office – however, it will play a role in undertaking certain types of tasks while also acting as an incentive for attracting and retaining talent.

Knowledge workers in today's modern economy are hyperconnected, both digitally and physically

Fig 5. Share of Dublin take-up by location

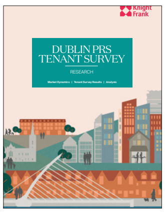


Source: Knight Frank

Brexit Under Pressure #3 - March 2020

The London Report 2020

The Wealth Report 2020



Dublin PRS Tenant Survey

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