RESEARCH

Knight Frank

DUBLIN

OFFICE MARKET OVERVIEW

Q2 2018

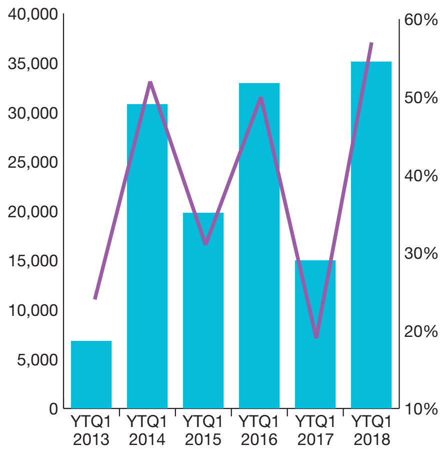
WITH SPECIAL FOCUS: PLACING THE DUBLIN OFFICE MARKET IN A EUROPEAN CONTEXT

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

SUMMARY

1. Dublin sees its highest level of jobs growth on record
2. Revision to unemployment estimate brings economy firmly into full employment territory
3. Take-up for the first six months of the year amounted to 1.65m sq ft, in-line with the same period last year
4. Commercial investment volumes reached €1.9 billion in the first six months of the year, which is already ahead of the ten-year annual average of €1.8 billion
5. Dublin's lettings market is 78% more valuable than the Manchester, Birmingham and Edinburgh markets combined

FIGURE 1
Dublin employment growth and share of Ireland



Source: Knight Frank Research

Q2 OVERVIEW

Take-up, new construction and investment volumes all continue to trend higher, underpinned by record employment growth in Dublin.

Economy

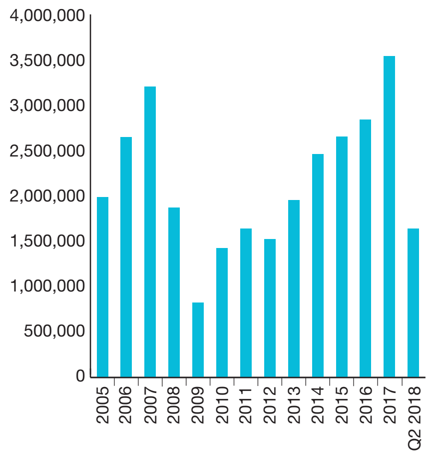
62,100 jobs were created in Ireland in the year to Q1 according to the latest CSO Labour Force Survey, with 35,100 – or 57% – of these located in Dublin. This is the highest year-on-year Dublin jobs growth on record having surpassed the previous high of 34,400 witnessed in the year to Q2 2007. On foot of this new data, the CSO revised downwards its previous unemployment estimate for March by 50bps, going from 6.1% to 5.6%. Subsequent declines in the live register in Q2 led the rate to fall further to 5.1% at the end of June. Since the unemployment rate peaked at 15.9% in Q1 2012, 357,300 jobs have now been added to the Irish economy with 140,400 – or 39% – of these created in Dublin during this six-year period.

In its Summer Economic Statement, the Department of Finance forecasted job creation of 60,000 for 2018, followed by a further 53,000 in 2019 and 43,000 in 2020. Given the decline in unemployment, where will these additional workers come from? While labour participation rates offer some scope for increase, the void will have to be primarily filled by net immigration. We have already witnessed a pick-up in this respect, with last year seeing the highest level of net immigration since 2008, although the 19,800 net inflow was a long way from the excess 100,000 recorded in 2007.

Occupier market

The occupier market continued to witness strong demand in Q2 with 900,713 sq ft transacting, bringing take-up for the first half of the year to 1,648,548 sq ft, in-line with the same period last year. With all five of the top transactions involving new schemes that have either been recently delivered or are currently under construction, the high level of take-up can be attributed to the flow of new stock that is emerging. This is unlocking pent-up demand and translating into deals in the market. The vacancy rate fell to 6.1% in Q2, representing a marginal decline from 6.2% in Q1.

FIGURE 2
Office take-up sq ft

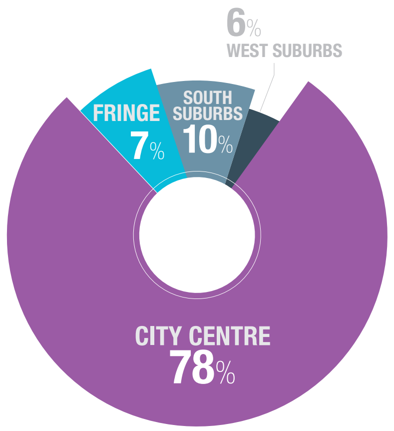


Source: Knight Frank Research

KNIGHT FRANK VIEW ON RISK

In our Q1 report, we discussed the challenges facing the economy as it moved towards full employment, an unemployment rate generally given as being below 5% to 6%. At the time, when the rate for March read 6.1%, the economy stood at the cusp of this range. However, the subsequent revision of this figure by the CSO combined with further employment gains during Q2, led to a 100 bps quarterly contraction of the unemployment rate to stand at 5.1% at the end of June. One of the challenges that the return to full employment brings is the increasing need – as the domestic available talent pool shrinks – to source workers from abroad. With the lack of residential supply already one of the biggest brakes on occupier expansion in Dublin, the downward revision to the unemployment rate – and the resulting greater reliance on sourcing workers from abroad – brings this challenge further into focus.

FIGURE 3
Take-up by location



Source: Knight Frank Research

A remarkable 78% of all space let was concentrated in the city centre, with Dublin 4 in particular increasing its market share to 26% – up from just 1% in Q1 – as a result of Google's decision to purchase the entirety of Boland's Quay. Google will occupy 220,732 sq ft at the scheme which will provide a strategic linkage with the company's European headquarters on Barrow Street where it occupies Montevetro, Gordon House, Gasworks House and Grand Mill Quay – a complex totalling 508,500 sq ft. The South Suburbs and the Fringe accounted for the next highest share with 10% and 7% respectively.

Taking a sectoral view, while TMT dominated the market accounting for 43% of take-up, the State considerably boosted its share in Q2 which rose to 22% – up from just 5% in Q1. Its share was enhanced by the IDA's taking of the remaining 112,000 sq ft at the Clancourt Group's Three Park Place which was the culmination of an extensive search by the IDA for a new HQ in advance of the expiration of their existing lease at Wilton Terrace in 2019.

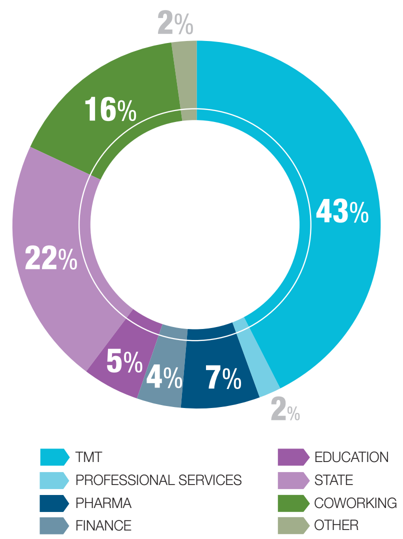
The Coworking sector also maintained its position as the third largest sector for the second quarter running, occupying 16% of the market. This was supported by the continued expansion of WeWork's network of shared office accommodation in Dublin with the company leasing the entirety of Hines' One Central Plaza and Green REIT's 5 Harcourt Road which comprises 74,000 sq ft and 49,300 sq ft respectively. Prime rents remain stable at €62.50 psf.

Development market

540,000 sq ft of new office space was delivered in Q2 with a number of new buildings reaching practical completion. The largest of these was Clancourt Group's Three Park Place which comprises 175,000 sq ft of office space and increases the footprint of the Group's Park Place scheme to just over 465,000 sq ft. The company has recently lodged plans which will extend the complex further by developing the old Eircom Telephone Exchange on Adelaide Road where it aims to construct a new building called Four Park Place which will total 235,000 sq ft.

In the meantime, the company is redeveloping the former Pod nightclub which will provide 15,425 sq ft of office space and will be known as Station Building Two upon completion in Q4 2018. Other significant projects that were completed in Q2 were TIO's 5 Hanover Quay and Ballymore/Oxley's No. 2 Dublin Landings which extend to 162,783 sq ft and 99,500 sq ft respectively. Finally, in terms of schemes granted planning permission, Kennedy Wilson were given the green light to develop a new scheme in Dublin's South Docklands called 10 Hanover Quay. The building will sit adjacent to the company's existing Capital Docks development and provide 68,400 sq ft on completion in Q2 2020.

FIGURE 4
Take-up by sector



Source: Knight Frank Research

FIGURE 5
Dublin prime office rents
€ per sq ft per annum

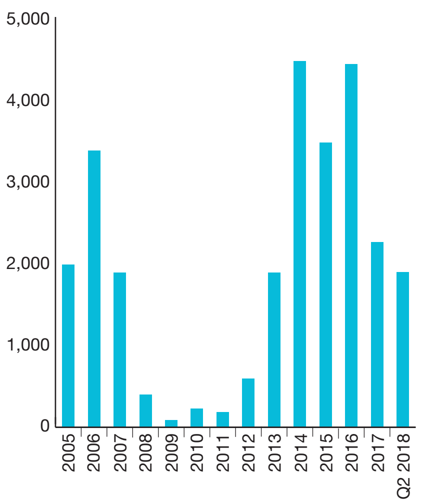
Source: Knight Frank Research

Top 5 office leasing transactions

Property	Tenant	Sector	Size (sq ft)
Boland's Quay, Dublin 4	Google	TMT	220,732
Three Park Place, Dublin 2	IDA	State	112,000
One Central Plaza, Dublin 2	WeWork	Coworking	74,000
5 Harcourt Road, Dublin 2	WeWork	Coworking	49,300
The Sharp Building, Dublin 2	Perrigo Pharma	Pharma	45,000

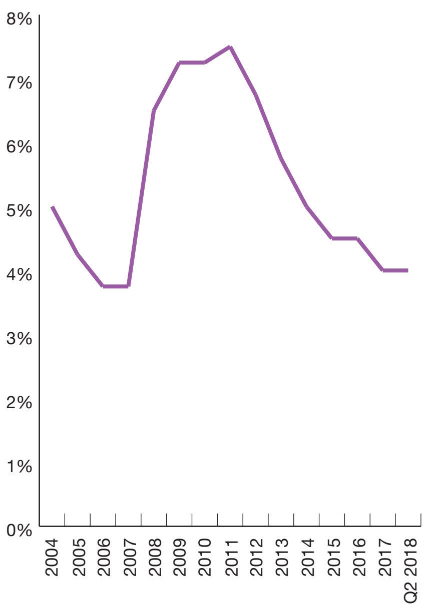
Source: Knight Frank Research

FIGURE 6
Irish commercial investment volumes € million



Source: Knight Frank Research

FIGURE 7
Dublin prime office yields



Source: Knight Frank Research

Investment

€973.1m worth of investment transactions changed hands during Q2 bringing total investment volumes for the first half of the year to just over €1.9 billion, which is already ahead of the ten-year annual average of €1.8 billion. Of the Q2 figure, the office sector accounted for 38% or just over €370.3m, while Dublin maintained its position as the primary destination of activity with 93% or €344.5m of this transacting in the capital.

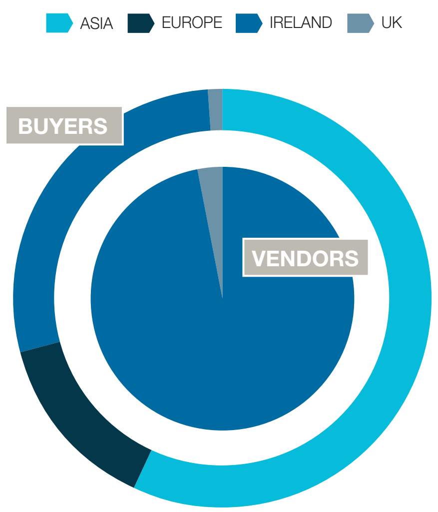
Investors deployed significant levels of capital in fringe areas of the city in Q2 as these locations encompassed approximately half (47%) of the entire investment spend, with Dublin 3 accounting for two of the top three deals. The largest of these was the acquisition of the Beckett Building on the East Wall Road for €101.0m by Knight Frank Investment Managers on behalf of South Korean investors Kookman Bank. The sale of the Beckett Building – which was purchased by the Comer Group in 2013 for €5.0m and subsequently refurbished with substantial capex before being let to Facebook – represented a net initial yield of 4.13%. The deal is noteworthy in that it represents the first large-scale purchase by a South Korean investor in the Dublin market.

Irish buyers were also active in Dublin 3, with Yew Grove REIT purchasing One and Three Gateway for €29.0m.

This investment, which represented a net initial yield of 6.41%, is the company's first acquisition since its initial public offering in June.

European investors were also active in the city fringe in Q2. MM Capital sold 31-36 Golden Lane in Dublin 8 to German new entrant KGAL for €25.5m at a yield of 5.26%. The sale comes a year after MM Capital purchased the building and let it to tech firm New Relic. Prime office yields were unchanged at 4.00%.

FIGURE 8
Buyer and vendor source
Of identifiable deals



Source: Knight Frank Research

Top 5 office investment transactions

Property	Seller	Buyer	Approx. price
Off-market asset swap of properties in Dublin 1 and Dublin 2	Confidential	Confidential	€160.0m
The Beckett Building, Dublin 3	Comer Group	Kookman Bank	€101.0m
One & Three Gateway, Dublin 3	Collen Group	Yew Grove REIT	€29.0m
31–36 Golden Lane, Dublin 8	MM Capital	KGAL	€25.5m
52–55 Sir John Rogerson's Quay, Dublin 2	Private	SSGA	€11.2m

Source: Knight Frank Research

SPECIAL FOCUS: PLACING THE DUBLIN OFFICE MARKET IN A EUROPEAN CONTEXT

Dublin's economic importance has often been compared to being of a level similar to that of a regional UK City such as Manchester, Birmingham or Edinburgh. However, we show that this view is incorrect with the value of Dublin's office letting market found to be greater than the value of the Manchester, Birmingham and Edinburgh office markets combined. The question then arises as to where Dublin sits in a European context, one which we seek to answer in this Special Focus by comparing office market data for 2017 across 21 cities in Europe.

POPULATION

- To set the scene, we have used UN data on urban agglomerations (with reference year 2015) to compare in a consistent fashion the relative sizes of each of the 21 subject cities in terms of population.
- Dublin's urban agglomeration was estimated to be 1.2m, ranking it as the 18th largest city or fourth smallest, in between Prague (1.3m) and Amsterdam (1.1m).
- Moscow (12.0m) had the highest population, followed by Paris (10.7m) and London (8.7m).
- While Edinburgh (0.5m) is the smallest city in our sample, Manchester (2.6m) and Birmingham (2.5m) are more than twice the size of Dublin and rank as the eighth and ninth largest cities respectively in our analysis.

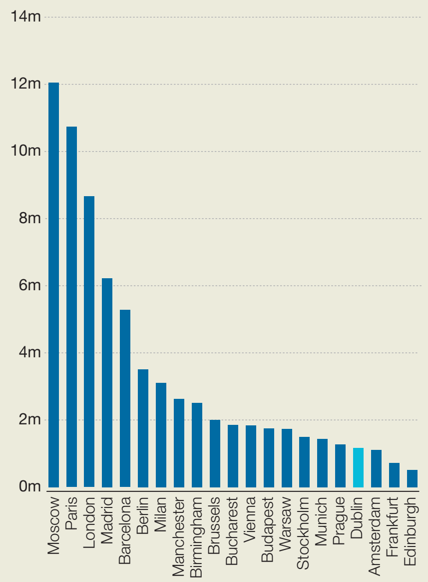
LETTING MARKET VALUE

- At €148.6m (see footnotes below), the annual value of the Dublin office letting market is estimated to be 78% larger than the Manchester, Birmingham and Edinburgh markets combined (€83.5m). Clearly then, Dublin is a much more important office market than that of a regional UK City.
- The analysis confirms just how small the Dublin market is compared to London, being just 13% the size of the €1.1 billion London market.
- Dublin ranks as the ninth most valuable office market in Europe, sitting behind Moscow (€158.4m) and Warsaw (€150.9m), but ahead of Madrid (€138.8m), Milan €116.8m) and Amsterdam (€99.0m).

TAKE-UP

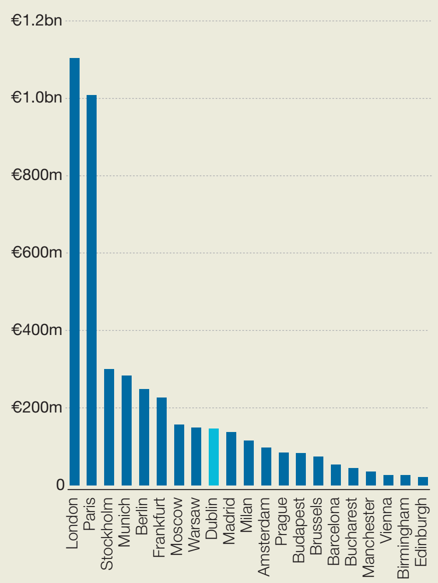
- While the Dublin office market experienced a record level of take-up in 2017 of c.3.6m sq ft, this was still towards the lower end of what was achieved in a European context and placed Dublin as the 14th highest in Europe. This was well below the likes of Paris (20.3m sq ft) and London (13.8m sq ft).
- However, take-up in Dublin was more than the combined take-up of Manchester (1.2m sq ft), Birmingham (1.0m sq ft) and Edinburgh (0.8m sq ft), placing it in-line with cities such as Amsterdam (4.0m sq ft), Brussels (3.8m sq ft) and Milan (3.6m sq ft).

Population



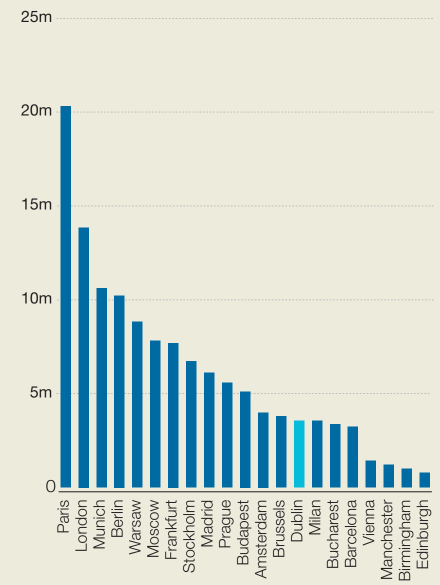
Source: Knight Frank Research

Letting market value



Source: Knight Frank Research

Take-up sq ft



Source: Knight Frank Research

- The value of an office letting market is a function of its annual take-up and average rent. While we have take-up data, there is no figure for average rent, hence we proxy it by taking two thirds of the prime headline rent in that city. For Dublin, €148.6m = 3.565m sq ft x (€62.50 x 2/3)). Currency translations for non-euro cities were undertaken for 29/12/2017.
- The analysis compares data for 21 cities across a range of metrics. It should be noted that there was no data available for stock levels for Milan and new completions for Amsterdam.
- The Paris office market is comprised of the Paris CBD as well as the remainder of the 20 arrondissements which are not included in the CBD. In addition, it also includes the La Defence and the Western Crescent. The London office market encompasses the City of London, the West End and the Docklands.

SPECIAL FOCUS: CONTINUED

RENTS

- In contrast, Dublin's prime headline rent of €62.50 psf was the fourth highest in Europe, only behind London (€120.77 psf), Paris (€75.25 psf) and Stockholm (€67.66 psf). Budapest (€24.53 psf), Prague (€22.85 psf) and Bucharest (€20.07 psf) had the lowest rents.
- Dublin's prime headline rent was 44% higher than Manchester's headline rent of €43.48 psf and 54% greater than both Birmingham and Edinburgh, both of which had headline rents of €40.46 psf.
- While Dublin rents look expensive when compared to our European neighbours, it reflects the relative economic success of the city in international terms, with Dublin punching above its weight in attracting financial and tech heavyweights. In conjunction with this, the lack of new office supply over the last number of years has also played a prominent role in recent rental inflation.

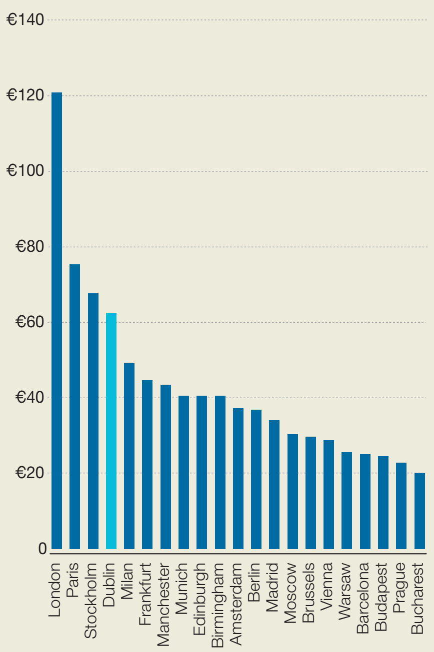
STOCK

- Dublin ranks 14th highest or seventh lowest in term of office stock. It is 14% the size of the Paris market (291.7m sq ft) and 18% the size of the London market (225.0m sq ft).
- It is more than double the size of Manchester (16.2m sq ft) and around four times that of Birmingham (10.9m sq ft) and Edinburgh (10.5m sq ft).
- Dublin's office stock is of a similar level to cities such as Budapest (36.8m sq ft) and Prague (36.0m sq ft).
- Comparing the provision of office stock with city population yields some interesting insights. For example, Dublin's urban agglomeration is of a similar size to Amsterdam – 1.2m versus 1.1m – but the latter has a much larger office stock (72.0m sq ft).
- Likewise, while Stockholm has a slightly higher population of 1.5m, its stock level is much greater at 126.6m sq ft.

VACANCY

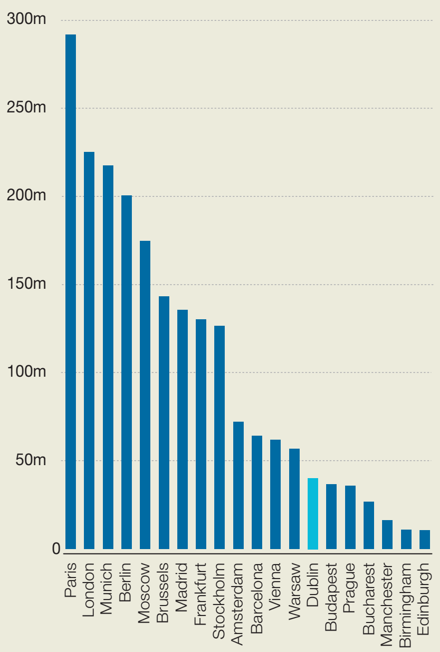
- At circa seven per cent, Dublin had the fifth lowest vacancy rate in Europe at the end of 2017, putting it between London (7.3%) and Paris (5.8%).
- The three other cities with a lower vacancy rate than Dublin were Vienna (5.4%), Berlin (2.3%) and Munich (2.2%).
- Comparing Dublin with the regional cities of the UK shows that vacancy is much higher there, with Birmingham, at 20.8%, having the highest vacancy of all the 21 cities analysed. Manchester has a vacancy rate of 11.9% while Edinburgh has a vacancy rate of 9.6%.
- The vacancy rate in Birmingham is an outlier, with the second highest vacancy rate being Moscow with 13.0% followed by Milan with 12.0%.
- In fact, six of the 21 cities have a vacancy rate in the 7% range while the average vacancy rate for the sample was 8.8%.

Rents € per sq ft



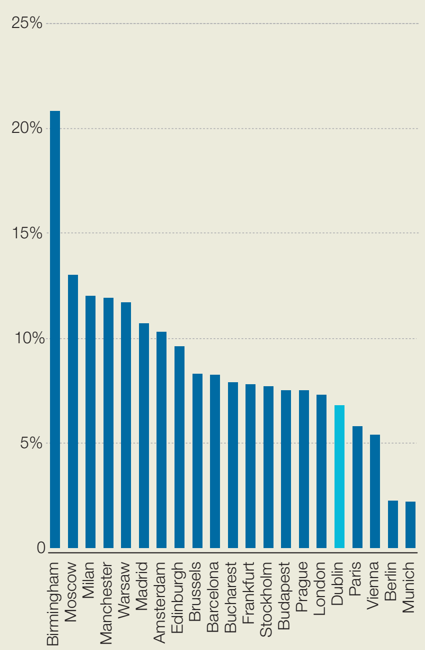
Source: Knight Frank Research

Stock sq ft



Source: Knight Frank Research

Vacancy



Source: Knight Frank Research

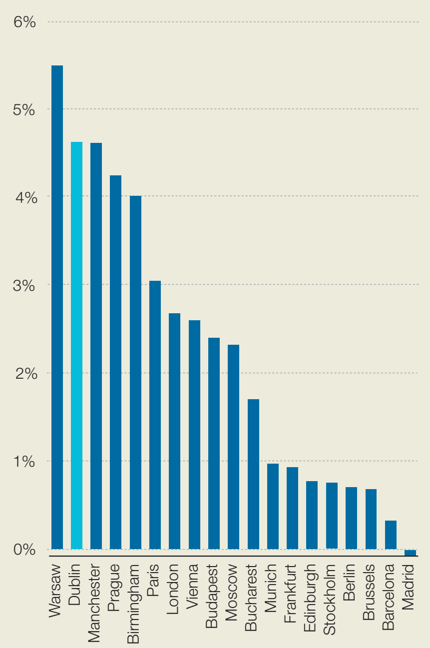
COMPLETIONS

- To compare new construction levels across the 21 cities, we examine the ratio of new construction delivered in 2017 to existing stock. This analysis shows that Dublin is joint second with Manchester (both 4.6%), and only behind Warsaw (5.5%).
- While this is undoubtedly high, it should be seen in the context of the low prevailing vacancy and the underprovision of Dublin's office stock in relation to population compared to its European peers. Thus, the relatively high ratio reflects a 'catch-up' process following years without new delivery.
- Comparing Dublin with the other regional UK cities, we see that Birmingham (4.0%) also has a high ratio of new completions to existing stock, ranking fifth, while Edinburgh (0.8%) is ranked 14th.
- Birmingham's ratio is of particular interest given that it has one of the highest vacancy rates amongst the 21 cities in this analysis.
- Barcelona and Madrid prop up the table with 0.3% and -0.1% respectively, the latter driven by withdrawals exceeding new supply.

YIELDS AND CAPITAL VALUES

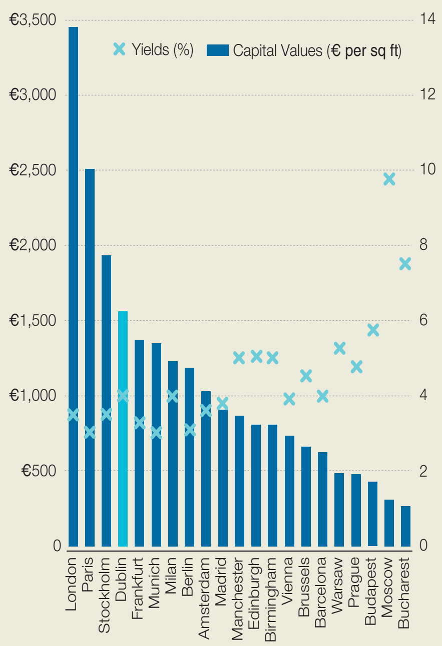
- While Dublin's yields have tightened to 4.0%, they look relatively cheap when compared to Amsterdam (3.6%), Stockholm (3.5%), Berlin (3.1%) and Munich (3.0%). This relative value holds true even after adjusting for spread over respective bonds yields. Reflecting the relative riskiness of investing in London versus the UK regions, yields in London were 3.5% compared to 5.0% for Birmingham, Manchester and Edinburgh.
- Looking at capital values, Dublin (€1,563 psf) has the fourth highest in Europe, trailing only London (€3,451 psf), Paris (€2,508 psf) and Stockholm (€1,933 psf). Capital values in Dublin are significantly ahead of Birmingham, Edinburgh (both €809 psf) and Manchester (€870 psf).
- The common dominator in Dublin's high performance in both the office letting market value and capital value rankings is the high relative rent. This is because the former is a function of rents and take-up while the latter is a function of rents and yields. Dublin ranks middle of the road in terms of take-up and yields.

Completions as a % of stock



Source: Knight Frank Research

Yields and capital values



Source: Knight Frank Research

CONCLUSION

- Dublin's high rents can be explained by the strongly performing economy – Ireland is fastest growing in Europe – combined with the lack of new supply over the last number of years. And while they are undoubtedly high from a European perspective, they are still less than half the prevailing headline level of the London market.
- Ultimately, the sustainability of rents rely on the cash flows generated by the underlying tenants that make-up the local occupier market. Dublin is in a fortunate position to have attracted some of the worlds leading companies, who's Dublin presence is often a key part of their global business, such that office rents play a relatively minor importance in directing their strategic decision making.
- The interesting question to answer is what strengths Dublin posses that has enabled it to build such an impressive tenant profile? Strengths – by their definition – can only be understood in relation to a competitor.
- A SWOT analysis of the respective strengths of the 21 cities would be a worthwhile additional piece of research in itself, but it is well documented that Dublin's success is a function of its competitive corporation tax rate, young and educated population, English speaking workforce, cultural and economic linkages with the United States and common law framework.
- Understanding these strengths – and how they are likely to evolve – vis-à-vis the 21 European cities contained within this analysis will determine the performance of the Dublin office market over the long-run. While Pan-European investors may be well accustomed to making these international comparisons as a matter of habit, domestically focused investors would be wise to pay close attention to the dynamics of the European market as they unfold.

RESEARCH

John Ring, Head of Research
+353 1 634 2466
john.ring@ie.knightfrank.com

Robert O'Connor, Research Analyst
+353 1 634 2466
robert.oconnor@ie.knightfrank.com

CAPITAL MARKETS

Adrian Trueick, Director
+353 1 634 2466
adrian.trueick@ie.knightfrank.com

Peter Flanagan, Director
+353 1 634 2466
peter.flanagan@ie.knightfrank.com

Ross Fogarty, Director
+353 1 634 2466
ross.fogarty@ie.knightfrank.com

OFFICES

Declan O'Reilly, Director
+353 1 634 2466
declan.oreilly@ie.knightfrank.com

Paul Hanly, Director
+353 1 634 2466
paul.hanly@ie.knightfrank.com

Jim O'Reilly, Director
+353 1 634 2466
jim.oreilly@ie.knightfrank.com

Gavin Maguire, Associate Director
+353 1 634 2466
gavin.maguire@ie.knightfrank.com

Mark Headon, Associate Director
+353 1 634 2466
mark.headon@ie.knightfrank.com

David Reddy, Associate Director
+353 1 634 2466
david.reddy@ie.knightfrank.com

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