RESEARCH

DUBLIN

OFFICE MARKET OVERVIEW **Q2 2019**

WITH SPECIAL FOCUS: WHO OWNS DUBLIN OFFICES?

OCCUPIER TRENDS | INVESTMENT TRENDS | MARKET OUTLOOK

SUMMARY

1. Macro weaknesses in the Eurozone economy increase the likelihood of further monetary stimulus

2. Dublin is expected to be the fastest growing capital city in Europe between 2020-2035, with it's population predicted to rise by 18%

3. 355,000 sq ft transacted in Q2 to bring take-up at the half-way point of the year to 1.7 million sq ft

4. €257.1 million worth of office investment transactions changed hands in Dublin during Q2, with a number of large sales expected to boost volumes in the second half of the year

5. Our analysis of investment flows since 2013 shows the ownership structure of the Dublin office market to be globally diversified

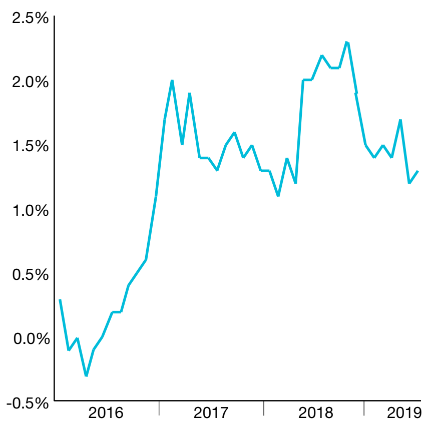
Q2 OVERVIEW

Despite a quiet second quarter, the first-half of the year sees the strongest-ever level of take-up.

Economy

Industrial production in the Eurozone beat expectations in May, increasing by 0.9% on the previous month according to Eurostat. It was not, however, enough to drag the index into positive territory on an annual basis, with a contraction of 0.5% recorded compared to May 2018. While production in Ireland increased by 8.2% annually, Germany saw a 4.3% contraction as global trade uncertainty hit output with other large European economies also facing headwinds. Inflation also remains weak, standing at 1.3% at the end of Q2, well below the ECB's target of close to, but under, 2%. This softness in the economy means that accommodative monetary policy measures will likely be re-introduced in Q3 in the form of interest rate cuts and quantitative easing. This will place further downward pressure on sovereign debt yields – Ireland's are already close to zero – and increase the relative attractiveness of risk assets such as Dublin office investments which currently trade at a risk premia of 4.0%.

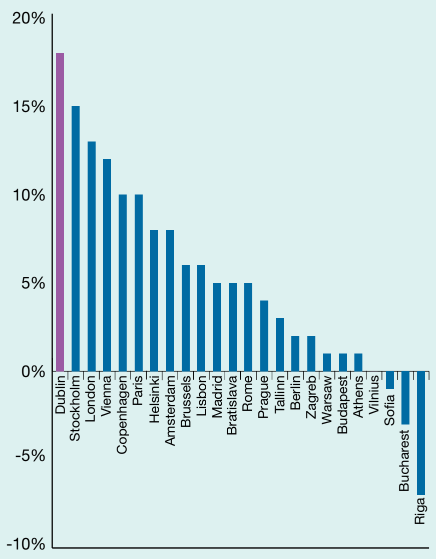
FIGURE 1
Eurozone inflation



Source: Eurostat

KNIGHT FRANK VIEW ON RISK

FIGURE 2
Forecast population growth of European Cities, 2020-2035



Source: UN

One of the most compelling reasons to invest in Dublin real estate comes from its positive long-run population growth prospects. Population forecasts undertaken by the United Nations show that, not only is Dublin expected to be the fastest growing capital city in Europe between 2020 and 2035, it is expected to be the fastest growing city of any of the 162 European cities greater than 300,000 people over the period.

Overall, the city is expected to grow by 18%, three times the average expected growth rate of 6%. Of course, while this is the most expected scenario according to the UN, it is just one of a number of paths that population growth may take. Consulting the CSO's Regional Population Projections published in June helps give a better understanding of the range of scenarios that may unfold, as it provides six scenarios for population growth in Dublin covering the same period as the UN forecast.

The primary determinants of these forecasts are based on three net inward migration scenarios of population growth at a national level (namely 10,000, 20,000 and 30,000 per annum) and are combined with internal distribution of this population growth under 'Dublin Inflow' and 'Dublin Outflow' scenarios. The latter are likely to be influenced heavily on whether infrastructural issues in Dublin – particularly those related to housing – are addressed.

The analysis shows that the 18% forecast by the UN is in-line with the third highest CSO projection for Dublin for the period, with the range of forecasts going from just 2% at the lower end to 28% under the highest scenario. The wide range in potential outcomes highlights that, while Dublin has the greatest potential according to the UN, it must undertake the necessary infrastructural investment for this potential to be realised.

Occupier market

355,000 sq ft of office space transacted in Q2, less than half the Q2 five-year average of 735,000 sq ft and the lowest quarterly figure since Q3 2014. However, due to the 1.4 million sq ft that transacted in Q1, it was enough to make it the highest-ever level of take-up for the first-half of a year.

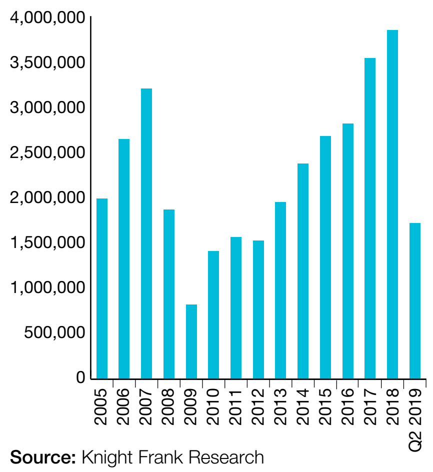
The largest deal of the quarter was the letting of 90,484 sq ft to Paddy Power at the Belfield Office Campus in Dublin 4, where they occupy 119,000 sq ft since moving their HQ from Tallaght in 2011. The latest letting comprises two deals, namely 49,291 sq ft at Blocks 7 and 8 on a short-term basis to accommodate staff while a 41,193 sq ft extension is being constructed at their current HQ and for which an agreement for lease has been signed.

Elsewhere, Genesis Aviation, became the first tenant at Block I, Central Park in Dublin 18, taking 24,706 sq ft at the recently completed building. The deal follows a €50.0 million investment in the firm by the Ireland Strategic Investment Fund last year, a move designed to support the company's plans to scale its business in Ireland. At Phoenix House in Dublin 8, the OPW have leased two floors of newly refurbished space from Bartra Capital totalling 22,683 sq ft. The remainder of the space in the 38,000 sq ft building is also occupied by the OPW, meaning that the State is now the sole occupant of the building.

It is noteworthy that three of the top five deals took place outside the city centre, with non-city centre locations accounting for a total of 62% of take-up. This is in contrast to Q1 when only 38% of deals were outside the city centre. The growing importance of the Coworking sector was again evident in Q2 with WeWork taking 17,139 sq ft at George's Quay House – their seventh deal in Dublin since entering the market in Q4 2017 – while Pembroke Hall took 15,946 sq ft at Ballast House. Unusually, TMT accounted for a low share of the market with just 9% of take-up as Professional Services took the top spot with 14%.

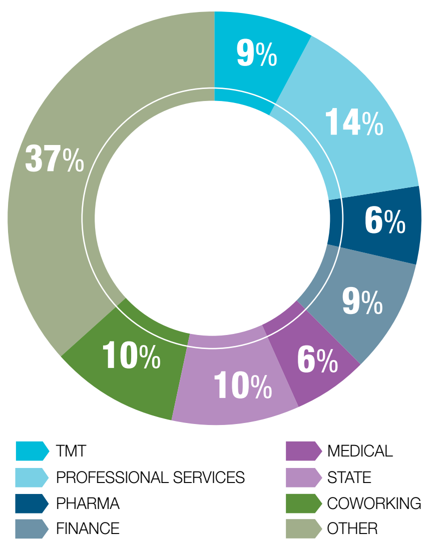
Coworking and the State let 10% each, while Finance comprised 9%. Pharma and Medical followed thereafter with 6% each. A wide variety of sectors accounted for the remaining 37% of take-up. Prime rents remained stable at €62.50 per sq ft.

FIGURE 3
Office take-up
sq ft



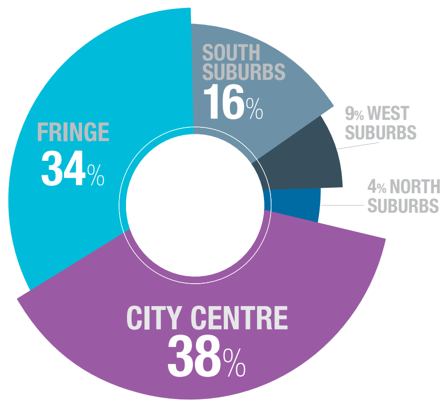
Source: Knight Frank Research

FIGURE 4
Take-up by sector



Source: Knight Frank Research

FIGURE 5
Take-up by location



Source: Knight Frank Research

Top 5 office leasing transactions

Property	Tenant	Sector	Size (sq ft)
Belfield Office Park, Dublin 4	Paddy Power	Other	90,484
Block I, Central Park, Dublin 18	Genesis Aviation	Finance	24,706
Phoenix House, Dublin 8	OPW	State	22,683
George's Quay House, Dublin 2	WeWork	Coworking	17,139
Ballast House, Dublin 2	Pembroke Hall	Coworking	15,946

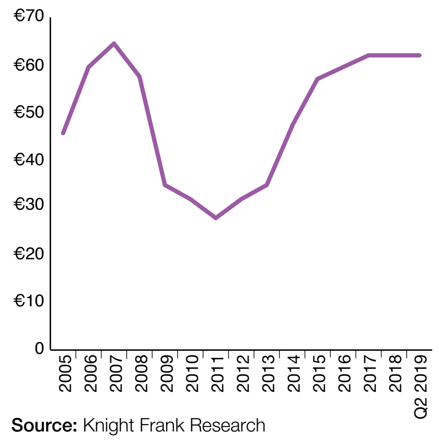
Source: Knight Frank Research

Development land

A number of notable applications obtained approval in Q2. Meyer Bergman, and Dublin-based partner BCP Asset Management, received planning for an additional 19,000 sq ft at their mixed-use office and retail development on Dawson Street which will extend to over 200,000 sq ft with completion due in Summer 2022.

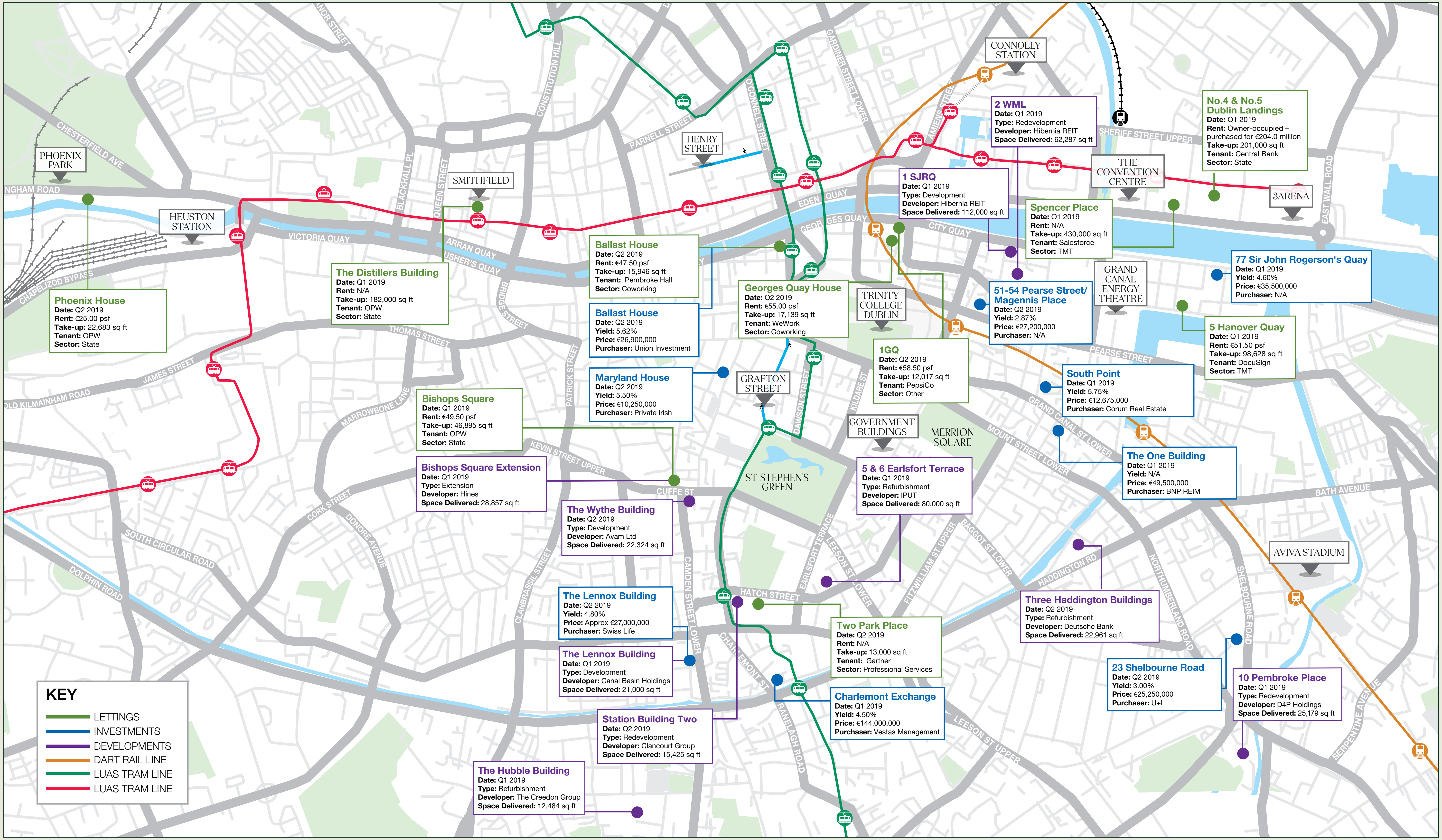
Hines obtained the green-light to proceed with their 115,000 sq ft Two Grand Parade project, while Ronan

FIGURE 6
Dublin prime office rents
€ per sq ft per annum



Source: Knight Frank Research

TOP TAKE-UP, INVESTMENTS AND DEVELOPMENTS IN H1 2019



Group Real Estate gained approval for their mixed-use development on Tara Street. Extending to 180,000 sq ft over 22 storeys, the scheme will be the tallest building in Dublin upon completion.

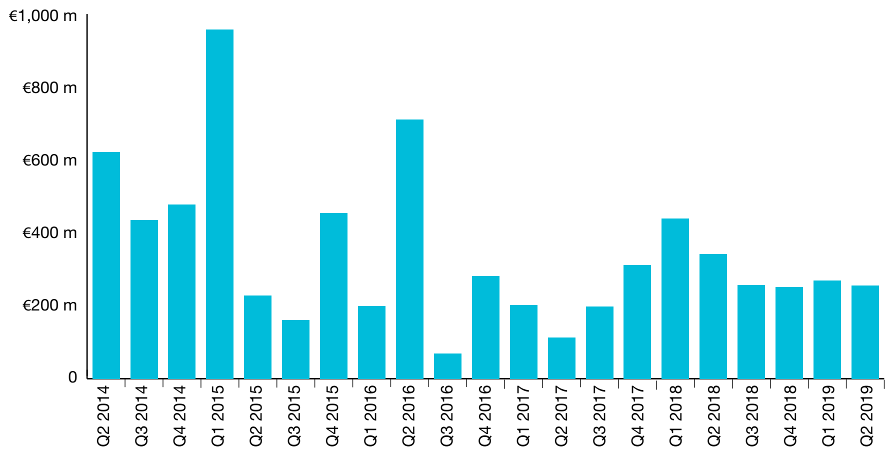
Investment

€257.1 million worth of office investment transactions changed hands in Dublin during Q2, bringing volumes for the first-half of the year to €529.2 million, accounting for 30% of the €1.8 billion spent on Irish commercial property investments over the period. Although the volume of Dublin office investments are a third lower when compared to the same period last year, there are a number of significant transactions currently in the pipeline that will boost numbers for 2019 should they be realised. Chief amongst these are Starwood Property Trust's €530.0 million portfolio of Dublin office assets and the sale of Green REIT which carries a Dublin office portfolio with a fair value of €1.2 billion.

While Irish buyers comprised the largest share of the market in Q2 – accounting for 42% of transactions – the diversity of the capital active was notable with UK, European and Asian buyers doing deals. Following their joint venture acquisition of Phoenix House in Dublin 8 last year, UK private equity group Henley along with joint venture partner Bartra Capital acquired a portfolio of 11 office assets in the Citywest Business Campus. The portfolio was bought from the original developers of the scheme – the Davy Hickey Property Group – as well as a private vendor for €105.0 million, in what was the largest transaction of the quarter. Elsewhere, U+I purchased 23 Shelbourne Road for €25.3 million from Friends First who recently refurbished the property having acquired it in 2016 for €18.0 million. In total, UK buyers accounted for 32% of the market.

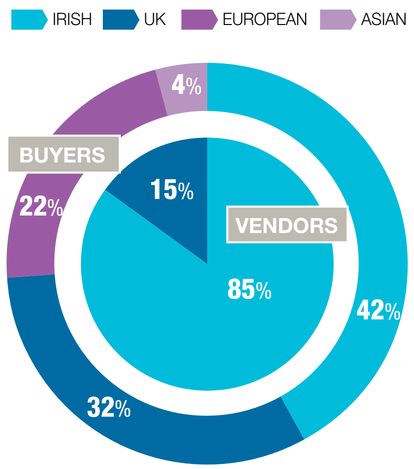
European Buyers comprised 22% of the market, supported by the acquisition of The Lennox Building and Ballast House. The Lennox building was purchased by Swiss Life for approximately €27.0 million for a net initial yield of 4.80%, while Ballast House was sold to Union Investments for €26.9 million with the deal representing a net initial yield of 5.62%. Both buildings are also occupied by coworking tenants – Iconic Offices and Pembroke Hall respectively – which demonstrates the growing importance of the coworking sector to the investment market.

FIGURE 7
Dublin office investment volumes



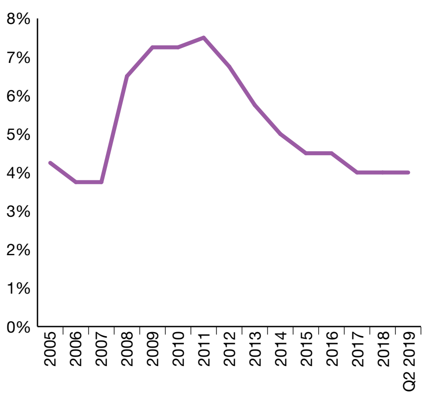
Source: Knight Frank Research

FIGURE 9
Buyer and vendor source



Source: Knight Frank Research

FIGURE 8
Dublin prime office yields



Source: Knight Frank Research

Top 5 office investment transactions

Property	Seller	Buyer	Approx. price
The Citywest Portfolio, Dublin 24	Davy Hickey Property Group & Private Vendor	Henley Bartra	€105.0m
51-54 Pearse St & Magennis Place, Dublin 2	Green Liffey Ltd	Confidential	€27.2m
The Lennox Building, Dublin 2	Canal Basin Holdings	Swiss Life	€27.0m
Ballast House, Dublin 2	Zetland Capital	Union Investment	€26.9m
23 Shelbourne Road, Dublin 4	Friends First	U+I	€25.3m

Source: Knight Frank Research

SPECIAL FOCUS: WHO OWNS DUBLIN OFFICES?

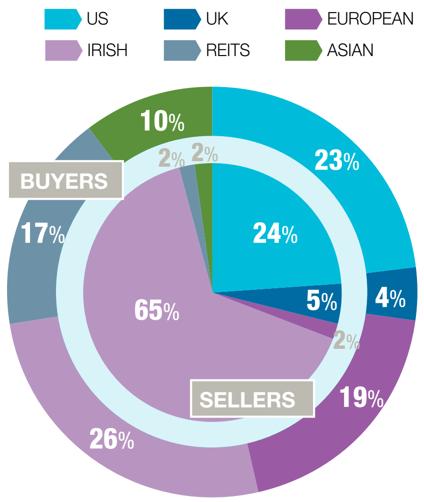
INTRODUCTION

While the previous commercial real estate boom and bust cycle in Ireland was largely comprised of Irish buyers and sellers (and financed by same), the investment market has seen a diverse range of capital sources active this cycle. This analysis examines the €8.5 billion worth of office investment transactions that have occurred in Dublin since 2013 – the year the investment recovery began in earnest – to understand the ownership structure of the current Dublin office market.

Following a summary of cumulative investment flows by region since 2013, the timing of acquisitions and disposals by each geographic source is then undertaken. This allows us to discover the net investment position by region and helps us understand the current ownership structure of Dublin's office market.

CUMULATIVE INVESTMENT FLOWS BY REGION

FIGURE 10
Cumulative investment flows, 2013 – H1 2019



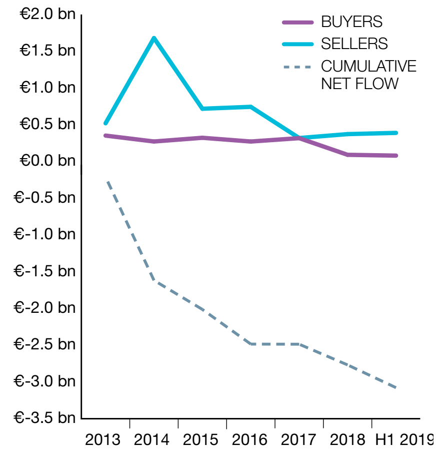
Source: Knight Frank Research

Irish direct investors in Dublin's office market have accounted for 26% of office purchases since 2013 compared to 56% for foreign investors, with REITs – who are mainly used by indirect foreign investors – accounting for the remaining 17% of purchases. The United States have been the largest direct foreign investors – accounting for 23% of purchases – followed by Europe (19%), Asia (10%) and the UK (4%).

Looking at sellers, it is no surprise that Ireland accounted for the majority of sales (65%), as NAMA deleveraged the country's exposure to the commercial real estate market. Interestingly, the United States accounted for 24% of sales so that their overall net spend was close to zero.

IRISH

FIGURE 11
Irish Dublin office investment flows

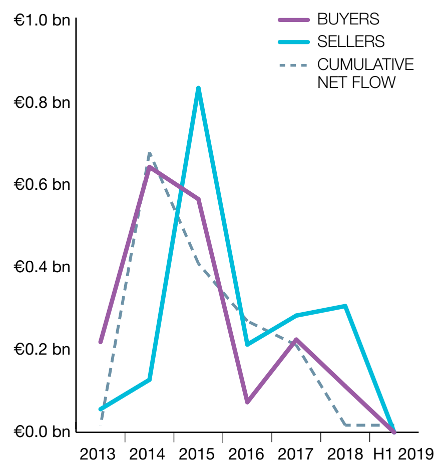


Source: Knight Frank Research

Ireland has been a net seller of Dublin office real estate since 2013 as Nama dominated the market, with €5.0 billion worth of assets sold compared to €2.0 billion purchased leaving a net reduction of €3.0 billion. Irish funds that were particularly active include IPUT and Irish Life who made a number of substantial investments during the period. Unlike other regions, Irish investors employ a variety of strategies along the risk-return spectrum, from core to opportunistic.

UNITED STATES

FIGURE 12
United States Dublin office investment flows



Source: Knight Frank Research

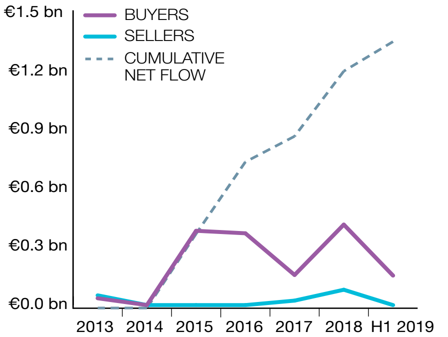
United States buyers were the largest source of private equity opportunistic capital and were net buyers in 2013 and 2014 and net sellers since then, in-line with the employment of a three to five-year investment strategy. While it is interesting to note that sales have equalled purchases so that the cumulative net flow is zero, the timing of the purchases and sales is important.

As they purchased early in the recovery – with capital values appreciating strongly since then – United States investors still retain a lot of equity in Dublin offices due to valuation gains. Furthermore, it is also worth bearing in mind that many United States buyers would have purchased a disproportionate amount of large bundled mixed-use portfolios before later re-trading them as individual office asset sales. This means that they would be included as office sales but not as office purchases, thus overstating the net reduction in Dublin office holdings.

EUROPEAN

FIGURE 13

European Dublin office investment flows



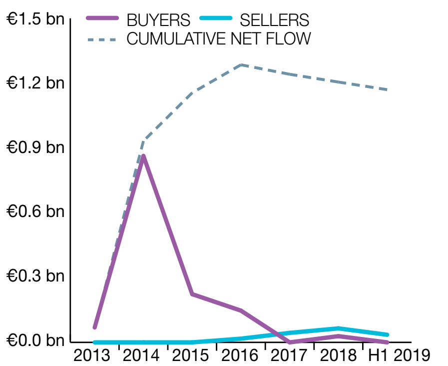
Source: Knight Frank Research

European buyers entered the market in a significant way in 2015 and have consistently built their exposure to the Dublin office market having spent a total of €1.5 billion since then. These buyers have been mostly comprised of pension funds pursuing core and core-plus strategies with a long-hold horizon. The attraction of Dublin to these investors is the absence of currency risk, the relative attractiveness of the spread of Dublin's office yield above the risk free rate and the availability of investment grade assets in Dublin due to the strong tenant mix present here.

REITS

FIGURE 14

REITS Dublin office investment flows



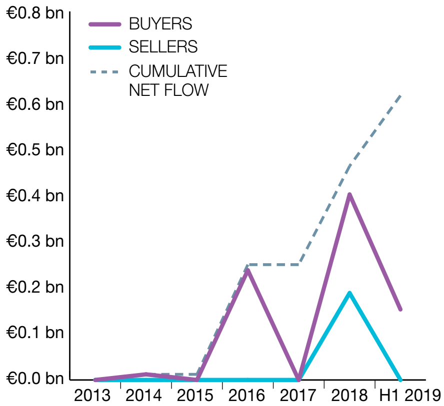
Source: Knight Frank Research

Hibernia REIT and Green REIT have made net purchases of €1.2 billion on the Dublin office market since 2013. By buying early – thus enjoying strong valuation revisions – and also by developing their own office assets, they now have a combined fair value of €2.4 billion worth of office investments according to their latest published valuations. The presence of the REITs has been an important part of the recovery in the market by enhancing liquidity and informational transparency.

ASIAN

FIGURE 15

Asian Dublin office investment flows



Source: Knight Frank Research

Asian buyers have been a relatively recent entrant to the market buying over €800 million on Dublin offices since 2016. Buyers have tended to gravitate towards the larger lot sizes, and mainly focused on core and core-plus strategies, although value-add capital is also active. With a focus on large lot sizes, liquidity is the key risk concern for them. The ever increasing number of Asian investors coming to the Dublin market over the past year is helping to mitigate this risk and, in a positive reinforcement loop, attracting further Asian buyers to participate in the market here.

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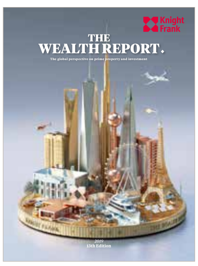

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