

Dublin Office Market

savills



Introduction

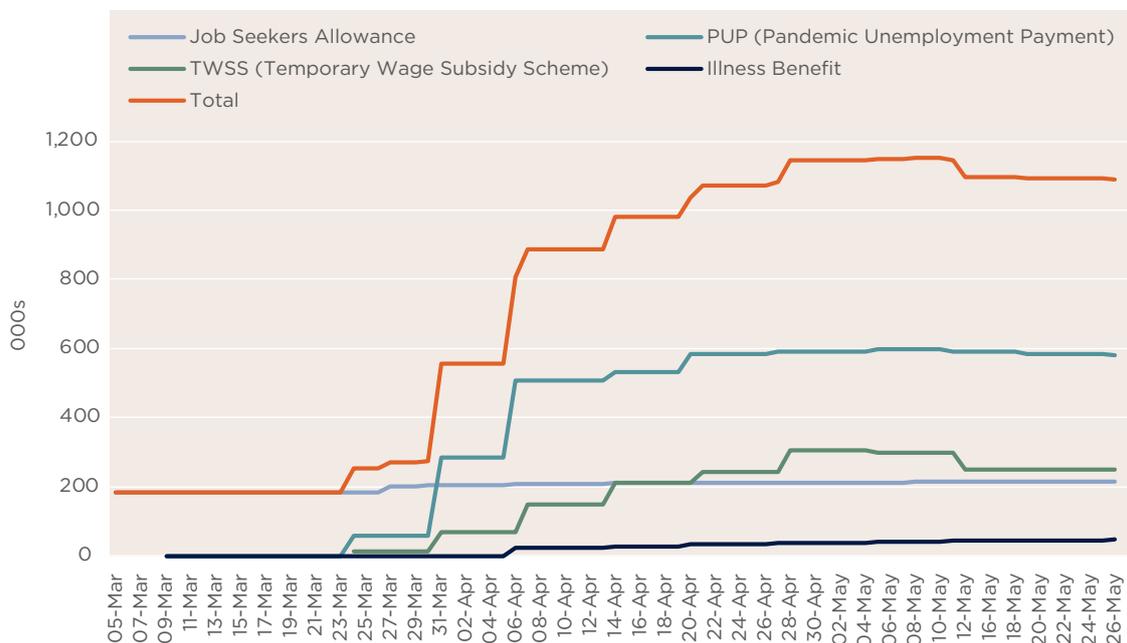
Coronavirus has wreaked havoc with the Irish and world economies. Pre-Covid Ireland had the fastest-growing economy in the EU - output rose by 5.5% and nearly 80,000 additional jobs were created in 2019. Robust growth fed into a surplus of €1.34bn which reduced the national debt to €204bn. Ultimately this fiscal space has helped the Government to react promptly to the sudden Covid crisis with a package of health service, social and business supports. To date around €15bn has been committed for these measures - although this figure will change as existing measures are tweaked, further measures are added, and the ultimate duration of the crisis period unfolds.

Ireland's fiscal response has been matched by many other countries. In addition, the major central banks have acted in unison to provide a global monetary stimulus with the ECB, the Federal Reserve and the

Bank of England all mobilising to inject financial liquidity.

The economic impact of the crisis is most clearly seen through the lens of the labour market. As shown in Figure 1, there are now over 1m workers on some form of income support - spread across four separate measures; the standard Job Seeker's Allowance, the sick pay scheme for self-isolation, the Covid-19 Pandemic Unemployment Payment (PUP) and the Revenue administered Temporary Wage Subsidy Scheme (TWSS). Notably, however, this figure appears to have peaked with the total number of persons on State income support schemes now beginning to edge lower. With the economy gradually re-opening from 18th May it seems that the most acute phase of this crisis has now passed.

Figure 1: Number of Persons in Receipt of Income Supports



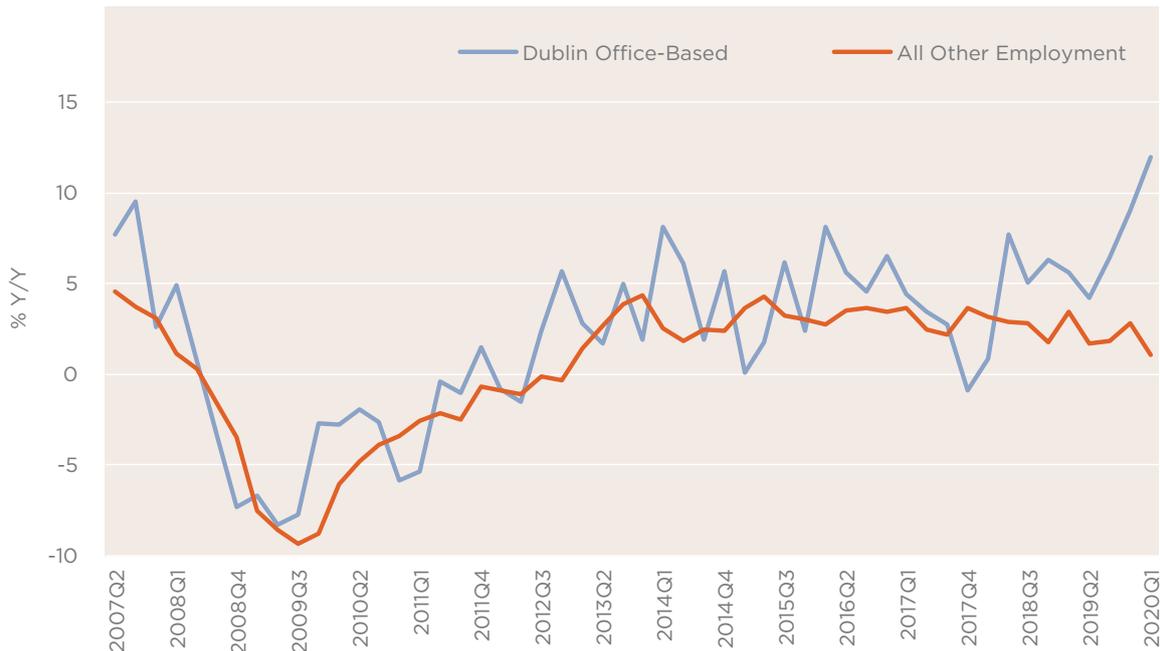
Source: The Department of Employment Affairs and Social Protection & Revenue Commissioners

Compared with other areas, office-based sectors have been more resilient to Covid disruptions. The public sector, professional services and technology companies which form a substantial part of the Dublin occupier base are better positioned than small consumer goods and personal services companies to keep working remotely, and the availability of TWSS has helped to mitigate redundancies in these sectors.¹

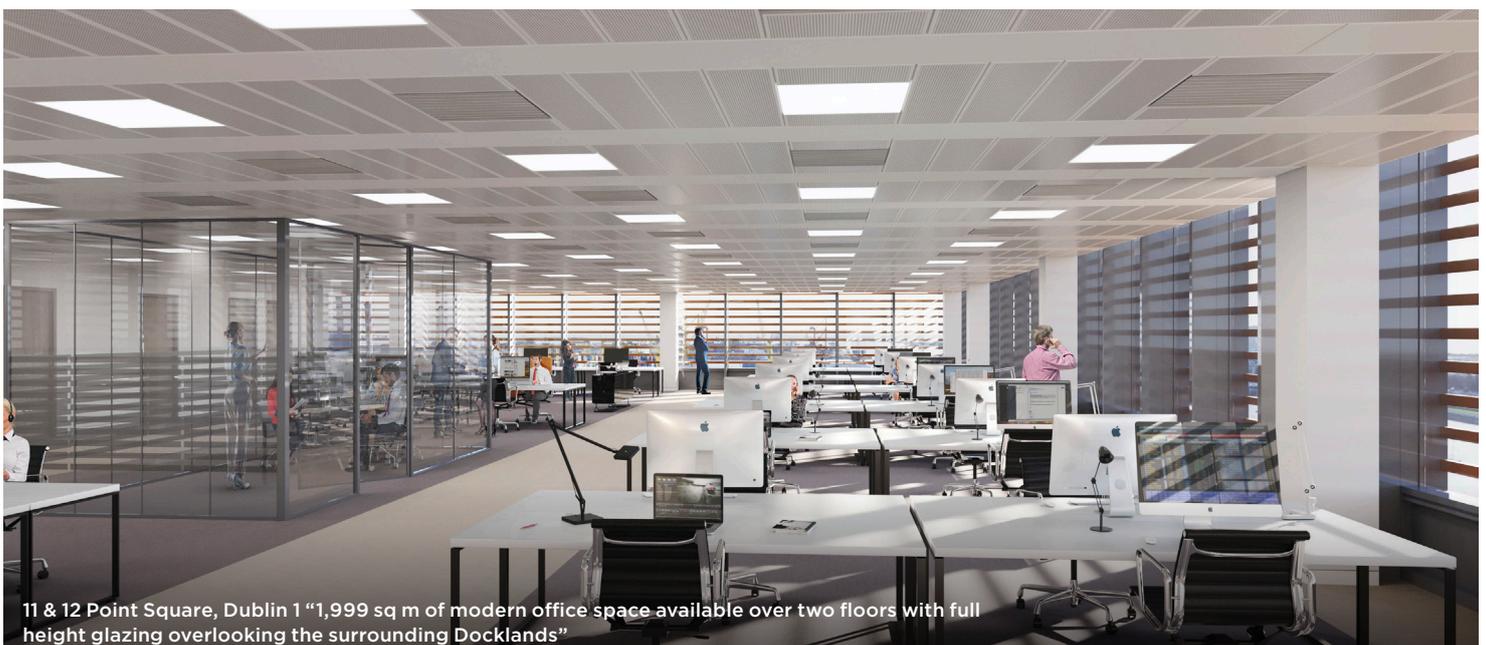
While there is clearly a major labour market disruption at present,

the 12 months to March saw strong employment growth with 51,600 additional jobs created. A remarkable 30,600 (59%) of these were office-based roles in Dublin and, as illustrated in Figure 2, growth in Dublin office-based employment (12%) comprehensively outstripped jobs growth in all other locations and sectors (1%). Indeed, this has now been a consistent trend for more than a decade. Even at standard occupancy rates, the jobs created the last 12 months should ultimately give rise to over 300,000 sq m of office space absorption in the capital.²

Figure 2: Growth in Dublin Office-Based Employment vs Growth in All Other Employment



Source: CSO



11 & 12 Point Square, Dublin 1 “1,999 sq m of modern office space available over two floors with full height glazing overlooking the surrounding Docklands”

¹ About half of all persons receiving the Covid-19 Unemployment and Enhanced Illness Benefit payments (49.2%) are concentrated in three sectors: Accommodation / Food Service, Retail / Wholesale and Construction. www.gov.ie/en/news/041fd1-update-on-payments-awarded-for-covid-19-pandemic-unemployment-payment/

² Our Q1 2019 report presented a detailed analysis of occupational density in the Dublin office market which is estimated at 10.3 sq m per office-based employee. Please see <https://pdf.euro.savills.co.uk/ireland-research/offices-mim-q1-2019-web.pdf> However, as discussed below, there is now potential for occupational density rates to reduce post-Covid.

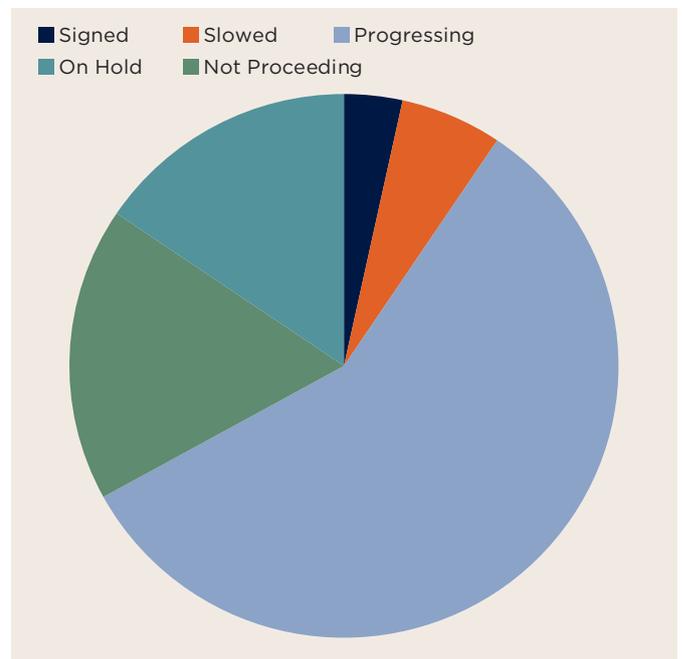


Market Activity - Demand

With coronavirus only emerging as a concern in late March, Q1 2020 saw 102,119 sq m of take-up – 75% above the 10-year average. Coronavirus has obviously created uncertainty around both the near-term and longer-term outlooks for office demand and Savills is closely monitoring in real time the impact of this on active demand and deal progress. Given the scale and scope of the shock it is unsurprising that some transactions have fallen away. Savills estimates that, out of the 88,448 sq m of leases agreed at end-Q1, 15,460 sq m have since fallen through. A further 13,730 sq m have been confirmed on-hold pending greater certainty on the impact of Covid-19. Inevitably progress has slowed on many other transactions. However leasing deals are still happening with six leases being signed since the announcement of restrictions. These include two that made it into the Q1 tally; Software company Guidewire took just under 7,900 sq m at Semple Exchange in Blanchardstown and Ellucian signed for 747 sq m at 45 Mespil Road. A further 11,340 sq m of space has been agreed in Q2 and 3,037 sq m of space has been contracted in April. Furthermore some notable deals which are progressing through legals should be signed despite Covid concerns as they are driven by impending lease events and expansions. Overall, the pace of lettings can be expected to pick up as the global economy begins to re-open – although our base case is that the post-Covid re-animation will be gradual and, potentially, non-linear.

The Q1 lettings translated into net absorption of 42,565 sq m. This is nearly twice the 10-year quarterly average and we would expect the completion of pre-lets from 2018 and 2019 to provide support for net absorption going forward. However the construction hiatus during lockdown could delay the pace at which these projects complete. This will also delay uncommitted pipeline space turning into vacant standing stock which might ordinarily then create downward pressure on rents. The space still has to compete for occupiers whether it is finished or not.

Figure 3: Current Status of End-Q1 Active Office Requirements



Source: Savills Research

Market Activity - Supply

On the supply-side 31,720 sq m of new space was completed in Q1 2020, which was offset by 3,493 sq m of demolitions, resulting in net completions of 28,227 sq m for the quarter. With net absorption

outstripping net development the amount of vacant space fell in the quarter and the vacancy rate dropped from 8.6% at the end of 2019 to 8.1% in Q1 2020.



Rents

With vacancy rates below their natural level, theoretically there should be upward pressure on rents. However, even before Coronavirus, agents reported no movement in prime headline rent figures during 2019 with landlords prioritising longer lease terms, rental caps-and-collars etc.. Prime headline rents of up to €650 per sq m per annum were still being achieved for the best buildings in the best locations in Q1 2020, although most CBD lettings are at rent levels which are below this in the range of €550 psm pa - €600 psm pa. Typical rent-frees were at most 1 month per year certain (effectively 8-9% of annual headline rent).

Developers with buildings that have reached, or are nearing practical completion, and who are not hampered by supply chain issues and slower building programmes are taking a resolute position on rents for now. Not being as credit fuelled as the last cycle, and with lenders showing some forbearance in the short-term, this tactic is advisable, especially as Covid containment measures make building viewings more difficult in practical terms. The consensus view is that the Covid related economic turbulence will pass. Meanwhile the US election and a Brexit trade deal should also be concluded by next year. So any weakness in office demand may be momentary and, in this context, it would be prudent for developers to incentivise deals rather than cut rents.

WORKING FROM HOME (WFH)

The possible long-term implications of Covid-19 for office demand are now being intensely debated. On one hand there are arguments that widespread working from home (WFH) will mainstream the concept, ultimately allowing companies to scale-back their office space requirements. Many large occupiers were already facilitating remote working before the Covid outbreak. However their experience was that staff mostly wanted to do this on Mondays and Fridays, meaning that the office footprint had to be maintained at a level that covers the peak mid-week headcount on-site. It remains to be seen whether roster systems can be implemented to manage this trend, allowing WFH to translate into reduced office-space demand.

However there are also counter pressures to the adoption of WFH; Given the variation in employees' childcare responsibilities and remote-working set-ups, the sudden closure of offices at the onset of Covid-19 has resulted in some people having a negative WFH experience. More generally, the protracted lockdown experience may actually reinforce perceptions of the need for a central location that facilitates communication, collaboration, socialisation and training.³

Given increased sensitivities to workplace biohazards employers may also seek to pursue social distancing by de-intensifying their use of office space after the pandemic has passed. In this case Covid-19 could feasibly lead to an increased demand for office space.

³ In a recent study by NUI Galway the top 3 challenges to remote working for employees were; not being able to switch off from work, difficulty collaborating and communicating with colleagues and poor physical workspace. Survey respondents also indicated that productivity at home was lower during lockdown due to simultaneously managing childcare and work. See McCarthy, A., Ahearne, A., Bohle Carbonell, K., Ó Siocháin, T. and Frost, D. (2020). Remote Working During COVID-19: Ireland's National Survey Initial Report. Galway, Ireland: NUI Galway Whitaker Institute & Western Development Commission.

Long Term Covid Effects: What Agents Are Hearing

OCCUPIER & LANDLORD CONSIDERATIONS

The long-term impact of Covid-19 remains to be seen and current sensitivities could pass once a medical solution becomes available. For now, landlords and tenants will be researching the long-term implications but also focusing on a number of short-term factors around the design and management of their buildings, which should not be construed as permanent solutions.

Sanitation

Social distancing and cleaning protocols will be a concern in all workplaces, but particularly those in multi-let buildings where the sharing of common areas (including receptions, lobbies, lifts, toilets) is unavoidable. We are likely to see an increased focus on easy-clean fit-outs with design features, surface materials and technologies that facilitate sanitation. Otherwise cleaning routines will drive up service charges in the short-term, potentially impacting on achievable rents.

There could be a move towards toilets being located within individual demises, allowing multi-let occupiers control the design and management of their own facilities. However retrofitting this into existing buildings is unlikely as it would require substantial reconfiguration of the building core.

Lifts

Lift capacity may have to be reduced to preserve social distancing and minimise the mixing of staff in multi-lets. In post-Covid China the lifts in some office buildings are currently only allowed to run at 50% capacity. To facilitate contact tracing lift operation is also likely to move towards an access control model. Large occupiers within multi-let buildings may seek their own dedicated lifts. This will be at the expense of longer waits, especially in tall buildings. Some occupiers may use this opportunity to encourage greater use of the stairs which brings health and wellness benefits. Reduced lift capacity may also lead to staggered staff arrival and departure times to prevent rush hour backlogs. In Ireland, where low-rise buildings prevail, we do not foresee restricted lift use being an issue in multi-tenanted buildings provided staircases can be utilised effectively.

Transport

Safety concerns may result in more use of private cars, bicycles, walking etc., although the latter are limited by Ireland's climate and our dispersed pattern of residential development. As there is limited city centre parking, a sustained nervousness about public transport may increase the attraction of suburban offices which have more car parking. However avoiding public transport is unrealistic for many employees and a sustainable long-term solution either requires an effective vaccine or reliable protective equipment which allows people to commute with confidence.

Occupational Density

Pre-Covid the average office employee in Dublin was allotted 10.3 sq m of space. Indeed some new buildings were being designed for occupancy ratios as high as 5 sq m per person. However implementing social distancing may require occupiers to review their operational density ratios. In North America Savills has observed density ratios of up to 1:40 sq m, with 1:20 potentially becoming more normal.

While these may be transitional arrangements, it is likely that some elements of social distancing are here to stay, meaning that occupiers may have to re-work their office layouts. In a reversal of trends over the last 20 years there may be less emphasis on open plan and shared/communal space and more focus on cellularisation of office spaces and teams, limiting untraceable mixing. Management of office footfall flow and one-way systems through office floorplates (illustrated via signage) will be explored by tenants. Even the operation of barista stations and canteens, and the use of pooled delph/crockery etc. will be carefully re-considered.

Air Conditioning

There has been speculation about the potential for Covid-19 to spread through air conditioning systems. This could lead to demand for increased filtration, more frequent fresh air changes, and possibly, a move from four pipe fan coil to VRF which can operate as a self-contained system on a floor by floor basis (although the latter tends to have a shorter lifespan which can be an issue for some occupiers). If lower occupational densities became usual, the need for cooling would decrease and new developments, especially in the suburbs, may revert to natural ventilation and narrower office floors as would have been the norm in the 1970s and 1980s. As well as being environmentally friendly such approaches could reduce initial design and installation costs, as well as ongoing operation and maintenance costs. The reduced initial mechanical and electrical costs could help to maintain the viability of office buildings if rent pressures emerge, with flexibility for occupiers to choose air-con or more natural, non-centralised, lower cost and sustainable set-ups.

Locational Strategies

Some large international banks have already indicated their intent to move away from mammoth centralised HQs to smaller buildings spread over different locations within cities. This could lead to a decline in the city campus style of occupation that many Tech companies prefer and that are evident in Dublin. Indeed we had already seen some of the larger Tech firms open new suburban hubs and this trend could develop, especially if car parking and cycling become more important to employees than public transport routes.

We expect much debate on these topics over the months ahead, led by occupiers who have responsibilities to their staff. Responding to this, developers will have to make big calls on design specifications. Developers should use the period ahead to at least consider how they could make their buildings more compatible with post-Covid sensitivities. Nonetheless Savills' view is that, although many short-term initiatives will be implemented to facilitate a return to work, these should not be interpreted as permanent features as they may only be required until social distancing measures begin to relax. Some initiatives may remain post-Covid, particularly as legal and HR functions will be sensitive to their duty of care as employers. However, in time we expect a return to more standard working arrangements which encourage interaction, collaboration and a more relaxed working environment. Longer term concerns about the privacy and cybersecurity risks of working from home may also motivate this. Increased flexibility will inevitably form part of this long-term vista, but it will not replace the functionality of the office workplace, which has always evolved to accommodate changing occupier demands.

Re-Opening Offices: Lessons from China⁴



3

separate shifts



Single entry/exit
points



Thermal imaging
cameras



50%

Reduction in
lift capacity



Air conditioning
turned off.
Ventilation through
open windows for
certain time periods

⁴ Savills has a well established presence in Asia with 30,000 staff in the region.

Landlord Recommendations

There has been a flight to size in recent years, with average letting increasing from 985 sq m in 2014 to 1,718 sq m in 2019. While this trend is expected to continue, with many leading tech firms expanding their footprint in Ireland, Covid-19 is likely to make smaller indigenous occupiers more cost conscious. In this context flexible buildings can prove very successful for landlords. Buildings with efficient, regular shaped floorplates and centralised cores can be readily split for a multi-tenant approach on floor-by-floor or part-floor arrangements. Landlords with older buildings that offer this flexibility could also benefit from increased occupier demand for basic space at a lower price point. Occupiers’ budgets are likely to contract and this will affect the fit-out costs and plans. Landlords that can offer flexible fitted office space will benefit from this.

When the economy softens our experience is that occupiers become unwilling to take ‘swing space’ in excess of their immediate requirement. In this environment flexible buildings where party walls between demises can move tend to win out. Centralised cores tend to facilitate this better. So, while larger floorplates will remain the preference, buildings with centralised cores that facilitate adaptable splits, as opposed to side cores which had been gaining popularity due to increased line-of-sight visibility across the office, should gain more leasing traction. Side cores also reduce the available window frontage and daylight if seeking to cellularise. Naturally ventilated buildings are also easier to split without mechanical and electrical circuits having to be reconfigured.



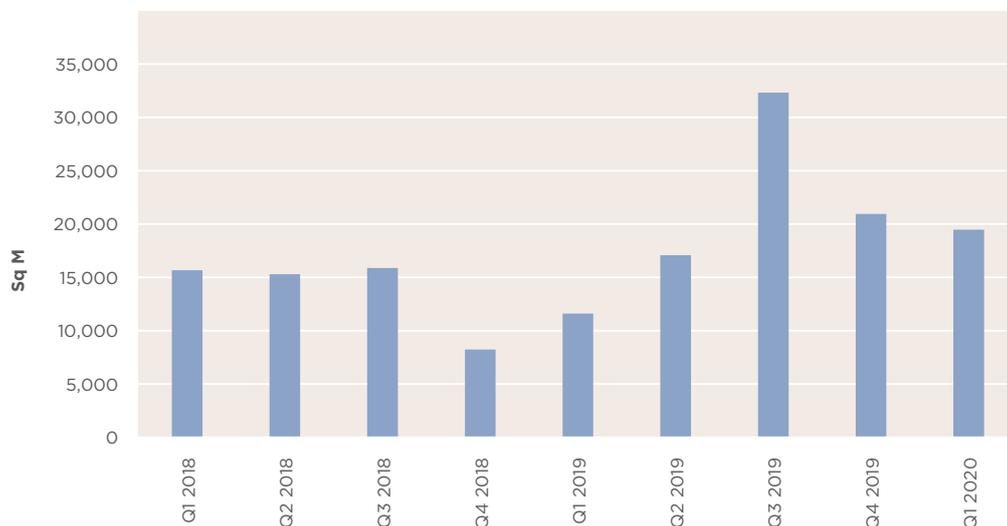
Outlook

The Dublin office market had momentum coming into Q1 2020, and this was reflected in an above average take-up and a falling vacancy rate. While the fundamental attractions of Dublin as an office location remain unaltered by Covid, uncertainty, postponement of business decisions and the practical difficulties associated with viewing accommodation will inevitably lead to lower take-up in Q2.

On the supply-side, Savills originally anticipated that approximately 308,400 sq m of new office space would be delivered in 2020. However, although construction has re-opened from May 18th, there has been a

lengthy hiatus and social distancing and supply chain disruption will continue to interfere with output going forward. Therefore our 2020 completions forecast has been reduced by approximately 33% to 205,000 sq m. Indeed this could slip further depending on the productivity implications of social distancing on-site. There is much debate in construction circles about whether each day of lockdown will add 1, 1.5, 2 or even more days to the programme when the sites re-open. There are no clear answers yet.

Figure 4: Availability of Tenant-Offered Grey Space



Source: Savills Research



Kildress House, Dublin 2 “A stunning new development of 2,064 sq m, situated in Dublin’s central business district.”

One factor that could potentially feed through as additional supply is tenant-offered ‘grey space’ (by way of sub-let or assignment). Grey space tends to be offered fitted and on a short-term basis by tenants as a means of cutting their overhead costs. The rents can be competitive as the parties offering this type of space are generally not concerned about valuation impacts. And, in such uncertain times, there is a demand for this type of space from occupiers who do not want to spend heavily on fit-outs and whose future headcount is unclear. However some leases restrict occupiers’ ability to put their excess space on the market. Moreover, relative to the sub-rent that can be generated, the cost of adapting fit-outs may make the whole exercise uneconomic. So, although Heads of Real Estate may wish to contribute to cost reduction through releasing space, this can be easier said than done in practice. The best chance of success with these deals occurs where the fit-out of the available space closely matches the potential sub-tenant’s requirements.

Savills continuously tracks the availability of tenant-supplied grey space. As shown in Figure 4 just under 19,500 sq m is currently available - only 6% of total vacant stock. It is possible that the availability of tenant-offered space could start to rise due to the Covid related economic

setback. However given the small amount of existing grey space and the impediments occupiers face in mobilising such space, Savills’ view is that grey space is unlikely to become a key driver of vacancy in the short-term.

Looking ahead, our central case has always been that vacancy would creep up gradually through 2020 due to more balanced fundamentals. Looking beyond the Covid pandemic, this remains our view. The current supply hiccup will pass. Meanwhile, notwithstanding the current global crisis, Dublin remains an attractive office location and the factors that made it a target for inward investment (the low Corporation Tax rate, use of the English language and Common Law system, close cultural ties with America, a young demographic and a long and successful track record of attracting FDI) will remain intact post Coronavirus and will continue to draw multinational office occupiers to Dublin.

There may be some short-term pressure on rents, particularly for secondary stock. However an expected strong economic recovery in 2021, and a more benign external environment post-US elections and clarification on the EU’s trading arrangement with Britain, suggest a bounce in rents once this period passes.

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