Q2 DUBLIN OFFICE MARKET 2023

BNP PARIBAS REAL ESTATE

Q2 2023 KEY TRENDS

Leasing remains subdued.
39,330 SQ M TAKEN IN Q2.
Brings H1 total to 65,853 sq m; -27% y/y

TECH REMAINS INACTIVE
accounting for just 12.6% of Q2 2023 take-up

FINANCIAL AND PROFESSIONAL SERVICES
have become more active, taking up some of the slack

However, these requirements are typically smaller,
LEADING TO A FRAGMENTED MARKET & SMALLER DEALS

LESS VALUE-ADD
from leasing as churn, downsizing deals and grey space make up more of the market

'GREY SPACE' REMAINS ELEVATED
relative to long-term average

Significant completions scheduled for H2 2023 will drive
VACANCY RATE TO ~15% BY YEAR END

PRIME HEADLINE RENTS REMAIN AT €646-€673 / SQ M / ANNUM
but y/y growth has reset to zero

Effects of rising vacancy visible in
SHORTENING LEASE TERMS AND INCREASED RENT FREE RELATIVE TO LEASE TERMS

MARKET ACTIVITY

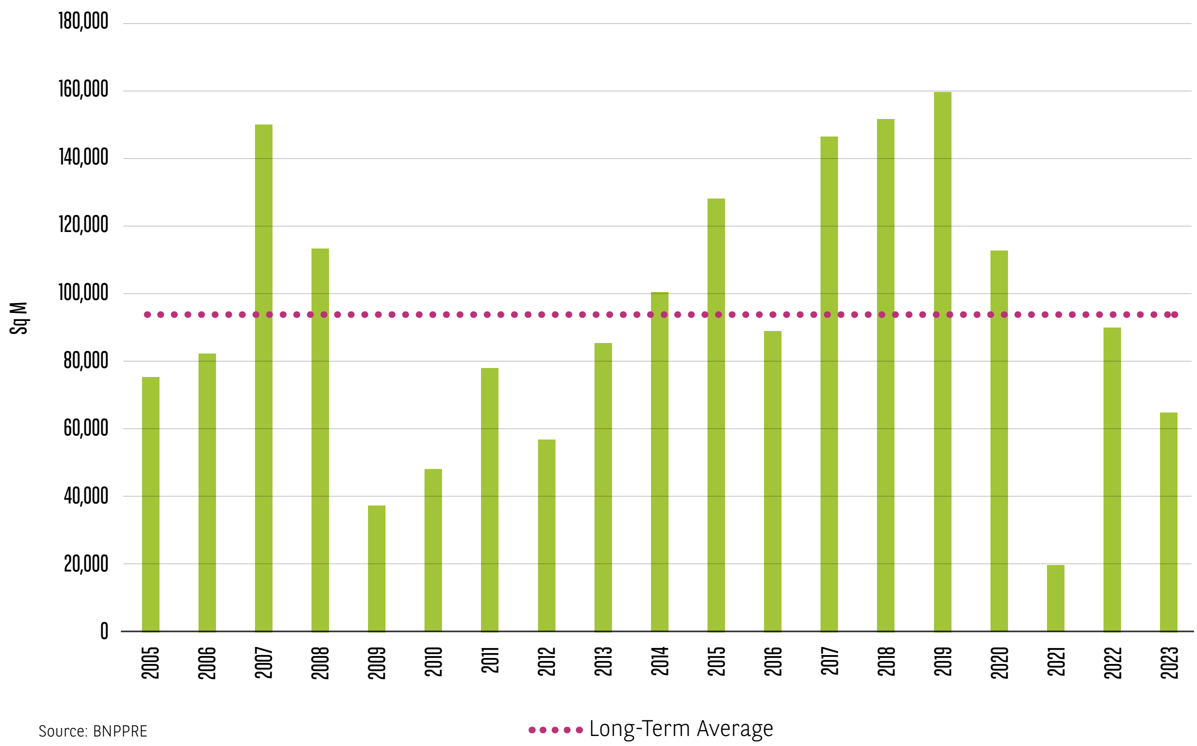
JOHN MCCARTNEY
Director & Head Of Research
BNP Paribas Real Estate

As predicted in our Q1 report, office leasing in Dublin picked-up somewhat between April and June. Nonetheless, it remains subdued by historical standards, with less than 40,000 sq m taken. Considering H1 as a whole, 65,853 sq m of purpose-built space has been leased since the start of the year. This represents a 27% discount on H1 2022 which, in itself, fell short of the long-term average.

39,330sq m

TAKEN-UP IN DUBLIN IN **Q2**

FIGURE 1: H1 OFFICE MARKET TAKE-UP - DUBLIN

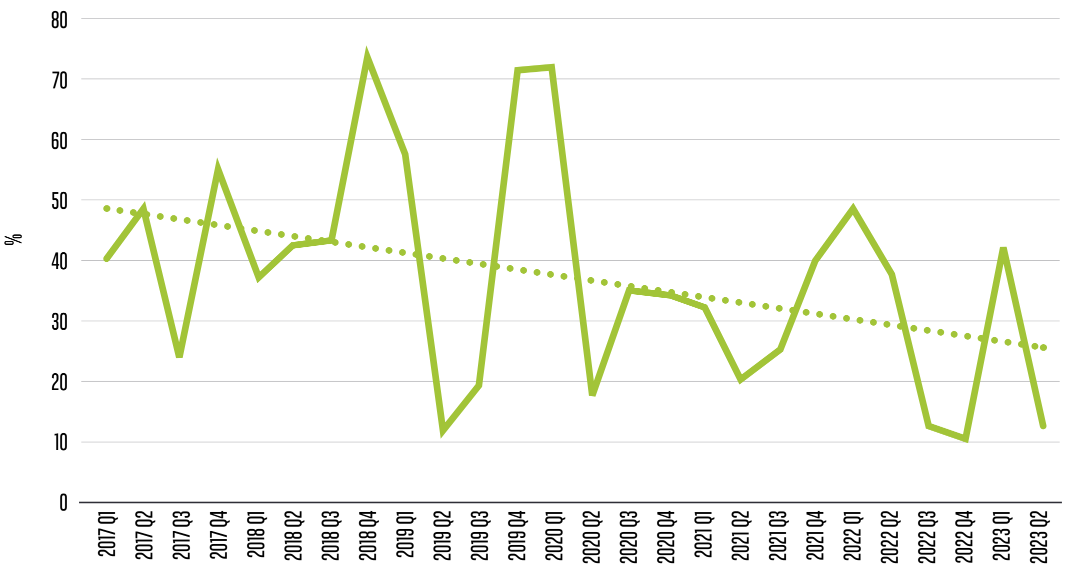


Source: BNPPRE

Despite the reduced quantum, agents were kept busy with 97 lettings in the first half; an almost identical number to H1 2022. This can only mean that the average deal size fell; from 945 sq m in H1 2022 to 679 sq m in the first six months of this year.

As previously flagged, the contraction in leased space, and deal sizes, reflects a pronounced shift in the sectoral composition of office demand. Between 2017-2020 tech firms accounted for 53% of Dublin office take-up, incorporating over 610,000 sq m of space. However, they have only taken 123,749 sq m since the start of 2021, and this trend continued in Q2 2023 with less than 5,000 sq m let to technology operators, accounting for just 12.6% of take-up.

FIGURE 2: TECH SHARE OF TAKE-UP



Source: BNPPRE

There are several reasons for the tech pull-back. Firstly, many global tech brands moved to establish large office campuses in Dublin ahead of recruitment in the pre-pandemic years. Examples include LinkedIn (c. 52,500 sq m at Wilton Park, in 2017 & 2019), Meta (c. 81,000 sq m at Fibonacci Square, Ballsbridge, in 2018) and Salesforce (c. 43,700 sq m at Spencer Place in 2019). Even in a benign macro environment, this would have dampened their business space requirements in the years that followed.

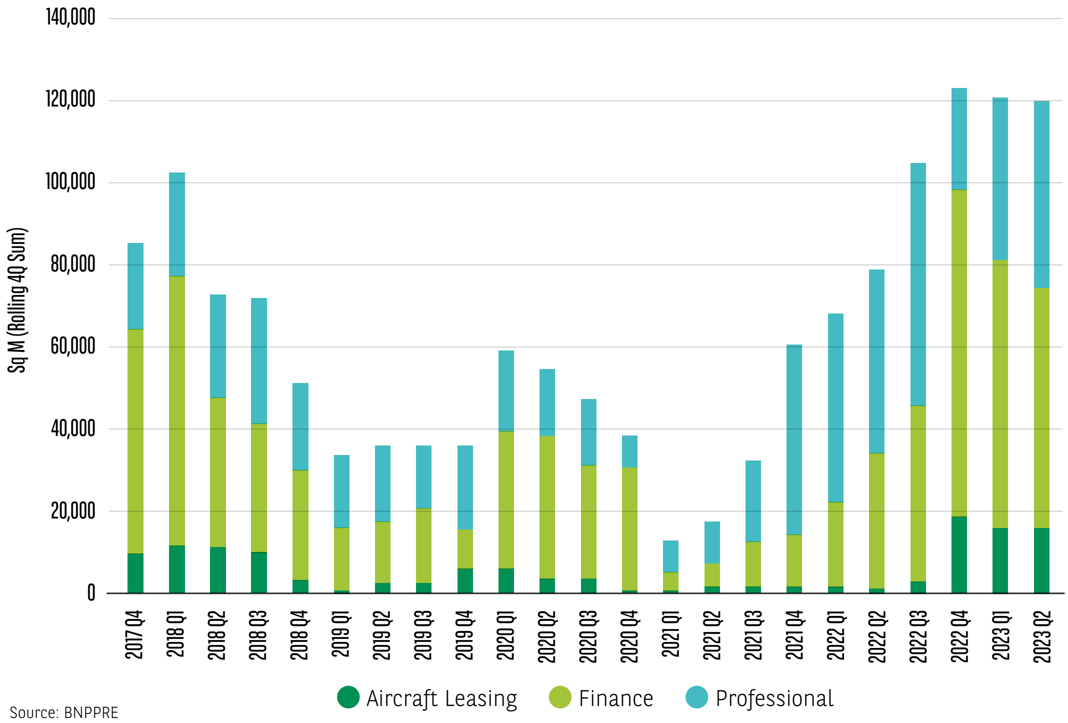
Secondly, after booming during the pandemic, the global tech industry slowed sharply in 2022, triggering a worldwide spate of jobs announcements. Ireland escaped the immediate pain, with net ICT employment only falling by 1,900 (1.5%) between its peak last August and May 2023. Nonetheless sectoral turbulence has almost certainly resulted in Dublin having fewer tech employees today than would otherwise have been the case.

Thirdly, by their nature, technology jobs are amenable to remote working, and research confirms that remote and hybrid strategies are most extensively used in the ICT industry. By facilitating a reduction in the office-space-per-employee ratio the post-Covid increase in remote working has, *ceteris paribus*, subtracted from ICT office demand.[1]

While the tech slowdown has left a vacuum, Dublin's office market benefits from a diverse occupier base. Policy decisions in the 1980s to develop an internationally traded financial services sector have led to the establishment of large scale funds management, insurance, asset finance, AML / compliance and wholesale banking operations in Dublin. Similarly, the pioneering success of Guinness Peat Aviation has made Dublin an international hub for aircraft leasing with over 60% of the world's leased aircraft now being managed from here. Growth in these activities, along with the continued requirements of local professional services firms, has generated significant additional office demand to mitigate the fall-off in tech requirements.

[1] See Working Remotely - CSO - Central Statistics Office. It should be noted that this effect is dampened somewhat by significant remote working in the tech industry already prior to Covid.

FIGURE 3: DUBLIN OFFICE TAKE-UP - GROWTH SECTORS



Source: BNPPRE

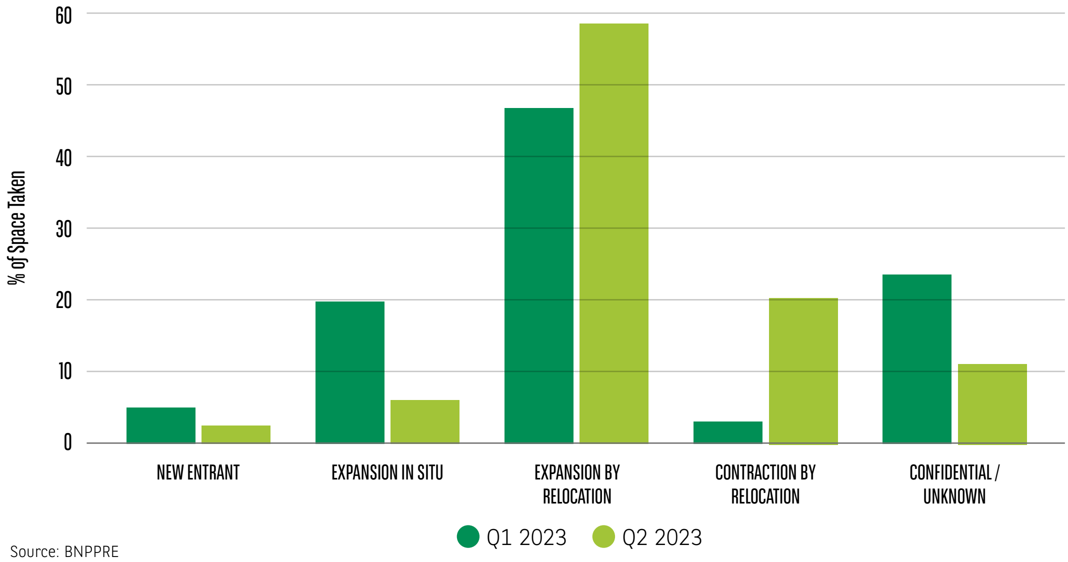
NET ABSORPTION

While take-up is a prerequisite for office space absorption, movement within the market, downsizing, and sub-letting can materially reduce the extent to which gross leasing translates into increased occupied space. There is a clear hierarchy in how different types of letting feed through to absorption. At the most positive end of the sale, lettings by occupiers entering the market for the first time feed directly into net absorption, as do those by occupiers expanding in-situ. Lettings by organisations that are moving to facilitate expansion also add to occupied space. But their impact is diluted by the vacated space that is put back on the market. At the negative end of the continuum, even though they contribute to take-up, downsizing moves subtract from net absorption. This is because, by definition, more space is handed back than taken.

Figure 4 provides mixed news about the composition of Q2 lettings. On the bright side, more than two-thirds of the leased space involved new entrants and expansions. However, the bulk of expansions were relocations, resulting in vacated space being handed back. Moreover there was a 12 percentage point rise in the proportion of lettings involving this type of 'churn' between Q1 and Q2.

Downsizing moves accounted for 21% of the space that was leased in Q2. This represents a big increase from 3% in Q1 and, while one should not infer too much from two data points, it is an important trend to watch. Over three years have passed since the onset of Covid-19 and it is reasonable to assume that many organisations are now settling on their preferred remote strategies. If these involve increased offsite or hybrid working, and if employee headcounts are not increasing sufficiently to offset this, we might now begin to expect a rise in downsizing transactions.

FIGURE 4: TAKE-UP BY TENANT ACTIVITY

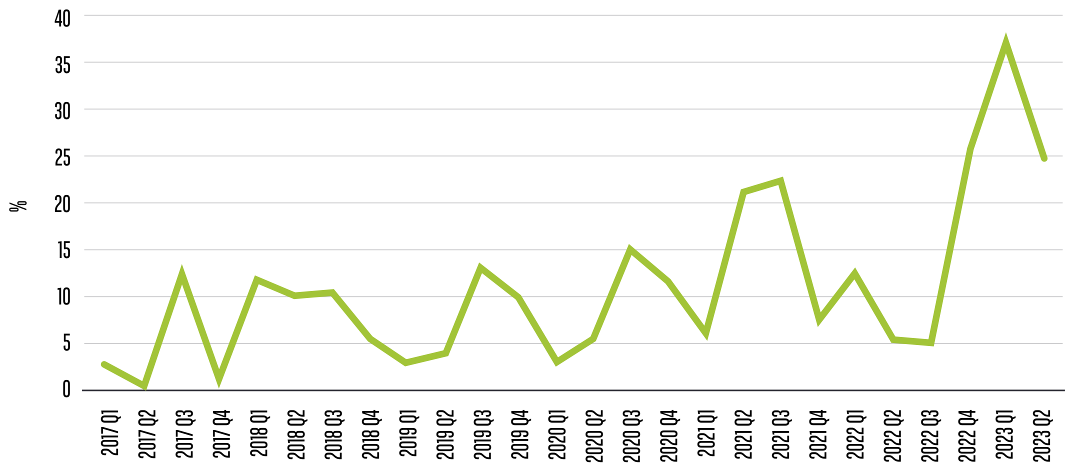


Source: BNPPRE

'Grey space' (i.e. space offered by tenants through sub-leasing / assignment) can also drive a wedge between take-up and net absorption. Custom-and-practice is to include sub-leased space within take-up. But it cannot be counted in net absorption (the change in occupied space) as it was already leased and income-producing before being sub-let.

As mentioned in our last report, cyclical factors and the structural shift to hybrid working have left office occupiers in many jurisdictions with surplus business space. In markets where shorter leases are the norm, tenants can quickly 'right-size' as leases expire. However in Ireland, where lease contracts are longer, 'right-sizing' is achieved in the short-run through sub-letting / assignment. Over the last two years many occupiers in Dublin, including some of the large tech firms mentioned above, have availed of this mechanism. This continues to be the case, and the share of sub-leased / assigned space within take-up remained elevated in Q2. This can be expected to eventually feed through to higher vacancy as grey space competes with traditional landlord marketed space, slowing the rate at which that accommodation is absorbed.

FIGURE 5: SUB-LEASED / ASSIGNED SHARE OF TAKE-UP

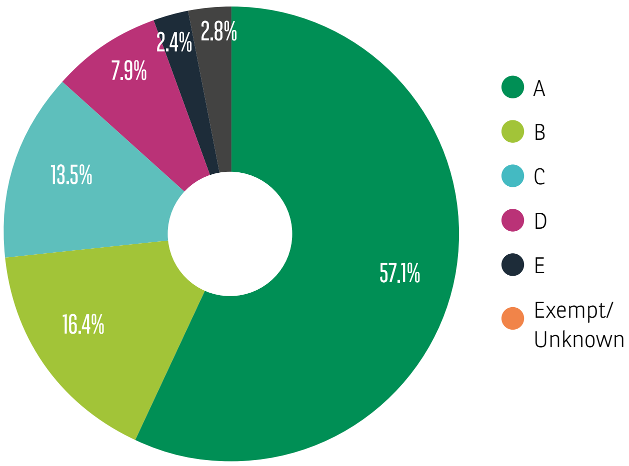


Source: BNPPRE

GREEN BUILDINGS

As has been well flagged, occupier preferences have shifted strongly in favour of low-carbon offices in recent years. Reflecting this, almost three quarters of the purpose-built space leased in Dublin over the last 18 months has been BER A or B rated, and in the city centre / docklands, this figure rises to over 80%.

FIGURE 6: DUBLIN OFFICE LETTINGS Q1 2022 – Q2 2023 BY BER RATING



SUPPLY AND VACANCY

With completion delayed on several buildings originally scheduled to finish in Q2, just under 30,000 sq m of new office space has been delivered in the first half of 2023. The impact of this on total stock has been significantly neutralised by the removal of some older buildings from stock. This includes the demolition of the former Garda HQ at Harcourt Square and the decommissioning for refurbishment of the A&L Goodbody offices at 25-28 North Wall Quay. Notwithstanding sluggish lettings, and a reduced conversion rate between lettings and net absorption, the result has been a proportionately bigger increase in occupied space than the total standing stock. Consequently the vacancy rate has edged down from 12.4% last December to just over 12.1% in June.

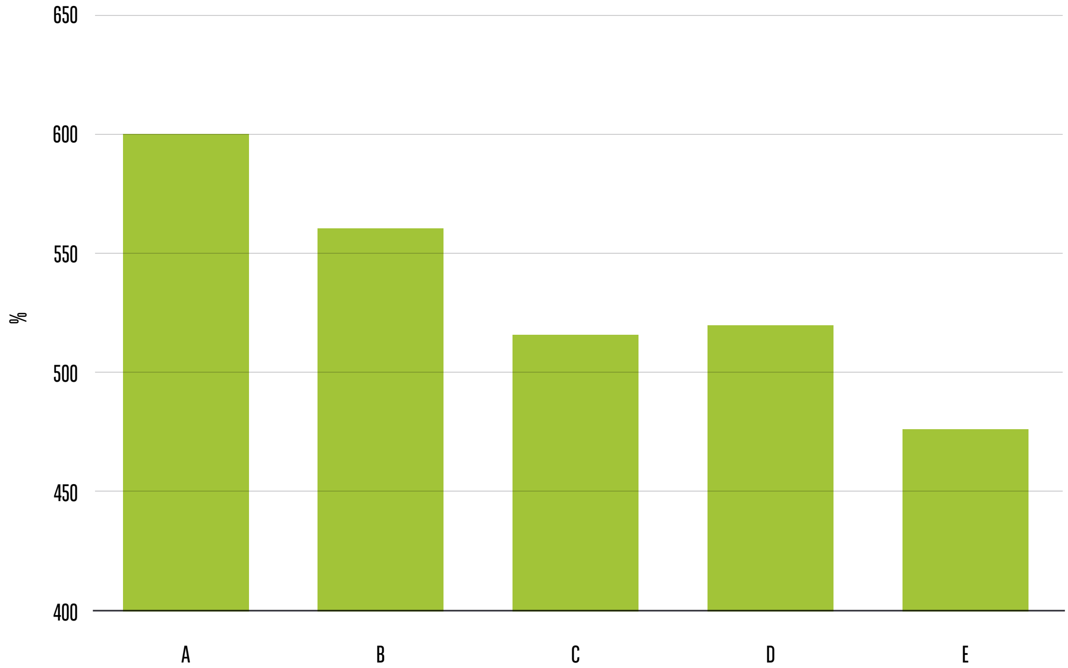
However, this comes against the run of play, and should be seen as an anomaly of timing. Deferred completions from H1, in combination with schemes already rostered to deliver in the second half of 2023, should result in strong office space completions for the remainder of the year. We believe around 200,000 sq m of new space will be delivered in 2023, which is likely to propel vacancy towards 15%.

RENTS AND LEASE TERMS

Reflecting their ESG commitments, global occupiers remain heavily focused on modern, low carbon offices in prime city centre and docklands locations. As these buildings remain relatively scarce, prime headline rents held-up at €673 per sq m per annum in Q1 2022.

However there are important caveats. Firstly, with the Q2 2022 uplift in prime rents dropping out of the annual comparison, the year-on-year increase in prime headline rents has now rebooted to nil.

FIGURE 7: AVERAGE HEADLINE RENTS FOR DUBLIN CITY CENTRE OFFICES BY BER – Q1 2022 – Q2 2023

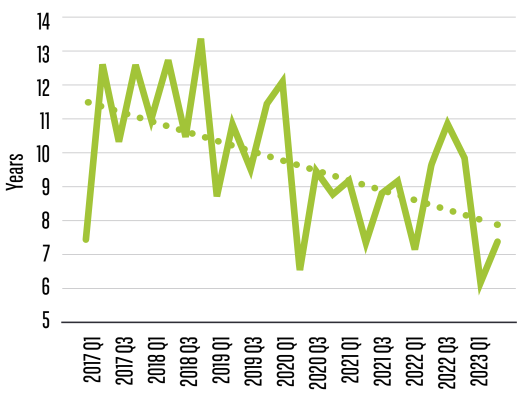


Secondly, as illustrated in Figure 7, rents attainable for older buildings with lower sustainability ratings are significantly less than those that can be achieved for prime Grade A stock, and these older buildings represent the majority of Dublin's office stock.

Thirdly, important elements of market pricing are not reflected in the simple headline rents measure.

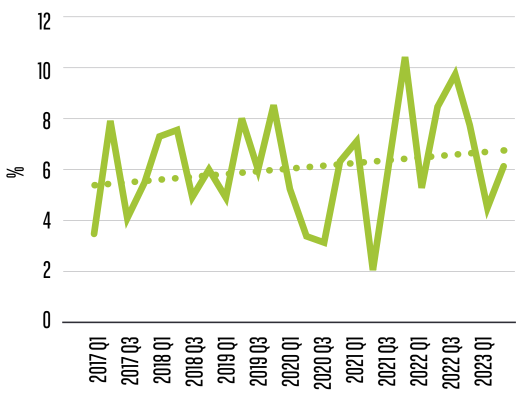
As shown in Figures 8a and b, even in prime city centre locations, the market has moved in favour of tenants with lease terms reducing sharply and with landlords being forced to offer bigger rent frees relative to the reduced terms.

FIGURE 8a: AVERAGE LEASE TERM – CITY CENTRE / DOCKLANDS



Source: BNPPRE

FIGURE 8b: RENT-FREE MONTHS AS A PERCENTAGE OF LEASE TERM – CITY CENTRE / DOCKLANDS



Source: BNPPRE

OUTLOOK

Ireland's labour market has continued to outperform in the post-Covid period, with the number of desk jobs rising by 15% since Q1 2020, compared with an EU average of 6.9%. Twenty-eight percent of Ireland's employees now work in desk-based sectors, compared with an EU average of 24.6%. However, despite these positive fundamentals, vacancy has risen faster in Dublin's office market than in most other locations in Europe.[2]

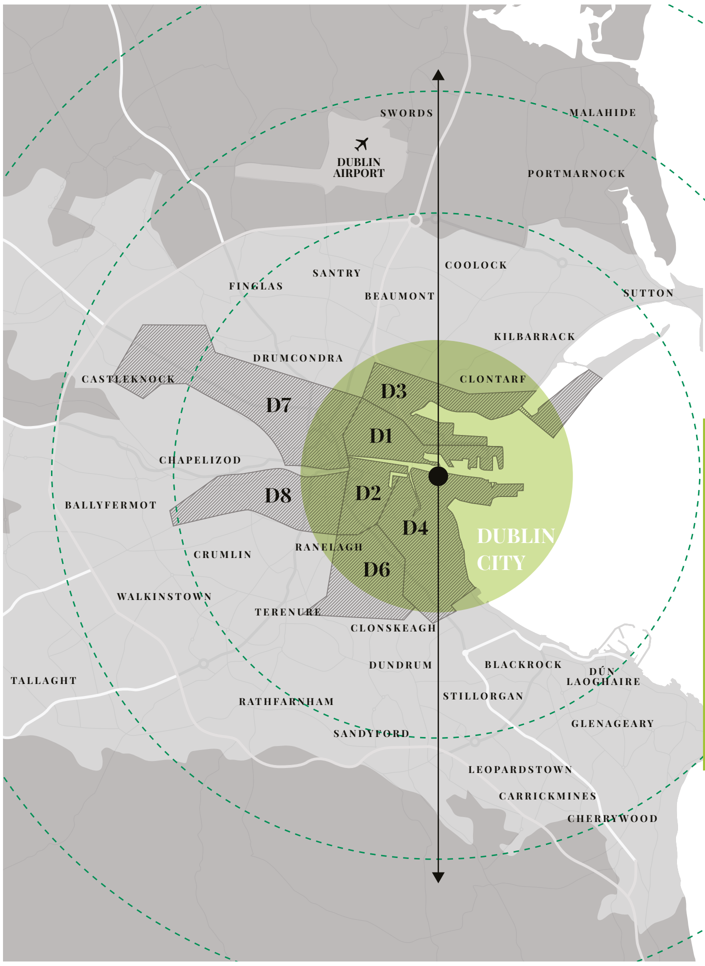
In part, this derives from weaker demand. Whereas office take-up across Europe fell by 24.6% between H1 2022 and H1 2023, Dublin has suffered a 27% decline. There are two main reasons for the slowdown in lettings. Firstly, as discussed above, Dublin is an established global technology hub. This will pay long term dividends as technology, by its nature, will keep advancing and creating commercial opportunities. Indeed, based on stock market valuations, the global tech industry is already recovering strongly from last year's turbulence. In the short term, however, this turbulence has disproportionately impacted the Dublin market because of the weighting of ICT firms within the occupier base. Secondly, as Illustrated in Figure 9, Ireland has been the EU's biggest adopter of remote working since Covid, which partially offsets the impact of service sector employment growth on office demand.[3] This reflects the fact that Ireland has the EU's second highest proportion of tertiary educated employees (53.4% vs EU average of 37.7%) who are more likely to be able to work remotely,[4] and perhaps also the fact that 46% of Ireland's employees are aged under 40 compared with an EU average of 41%.

FIGURE 9: CHANGE IN PERCENTAGE OF WORKERS SOMETIMES / USUALLY WORKING FROM HOME 2022 VS 2019

Source: Eurostat

While weaker demand has played a role, the supply side has also contributed to the rise in Dublin office vacancy. 2022 was the strongest year for Dublin office completions since 2008 with c. 200,000 sq m delivered. Notwithstanding a quiet Q2, completions will be similar this year. Even allowing for a 3% increase in reserved space during Q2, the prospect of at least one large (c. 20,000 sq m) pre-let to come, and the seasonal end-year lettings boost (56.1% of annual leasing historically happens in H2), we believe that 2023 take-up will land between 150,000 – 170,000 sq m. This will not be sufficient to absorb the net additional space that is delivered. As such the vacancy rate will kick-up towards 15% by year-end. This is likely to put pressure on rents, even at the prime end of the market. Once again, however, the long-term picture remains positive. In particular, the office construction pipeline falls away considerably from 2024, and this will see vacancy peaking at fairly manageable levels later this year / early next year before beginning to retreat again.

[2] Dublin offices are too dear and sales at the prime end of the market have effectively paused – The Irish Times
[3] 36.2% of employees were sometimes or usually working from home in 2022 vs 19.9% before Covid in 2019.
[4] The incidence of remote working in Ireland is highest among managers, professionals and associate professional / technical workers – both pre and post Covid 19. See Working Remotely - CSO - Central Statistics Office



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2023 Q2 Take-Up

39,330 sq m

DUBLIN CITY (DUBLIN 1,2 and 4)	DUBLIN FRINGE (DUBLIN 3,6,7 and 8)	SUBURBS
15,743 sq m	8,318 sq m	15,269 sq m
40%	21.1%	38.9%

“ With reserved space edging up between Q1 and Q2, and with H2 traditionally being the busier period, 2023 take-up is likely to be in the 150,000 – 170,000 sq m range ”

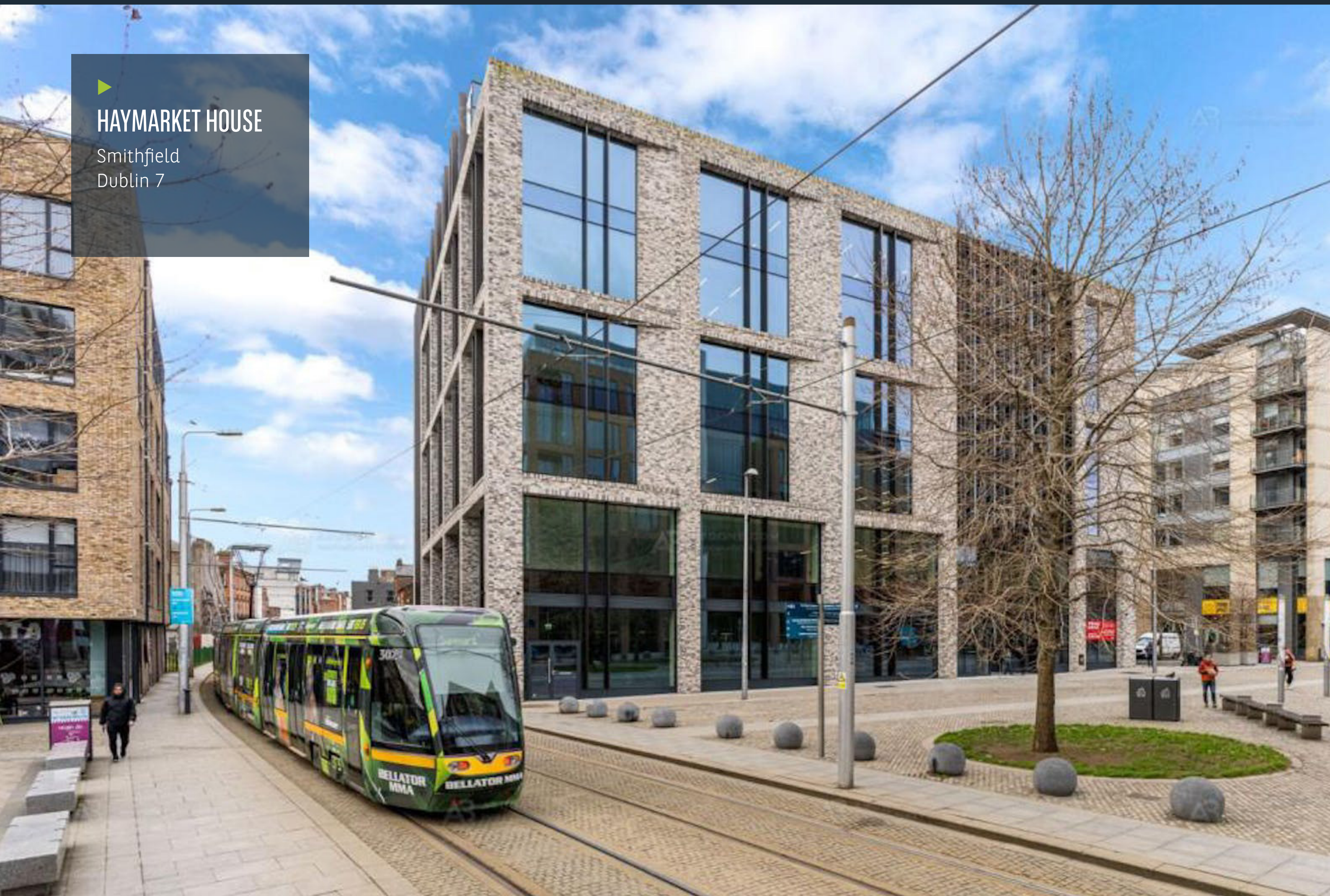
JOHN MCCARTNEY
Director,
Head of Research,
BNP Paribas Real Estate Ireland

“ There is now very clearly a two tier market with large corporate occupiers prioritising low-carbon, energy efficient buildings, and this is evident in the most recent leasing statistics ”

KEITH O’NEILL
Executive Director,
Head of Office Agency,
BNP Paribas Real Estate

TOP 10 DEALS Q2 2023

	BUILDING	LOCATION	TENANT	SQ M	BER RATING
1	Haymarket House, Smithfield	Dublin 7	NTA	7,395	A
2	Cadenza, Earlsfort Terrace	Dublin 2	KKR	3,645	A
3	Termini, 3 Arkle Road, Sandyford	Dublin 18	Jacobs International	2,834	A
4	Harcourt Square, Harcourt Street	Dublin 2	KPMG	2,518	A
5	4th & Part 5th Floor, 2 Stemple Exchange, Blanchardstown	Dublin 15	Synopsys	2,127	A
6	2nd Floor, The Refiector, Hanover Quay	Dublin 2	Air BnB	1,658	A
7	1 WML, Windmill Lane	Dublin 2	SCOR	1,336	B
8	The Loft, Dundrum	Dublin 16	Western Union	1,050	C
9	1st Floor, 3090 - 3094 Lake Drive, Citywest	Dublin 24	Adobe Systems Software Ireland Limited	1,044	B
10	Part 3rd Floor, Block 5 Irish Life Centre	Dublin 1	Apex Fund Services	1,041	A



HAYMARKET HOUSE
Smithfield
Dublin 7

	CITY CENTRE	SUBURBS
Highest Rents	€662 per sq m pa	€363 per sq m pa
Number of Deals	21	28
Average Deal Size	750 sq m	545 sq m
Typical Lease Term	15/20 years	10/15 years
Typical Lease Break	7/10 years	5 years

* Grade A sustainable buildings.

SPACE TAKEN BY DEAL SIZE AND LOCATION

	<500 SQ M	500 / 999 SQ M	1,000 / 1,999 SQ M	2,000 – 4,999 SQ M	5,000 – 9,999 SQ M	>=10,000 SQ M
City Centre	4,014	1,532	4,035	6,162	0	0
City Fringe	922	0	0	0	7,396	0
Suburbs	4,985	3,230	2,094	4,960	0	0

THE REFLECTOR
Hanover Quay,
Dublin 2

BNP PARIBAS REAL ESTATE

57 Adelaide Road
Dublin 2, Ireland
+353 1 661 1233
realestate.bnpparibas.ie

PSRA No: 002702

DR. JOHN MCCARTNEY
DIRECTOR & HEAD OF RESEARCH
BNP PARIBAS REAL ESTATE

T +353 1 661 1233
M +353 87 974 8485
john.mccartney@bnpparibas.com

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KEITH O'NEILL
EXECUTIVE DIRECTOR
HEAD OF OFFICE AGENCY

T +353 1 661 1233
M +353 86 857 9696
keith.oneill@bnpparibas.com

JOHN CANNON
ASSOCIATE DIRECTOR
OFFICE AGENCY

T +353 1 661 1233
M +353 87 396 6725
john.cannon@bnpparibas.com

AMY KERR
GRADUATE SURVEYOR
OFFICE AGENCY

T +353 1 661 1233
M +353 87 127 4246
amy.kerr@bnpparibas.com

FIONN FINLAY
GRADUATE SURVEYOR
OFFICE AGENCY

T +353 1 661 1233
M +353 87 375 2829
fionn.finlay@bnpparibas.com

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