Q3 DUBLIN OFFICE MARKET 2023

BNP PARIBAS REAL ESTATE

1 GRAND CANAL SQUARE
Image courtesy of IPUT Real Estate Dublin

Q3 2023 KEY TRENDS

LEASING REMAINS SUBDUED
Q3 Take-up down by two-thirds
94,464 sq m taken YTD - down 43%

NO DEALS OF >= 5,000 SQ M
Average deal size halves

TECH ACCOUNTS FOR JUST 8.4% OF TAKE-UP
lowest share since quarterly records began

WEAK TAKE-UP AND ELEVATED SUB-LETTING
Dragging on net absorption

BUDGET CONSCIOUS NEW ENTRANTS
smaller parcels of lower grade space

DOWNSIZERS VERY FOCUSED ON
'less-but-better' accommodation

VACANCY UP TO 12.5%
set to peak at c.16% next year

PRIME HEADLINE RENTS REMAIN AT €673 PER SQ M PER ANNUM
Lease terms moving in favour of tenants

PEAK VACANCY OVERHANG WILL BE RELATIVELY MODEST
but it may take longer to digest than in previous recovery cycles

MARKET ACTIVITY

JOHN MCCARTNEY
Director & Head Of Research
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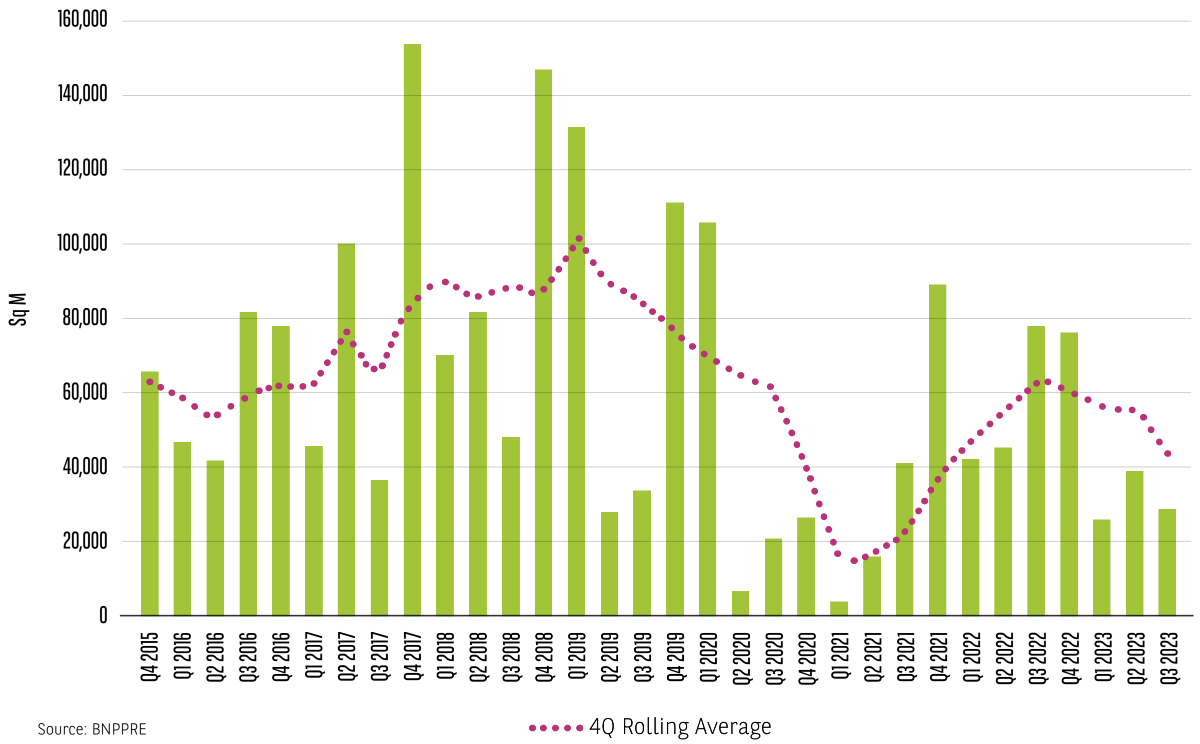
With Q3 traditionally accounting for less than one-fifth of the year's take-up, and with remote working, a dormant ICT sector and the slowing economy all dragging on demand, office leasing was expected to remain subdued in Q3 2023. This is what transpired with just 28,817 sq m let between July and September – a 63% drop compared with Q3 last year. Ignoring 2020, which was impacted by Covid, 2023 now accounts for two of the four slowest quarters for leasing in Dublin over the last decade.

28,817 sq m
TAKEN-UP IN **Q3**

FIGURE 1: OFFICE MARKET TAKE-UP - DUBLIN

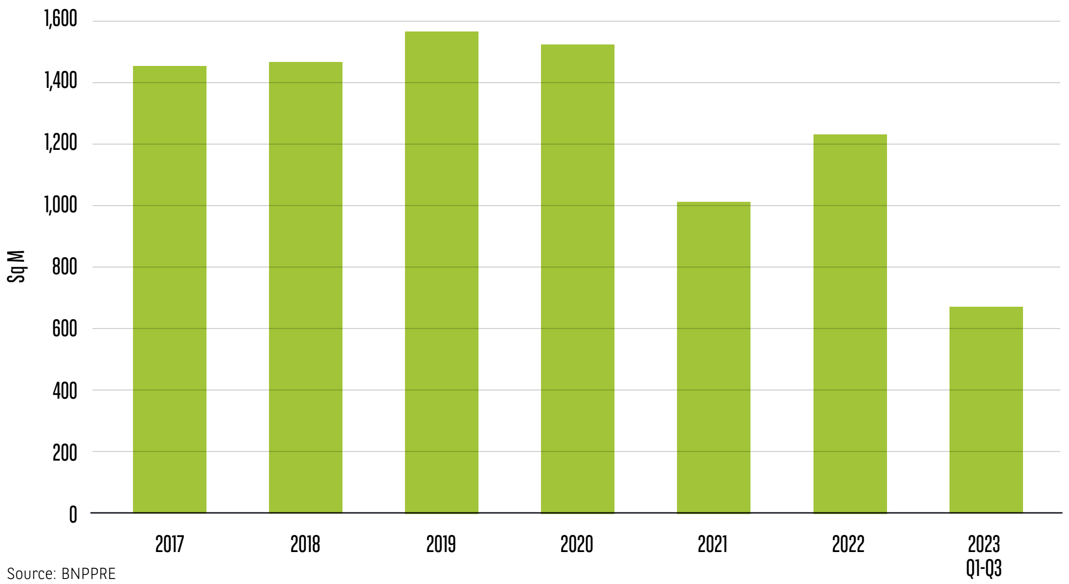


Source: BNPPRE

Despite sharply reduced leasing volumes, 140 deals have been done over the first three quarters of the year - line-ball with 2022 and only slightly behind the pre-Covid average. Inevitably, this means that the average deal size has fallen – from 1,236 sq m in 2022 to 675 sq m in the year to date. This has practical ramifications for both landlords and brokers. For their part, landlords who have been seeking single tenants for large office blocks are having to pivot towards multi-let strategies. Meanwhile brokerages which thrived in the pre-pandemic era from large corporate deals and global service contracts are having to re-discover their traditional agency skills.

Several factors are impacting the average deal size. Firstly, there has been a pronounced sectoral shift in demand. ICT accounted for 52% of all the office space leased in Dublin between 2017-2019 as some of the world's biggest tech brands established large campus sites in the city. However, with these occupiers now dormant, 'traditional' financial, professional and public service occupiers are naturally accounting for a bigger share of take-up, and their average space requirements are smaller. There are legitimate reasons for expecting tech requirements to recover. However, remote working and sustainability dynamics may have a more lasting impact on the average deal size, and there is mounting evidence that occupier preferences are shifting in favour of 'less-but-better' office space.

FIGURE 2: AVERAGE DEAL SIZE – DUBLIN OFFICE LETTINGS



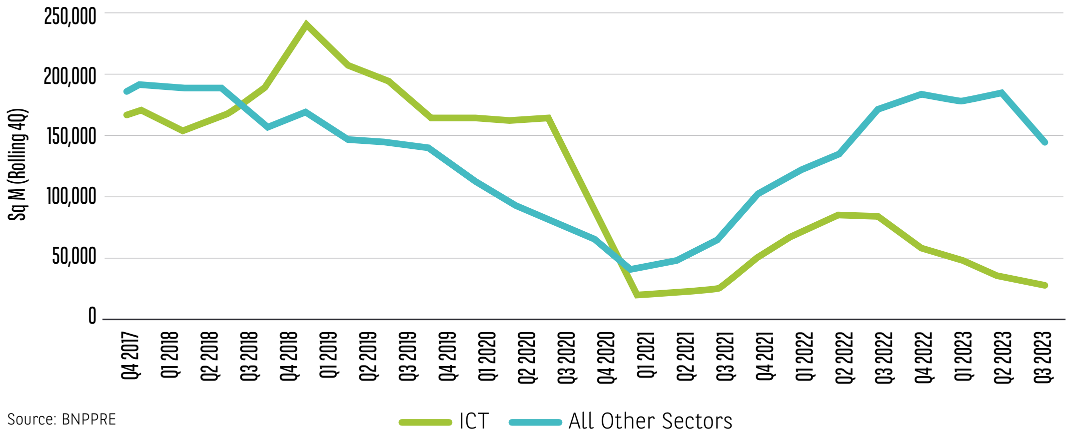
Source: BNPPRE

TAKE-UP BY SECTOR

Year-to-date, office leasing is down across all sectors except Industry. The sharp fall-off in tech leasing continued in Q3 with just 2,426 sq m signed-for across five deals. This accounts for 8.4% of the space taken – ICT's lowest share of activity since quarterly records began. Multiple factors are feeding into this. As outlined above, the tech sector front-loaded on business space immediately before the pandemic. Under any circumstances this was likely to leave a leasing vacuum in its wake. However it seems that remote working and last year's global tech shock are also contributing to the slowdown. Tech has been the biggest adopter of remote working in Ireland and, for a given level of employment in the sector, this can clearly deduct from office demand.[1] The 2022 tech shock is also having a lingering impact. Ireland has escaped significant job losses – ICT employment is down by only 2.3% in the year to August, and remains 15.2% above its March 2020 level. Nonetheless global hiring freezes and headcount reductions have created a zeitgeist within the industry that is generally unfavourable for office leasing.

[1] See [Working Remotely - CSO - Central Statistics Office](). It should be noted that there was significant remote working in the tech industry prior to Covid.

FIGURE 3: ICT TAKE-UP VS ALL OTHER SECTORS



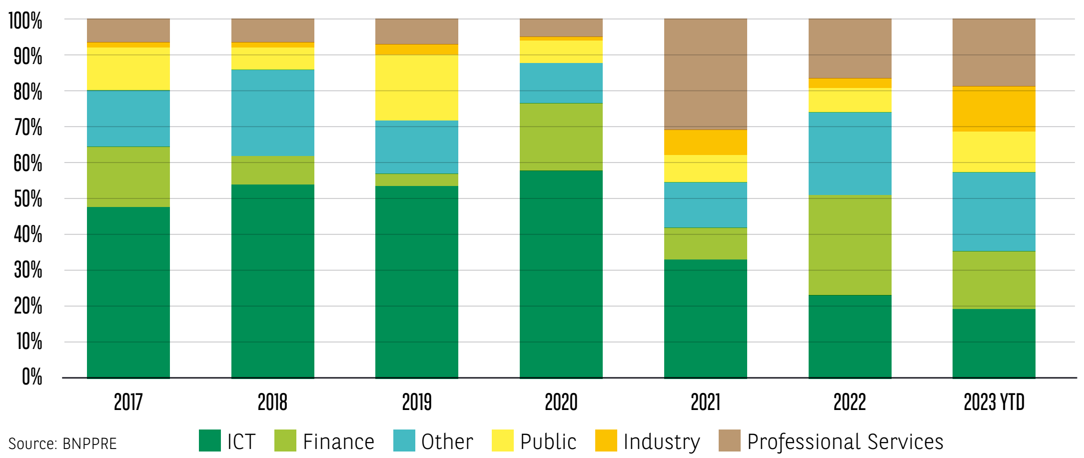
Source: BNPPRE

Subdued ICT take-up was compensated for by increased activity across other sectors during 2021 and 2022. However, the recovery in non-tech leasing has flattened and, ultimately, gone into reverse during 2023 (Figure 3). Financial services was a star of last year's leasing market with take-up rising fivefold on 2021. However this momentum has faded with leasing down 58 percent year-to-date (compared with an overall market decline of 43%). Nonetheless, full-employment and the higher interest rate environment provide a generally favourable backdrop for financial services, and employment in the industry continues to rise strongly despite the closure of two major banks. Reflecting this, some notable office requirements are live across the areas of banking, fintech and insurance.

Activities such as legal and accounting services are characteristically defensive, and the professional services sector has continued to provide a steady source of office demand through the post-Covid period. It was Q3's busiest sector with just over 7,000 sq m taken – accounting for 24.4% of take-up. Over half of this space (3,675 sq m) was taken by legal firms over seven lettings, two of which were new entrants from the UK.

A further 832 sq m of professional services lettings came from tenants such as architects, planning consultants and project managers that service construction sector clients. Highlighting the continued importance of construction to the Irish economy, an additional 6,141 sq m was taken directly by building and development companies which are classified as 'Industry'. This includes the largest deal of the quarter, the €8m purchase of a 3,272 sq m office by John Sisk / Capwell Investments at Citywest. This transaction made Industry the second largest taker of Dublin office space in Q3 (23% of take-up), and it was the only sector that enjoyed an absolute increase in year-to-date office leasing.

FIGURE 4: SHARE OF DUBLIN OFFICE TAKE-UP BY SECTOR



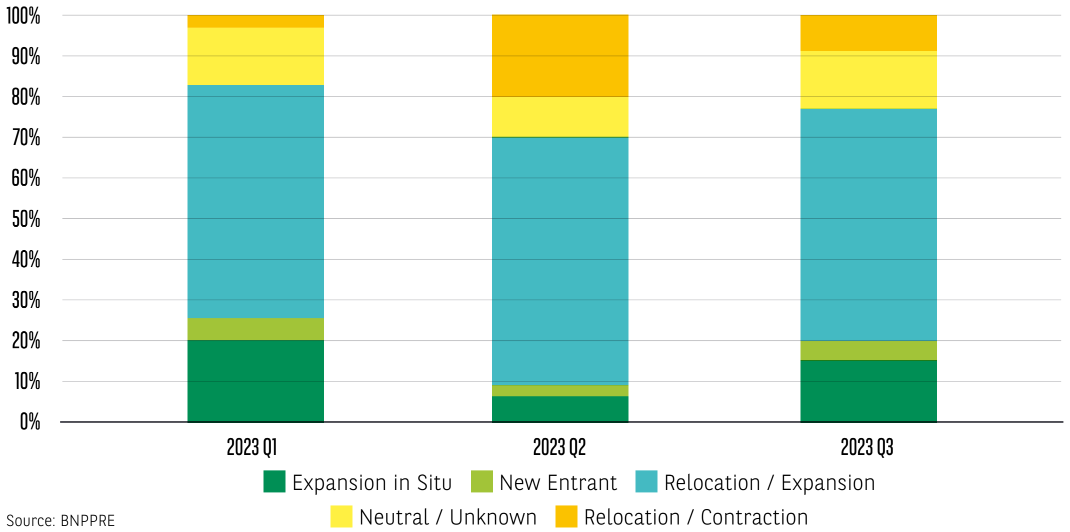
Source: BNPPRE

NET ABSORPTION

While take-up is necessary for office absorption, movement within the market, downsizing, and sub-letting can reduce the extent to which it translates into increased occupied space. There is a clear hierarchy in how different types of transaction feed through to absorption;

1. New Entrants and Expansions in-Situ - At the most positive end of the sale, the gross amount of space taken-up by new entrants and organisations that are expanding within their existing buildings feeds directly through to net absorption.
2. Expansion by Relocation - Lettings by organisations moving to a bigger office also add to occupied space. However their impact on overall market occupancy is somewhat reduced by the fact that vacated space is being returned to the market.
3. Ownership Changes – In situations where the occupier stays in place, but the building's ownership changes, the impact on absorption is neutral. There are two classic cases; In a sale-and-leaseback the former owner will sign a new lease which is counted in take-up. But there is no change in occupied space. Paradoxically the opposite situation, in which a tenant buys the building it currently occupies, is also neutral in terms of absorption; the purchase registers as take-up but, again, there is no change in the amount of occupied space. The biggest deal in Q3, Sisk's purchase of 3007 Lake Drive in Citywest for owner-occupation, provides a timely example of this.
4. Contraction by Relocation – Downsizing moves unambiguously subtract from net absorption. This is because, by definition, more space is handed back than taken.

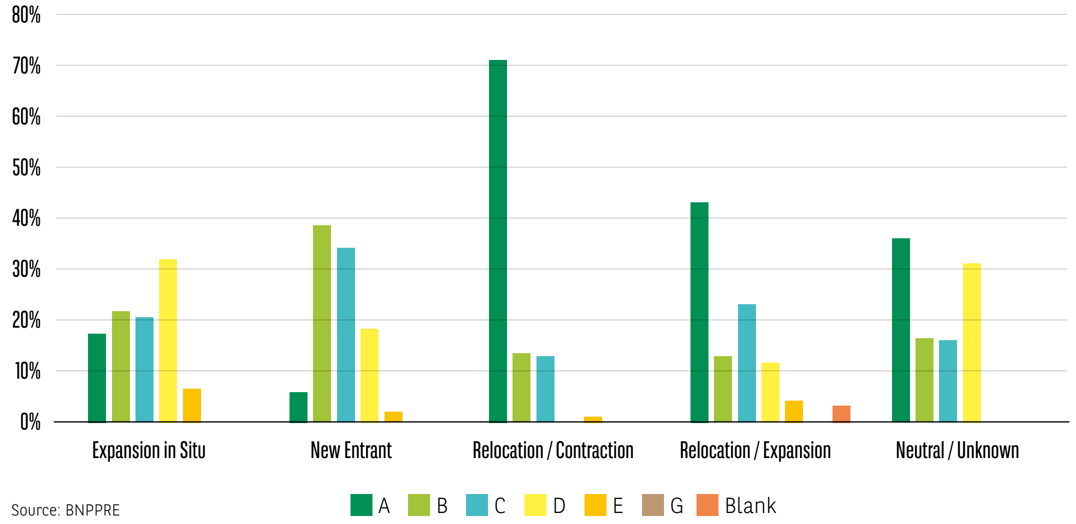
FIGURE 5: TAKE-UP BY TENANT ACTIVITY



Source: BNPPRE

Figure 5 disaggregates Dublin office lettings into these categories. Positively for the market, three quarters of take-up between July and September involved some form of expansion – a slight increase on Q2. The most beneficial forms of take-up – expansions in-situ and new entrants – accounted for 15.4% and 4.5% of Q3 activity respectively. So far this year, the former have contributed 12,240 sq m to take-up (13%), and their prevalence reflects a motivation by occupiers to avoid the increasingly expensive fit-out costs associated with moving to a new building. New entrants account for a small share of take-up, but their presence provides an important outlet for landlords offering smaller and older buildings which provide low-cost landing space. The average new entrant in 2023 has taken just 293 sq m, less than half of the average for all other tenant types (714 sq m). Moreover, as illustrated in Figure 6, new entrants are much less likely than other tenants to take A-rated space. In the first three quarters of this year less than 6% of the space taken by this group had a BER rating of A, compared with a market average of 42%.

FIGURE 6: PERCENTAGE OF SPACE TAKEN BY TENANT ACTIVITY, BROKEN DOWN BY BER RATING

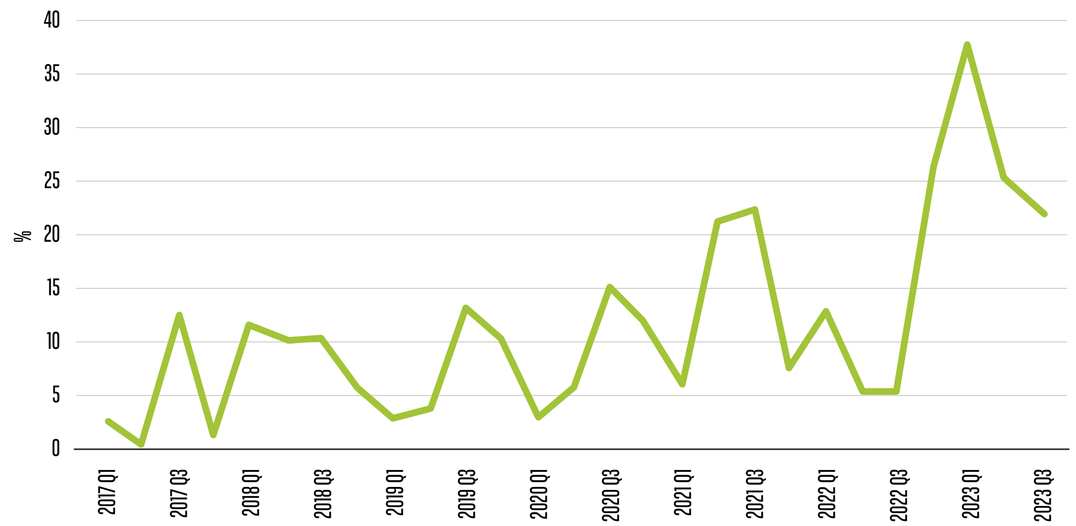


Source: BNPPRE

Interestingly, the opposite preference is evident among organisations which are downsizing. Contraction by relocation accounts for 12.3% of take-up YTD. But, as illustrated in Figure 6, almost three quarters of this space is A-rated. This evidence tallies with agents' observation of the 'less-but-better' phenomenon; By integrating their remote working and ESG strategies, organisations are seeking to achieve savings from reducing their office footprint, but also to deploy these savings into leasing premium space which will assist with employee engagement and help to meet ESG targets.

As previously reported, cyclical factors and the structural shift to hybrid work have left office occupiers with surplus business space in many jurisdictions. In markets like Ireland, where tenants are typically locked-in to long leases, 'right-sizing' can be achieved ahead of scheduled lease events through sub-letting / assignment. Occupiers with excess space continue to avail of this mechanism and the share of grey space within take-up remained elevated in Q3. 6,330 sq m of the quarter's take-up – over one fifth of the total, was tenant offered and, although this is counted within take-up, it does not contribute to net absorption (the change in occupied space) as it was already occupied.

FIGURE 7: SUB-LEASED / ASSIGNED SHARE OF TAKE-UP



Source: BNPPRE

SUPPLY AND VACANCY

Just under 36,000 sq m of new office space was delivered in Q3, including two new blocks on Dawson Street, which is in the heart of the traditional CBD, and another in the South Docks. This brings total completions over the first three quarters of 2023 to c. 65,000 sq m. With sluggish take-up and reduced net absorption because of sub-letting and 'churn', the market has been unable to digest this additional space, and vacancy has risen. However, the extent of upward pressure on vacancy has been significantly mitigated by withdrawals from stock this year. These include the demolition of the former Garda Headquarters at Harcourt Square, and the temporary decommissioning for redevelopment of 25-28 North Wall Quay and the Treasury Building on Grand Canal Street (approximately 38,000 sq m in aggregate). When these netting balances wash through, vacancy has only crept up from 12.4% last December to 12.5% in Q3.

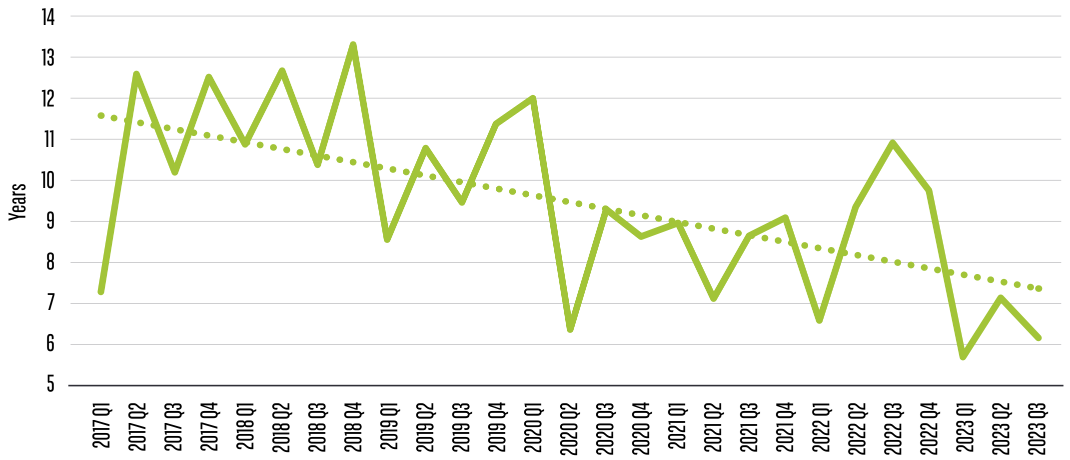
RENTS AND LEASE TERMS

Reflecting their ESG commitments, global occupiers remain heavily focused on modern, low carbon offices in prime city centre and docklands locations. Over the last few years this Grade A space has been scarce, driving prime headline rents to €673 per sq m per annum. However the scarcity is now abating from both sides. In terms of supply, there has been a strong flow of new office completions over the last 18 months, and a number of speculatively developed blocks have now reached completion without a tenant. Compounding this, some properties which were pre-let have become available by way of assignment post-completion. Examples include 28 Fitzwilliam in Dublin 2 and Fibonacci Square in Ballsbridge. While this space is technically not vacant, it indirectly adds to vacancy because it competes with traditional landlord offered space, slowing the rate at which that is leased-up.

On the demand side, as noted above, top-line leasing is under pressure. This reflects cyclical factors such as a slowing global economy and sector-specific challenges in the tech industry. But structural factors such as remote working and the emergence of a 'less-but-better' dynamic are also dragging on average letting sizes.

The upshot has been a rise in vacancy. So far, prime headline rents have held-up at €673 per sq m per annum, and this continued through Q3. However, history and logic dictate that rising vacancy eventually impacts on rents and, as previously reported, shortening lease terms betray the fact that market conditions are moving in favour of tenants.

FIGURE 8: AVERAGE LEASE TERM, CITY CENTRE OFFICES



Source: BNPPRE

OUTLOOK

Heading into the home straight we now have clearer visibility on office completions for 2023. Due to the usual deferrals because of onsite delays, we now believe that no more than 170,000 sq m will be delivered.

Take-up remains subdued due to lingering tech sector turbulence, the impact of a global slowdown on confidence and jobs growth, and the effects of remote working and ESG on space-per-employee ratios. With just under 95,000 sq m taken in the first three quarters, our full year take-up forecast of 150,000 sq m remains achievable – particularly given seasonal effects and the fact that reserved space has steadily risen over the last three quarters.[2] With sub-letting and churn dragging on net absorption, this will not be sufficient to digest the net additional space delivered, even if we factor in decommissioned buildings. As a result, vacancy will rise further by year-end. Previously we expected vacancy to peak in Q4 this year. However, due to the deferral of some completions into 2024, it is now more likely to top-out next year.

Considering the medium term outlook, it is useful to decompose the current market downswing into its likely depth and duration components. A legacy of the Global Financial Crisis is that debt capital for speculative office development has been tightly controlled. As a result, the construction pipeline has never been allowed to run too far ahead of demand. A number of large office blocks are currently nearing completion and we now expect approximately 100,000 sq m to be delivered in Q4. After that, however, the pipeline for 2024 and 2025 completion falls away. This greatly limits the scale of the likely oversupply when the market reaches bottom-dead-centre next year. Our modelling forecasts vacancy to peak at around 16%. Relative to a natural vacancy rate of 11%,[3] this implies a peak overhang of around 220,000 sq m, meaning that the depth of the current downswing is destined to be quite modest (see Table 1).[4]

TABLE 1: COMPUTATION OF PEAK VACANCY OVERHANG

A	Forecast Office Stock 2024	4,350,000 sq m
B	Forecast Vacancy Rate 2024	16%
C	Natural Vacancy Rate	11%
D	Forecast Vacant Stock 2024 (a*b)	696,000 sq m
E	Naturally Vacant Stock (a*c)	478,500 sq m
F	Vacancy Overhang 2024 (d-e)	217,500 sq m

However, notwithstanding the limited scale of peak oversupply, the rate at which each square metre gets digested is likely to be slower than in previous recovery cycles. This is due to a decline in the space-per-employee ratio which reflects two things. Most obviously, remote working has allowed firms to rationalise their office space and, as a result, service sector hiring has proportionately outstripped office absorption since the onset of Covid. Moreover, as outlined above, we believe the ESG agenda is also playing a role by causing occupiers to prioritise quality over quantity in deploying their finite accommodation budgets.

[2] Q4 has accounted for 36.6% of annual take-up on average between 2015-2022. Reserved space rose by 17.8% in Q1, 3.2% in Q2 and a further 7.3% in Q3. Historically there is a 0.77% correlation between reserved space one quarter ago and take-up in the current quarter, although agents report that deals are currently taking longer to clear legals.

[3] The NVR is the vacancy rate which establishes the tipping point between positive and negative rental growth. Sanderson, Farrelly and Thoday (2006) found that Dublin's office market had the second highest natural vacancy rate of 12 European locations at 10.9% (compared with a European average of 8.1%), while McCartney (2012) estimated the Dublin NVR at 11%.

[4] The overhang at the lowest point of our last office cycle in Q4 2010 was 423,000 sq m.

Back-of-the-envelope calculations suggest that the average space-per-employee ratio has fallen by approximately 1.2 sq m per head since Q1 2020. This implies a relatively modest drag on the absorption rate due to new occupier dynamics. However post-pandemic lettings still account for a low weighting within Dublin's occupied office stock. Therefore the marginal space-per-employee ratio, which is considerably lower than the average ratio, may be a better indicator of the pace at which future jobs growth is likely to consume the vacancy overhang. Even with this, however, uncertainty prevails about whether hybrid working practices in today's full-employment economy have settled at a steady state, or whether calls for a return to the office will strengthen if and when labour market conditions deteriorate.

In conclusion, Dublin's office market currently faces supply and demand side headwinds. As we possess detailed knowledge of the construction pipeline, greater certainty surrounds the supply challenges. This intelligence suggests that vacancy will get worse before it gets better. Critically, however, oversupply is likely to peak at relatively modest levels by historical standards.

There is much less certainty on the demand side. The global economy has slowed considerably since the post-Covid rebound in 2021, and the IMF predicts a further modest slowdown next year. As a small open economy Ireland will be affected, and our local forecasting bodies have moved in recent weeks to cut their growth projections for the Irish economy. Nonetheless, as shown in Table 2, they continue to forecast relatively robust jobs growth which should be generally positive for the office market.

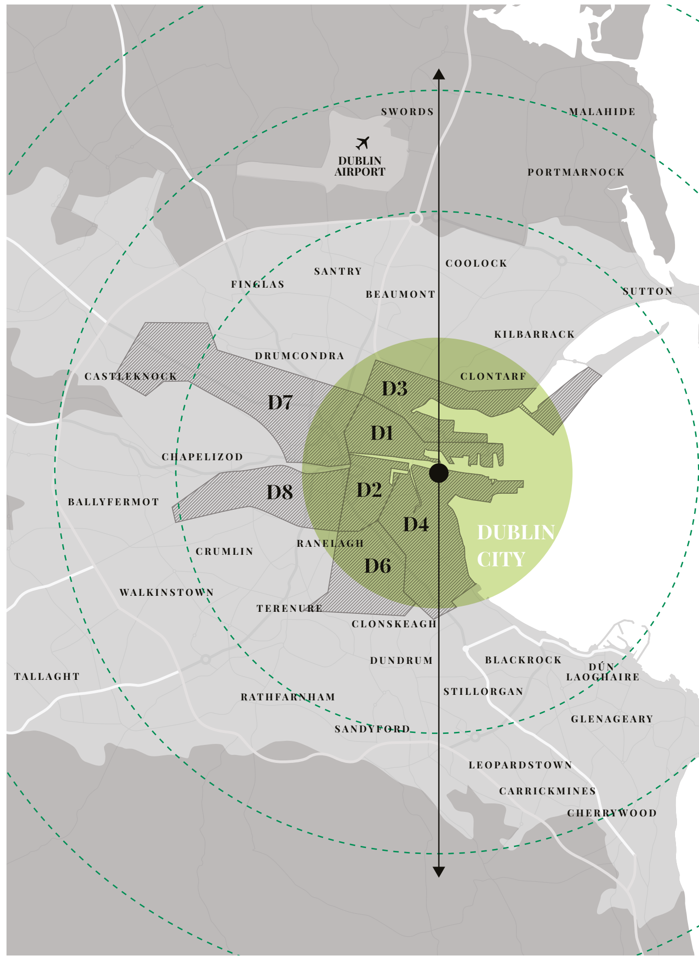
TABLE 2: EMPLOYMENT GROWTH FORECASTS (%Y/Y)

FORECASTING BODY	FORECAST DATE	2024	2025	2026
Central Bank of Ireland	SEP 2023	1.7	1.5	
Dept. of Finance	OCT 2023	1.3	1.3	1.4
ESRI	OCT 2023	1.6		

For the reasons discussed, it is unclear how quickly this jobs growth will eat away at the vacancy overhang after office construction slows from next year. However, it seems inevitable that sustained employment gains will generate positive business space absorption which will, at some point, consume the surplus from this development cycle, eventually creating a scarcity and triggering the next development cycle. Indeed, in this context, it is notable that some of the most experienced and astute institutional developers are already preparing for this by progressing planning for new offices to be delivered later this decade.

TECH ACCOUNTED FOR JUST 8.4% OF TAKE-UP -
its lowest share since quarterly records began

72% OF ORGANISATIONS
which have downsized in 2023
HAVE TAKEN-UP A-RATED SPACE



2023 Q3 Take-Up
28,817 sq m

DUBLIN CITY (DUBLIN 1,2 and 4)	DUBLIN FRINGE (DUBLIN 3,6,7 and 8)	SUBURBS
18,084 sq m	2,417 sq m	8,316 sq m
63%	8%	29%

> "The office market downswing will bottom-out in 2024. Disciplined development funding means peak vacancy will be on a manageable scale by historic standards. However, the relationship between jobs growth and office demand has been weakened by remote working, and this may slow the rate at which vacancy comes back down"

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

> "The market is moving towards a 'less-but-better' model as occupiers seek to deploy savings from a reduced office footprint into paying for better quality space"

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

TOP 10 DEALS Q2 2023

	BUILDING	LOCATION	TENANT	SQ M
1	3007 Lake Drive, Citywest	Dublin 24	John Sisk & Son / Capwell Investments	3,272
2	Unit 9, Swords Business Campus	Co. Dublin	Confidential	2,090
3	55 Charlemont Place	Dublin 2	Carne Group	2,023
4	1 Grand Canal Square	Dublin 3	Procore	1,970
5	One Shelbourne Buildings, Ballsbridge	Dublin 4	Commission na Mean / BAI	1,906
6	40 Mespil Road	Dublin 4	Azets	1,496
7	Donnybrook House, Donnybrook	Dublin 4	IWG	1,415
8	One Molesworth	Dublin 2	Simmons & Simmons	1,221
9	One Cumberland (6th Floor)	Dublin 2	Bentley Systems	965
10	One Park Place	Dublin 2	K&L Gates	938

57 ADELAIDE ROAD
Fully let to 4 new Tenants' in the last 2 years.

	CITY CENTRE	SUBURBS
Highest Rents	€888 per sq m pa	€301 per sq m pa
Number of Deals	29	11
Average Deal Size	624 sq m	756 sq m
Typical Lease Term	15 years	10-15 years
Typical Lease Break	7-8 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	16	8	4	1	0	0
City Fringe		0	0	0	0	0
Suburbs	2	1	1	0	0	0

BLACKROCK VILLAGE CENTRE OFFICES
Final office suite remaining as 2 of 3 floors now let.

GLENCAR HOUSE
BALLSBRIDGE
6,968 sq m of premium office space available to let. Due to complete in Q4 2023.

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