Q4 DUBLIN OFFICE MARKET 2023

BNP PARIBAS REAL ESTATE

THE EXO BUILDING
3,300 sq m let to Yahoo

Q4 2023 KEY TRENDS

Q4 Take-up of 28,487 sq m brings full-year total to 122,951 sq m **HALF OF 2022 FIGURE**	**LOWEST TAKE-UP SINCE 2010** including Covid years
CONTRACTION REFLECTS FEWER DEALS (176 vs 197 in 2022) and reduced average deal size (748 sq m vs 1,236 sq m)	**MODEST EXPANSION IN STANDING STOCK** due to completions undershoot (only 80,000 sq m) and continued demolitions
This limited the **VACANCY INCREASE TO 13.1%** *protem*	**DELAYED 2023 COMPLETIONS WILL DRIVE STRONG SUPPLY GROWTH THIS YEAR** propelling vacancy upwards
Prime headline rents remain at **€673 PER SQ M PER ANNUM**	**INCREASING RENT-FREE AND SOFTENING AVERAGE RENTS** witness marks of weak underlying conditions

RESERVED SPACE DRIFTED SLIGHTLY LOWER at year end

MARKET ACTIVITY

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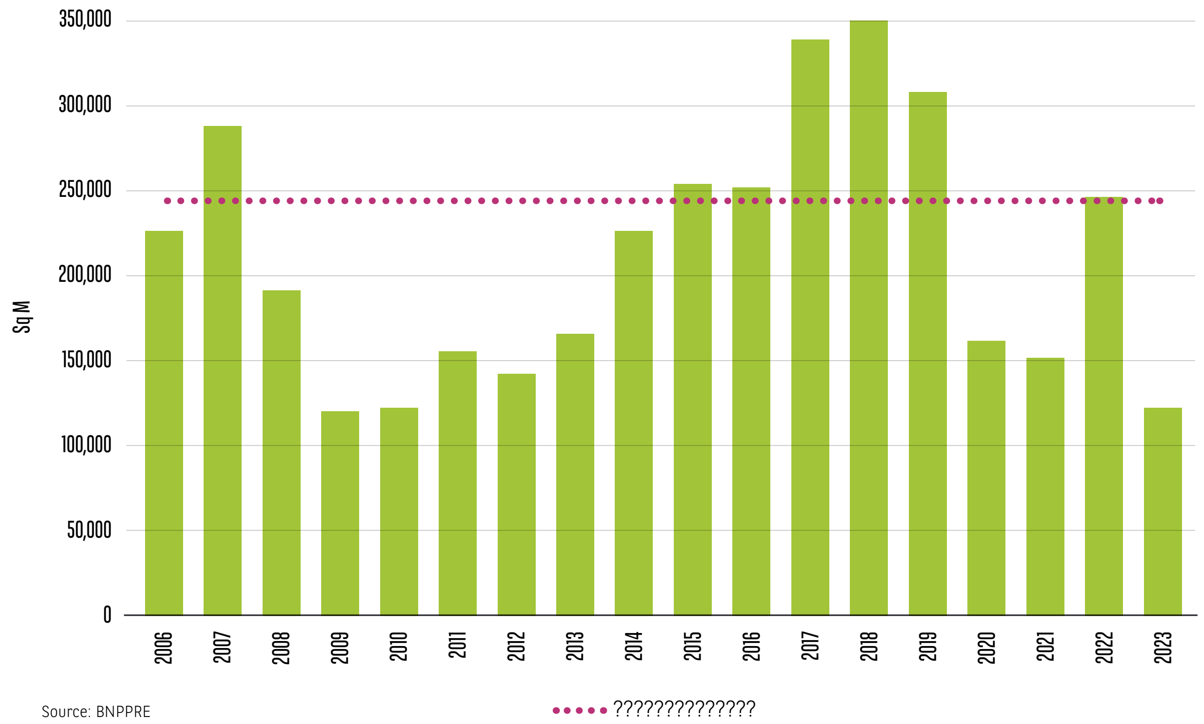
28,487 sq m of purpose-built office space was taken-up in Dublin between October and December. With the exception of 2020, when Covid effectively shut the market, this was the slowest Q4 in over a decade. It was also 70% below the long-term average for the final quarter which typically benefits from a push to get deals signed within the annual accounting period. Over the full-year, 122,951 sq m were taken. To put it in context, this was the lowest annual take-up since 2010 when the financial crisis was at its apex.

28,487 sq m

TAKEN-UP IN **Q4**

FIGURE 1: OFFICE MARKET TAKE-UP - DUBLIN

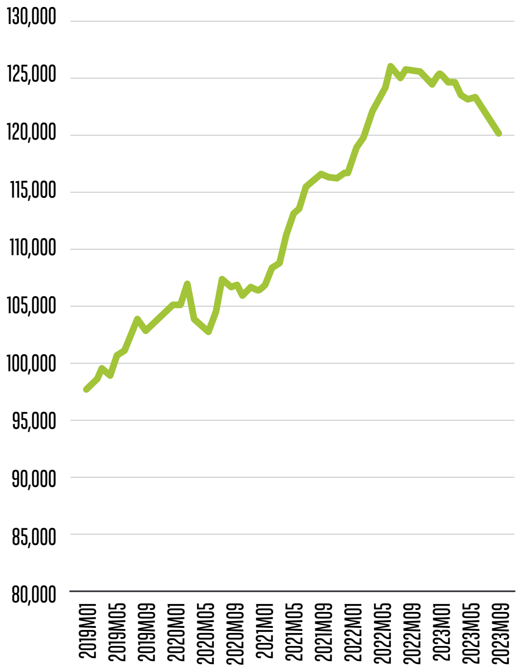


Source: BNPPRE

The global economy has become less supportive of business space demand. Compounding this, sectoral issues in the technology industry and the structural challenge of remote working have subtracted further from demand.

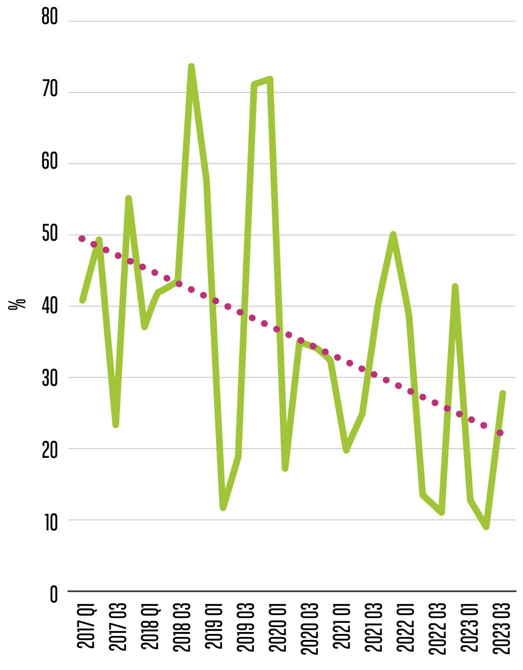
As an archetypal open economy Ireland is heavily exposed to these universal trends. The scale of multinational activity complicates any assessment of Ireland's macroeconomic health, but the more illuminating signals – including Modified Domestic Demand and unemployment – trended weaker in 2023. Moreover, after initially holding-up well in the face of 2022's global tech shock, ICT employment is now slipping, and currently stands 4.4% off its August 2022 peak (Figure 2a).

FIGURE 2a: ICT EMPLOYMENT - IRELAND



Source: CSO

FIGURE 2b: TECH SHARE OF TAKE-UP



Source: BNPPRE

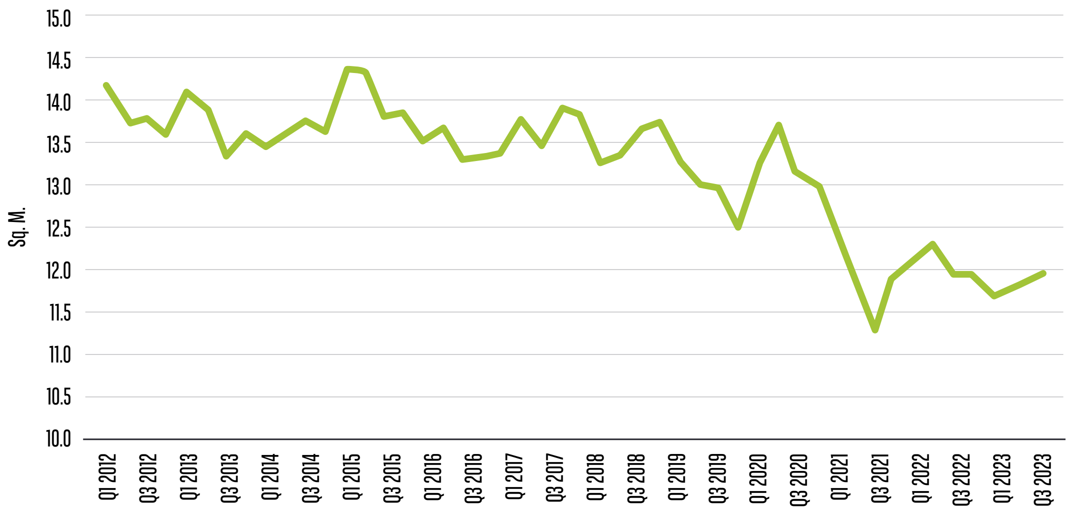
Given the Dublin market's heavy reliance on tech in recent years, this has naturally impacted overall office demand. As shown in Figure 2b, ICT accounted for over 50% of take-up between 2019-2021, but this slipped to 21.4% in 2023. In absolute terms, only 26,000 sq m was leased to technology firms in 2023, a 54% decline on 2022.

A second consequence of the heavy ICT weighting in Dublin's occupational mix has been the disproportionate impact of remote working. Tech employees have a higher propensity to avail of hybrid working[1] and, partly as a result, Ireland experienced the fastest growth in remote working of any EU country between 2019-2022.[2]

Figure 3 begins to explore the impact of hybrid working on office demand. The average space-per-employee ratio – calculated as total occupied space in the market divided by the number of office-based workers in Dublin - stepped-down noticeably after Covid, indicating a weakening of the relationship between employment and office demand. Nevertheless, the post-Covid average remains at a respectable 11.9 sq m per employee. At first glance, this might suggest 11.9 sq m of office space consumption for each additional service sector job, which would quickly eat through the current vacancy overhang.

[1] See Working Remotely - CSO - Central Statistics Office. It should be noted that there was significant remote working in the tech industry already prior to Covid.
[2] Per Eurostat, 36.2% of employees were sometimes or usually working from home in 2022 vs 19.9% before Covid in 2019. See Ireland tops EU poll for working from home growth (rte.ie)

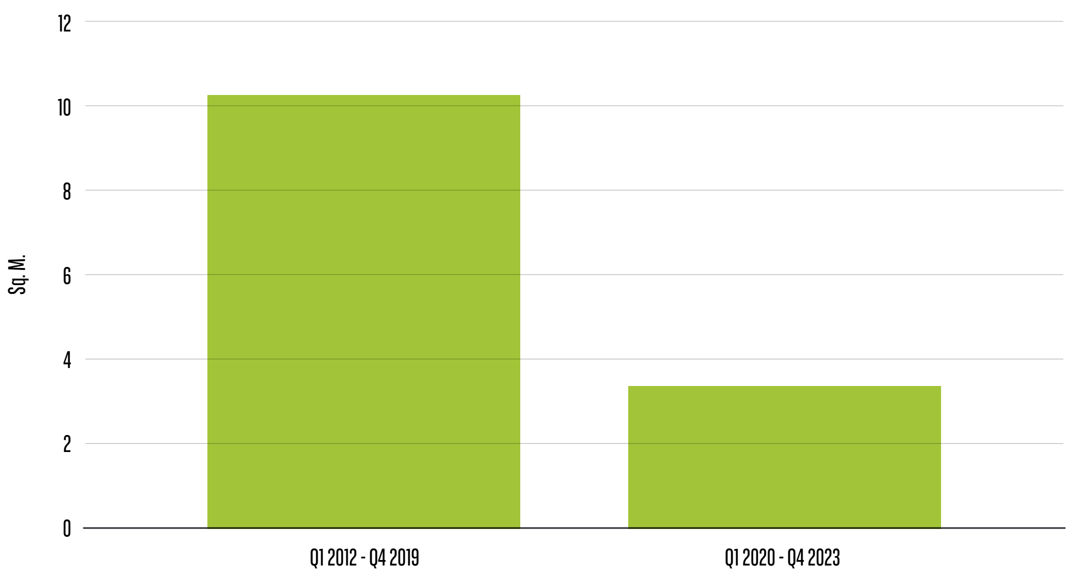
FIGURE 3: AVERAGE SPACE PER EMPLOYEE RATIO, DUBLIN OFFICE MARKET



Source: BNPPRE

However, such logic ignores the fact that most of the occupied space in today's market originates from leases that were signed before Covid. Therefore a more realistic read on the current relationship between jobs growth and office demand is the 'marginal space per-employee ratio' - the *change* in occupied space since the onset of Covid, divided by the *change* in office-based employment.

FIGURE 4: MARGINAL OFFICE SPACE PER EMPLOYEE RATIO, PRE AND POST-COVID



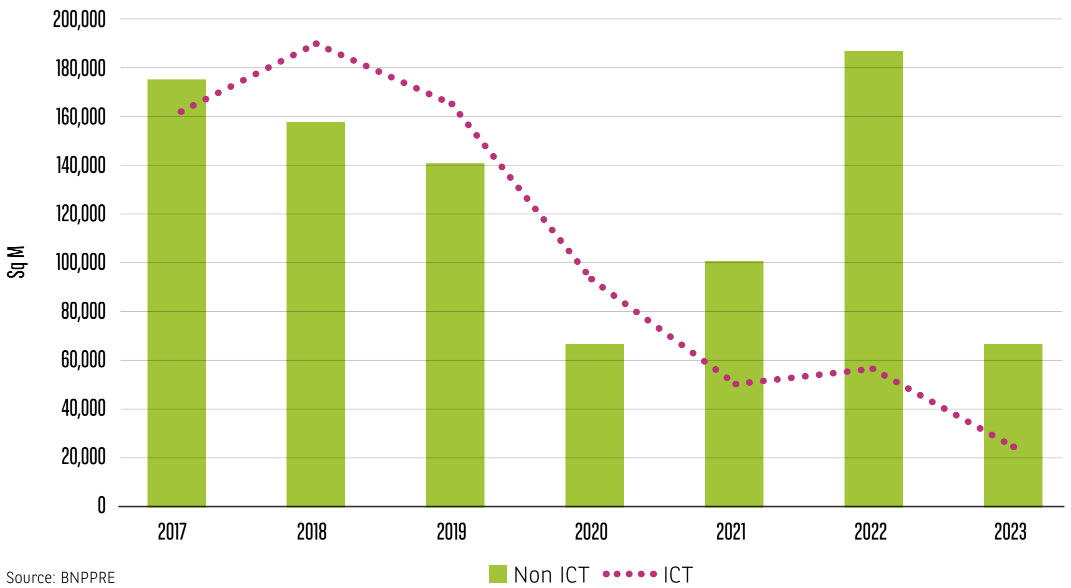
Source: BNPPRE

Figure 4 shows that this marginal ratio fell by two-thirds post-Covid; from 10.2 sq m between 2012 –2019, to just 3.2 sq m thereafter. The implications are profound; Whereas the average calculation implies office consumption of 11.9 sq m for each additional job, the marginal ratio suggests a much lower figure of 3.2 sq m. Inescapably, this implies a longer pathway to recovery for the market once peak vacancy has been reached.

TAKE-UP BY SECTOR

This time last year we reported that, although tech leasing had failed to recover to its pre-Covid levels, the remainder of the market had rebounded to where it stood in early 2020. However this is no longer the case. As illustrated in Figure 5, non-tech occupiers accounted for 97,000 sq m of the year's take-up, a 48% drop compared with 2022. This confirms that the current weakness in office demand is a broader phenomenon, deriving from the wider macroeconomic and structural factors discussed above.

FIGURE 5: ICT TAKE-UP VS ALL OTHER SECTORS



Source: BNPPRE

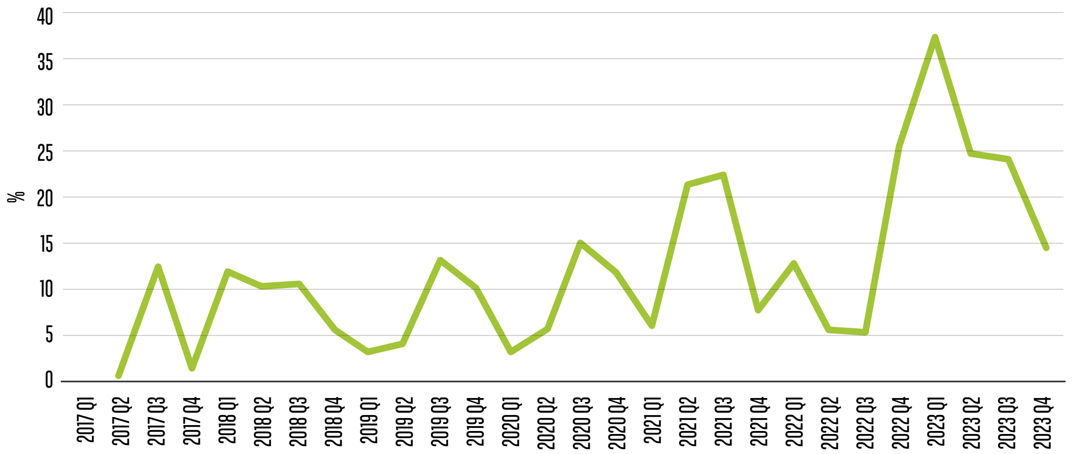
Drilling into the detail, most sectors of the occupier market experienced a leasing pull-back in 2023. This was most pronounced among aircraft leasing (-92%), serviced office (-80%) and financial services organisations (-69%). Public sector activity was broadly unchanged, while industrial and construction firms acquiring space to serve their administrative functions bucked the trend by taking 14,169 sq m – twice the 2022 amount, and 11.5% of the year's total.

NET ABSORPTION

While take-up is necessary for office absorption, sub-letting, movement within the market and downsizing determine the extent to which this translates into increased occupied space. In addition to the decline in top-line leasing, these factors have heavily deducted from absorption in recent quarters. However, there are now perhaps emerging signs of positive news.

Following the Covid pandemic, many organisations found themselves with surplus accommodation and used sub-leasing and assignment mechanisms to better align their business space with their operational needs. However, although the sub-leased / assigned share of take-up remains above its long-term average, it has contracted quite sharply in the last three quarters. The most obvious explanation is that, because four years have elapsed since the Covid shock, many organisations have now worked through their plans to dispose of surplus space. At the same time, organisations taking out new leases have better developed hybrid strategies and, as a result, have become more realistic about their requirements.

FIGURE 6: SUB-LEASED / ASSIGNED SPACE AS A PROPORTION OF TOTAL TAKE-UP

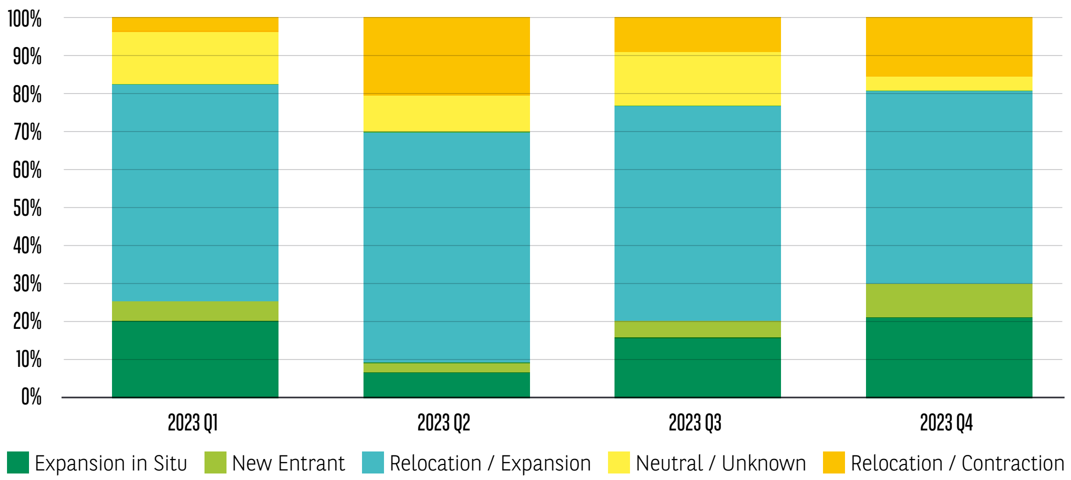


Source: BNPPRE

There are also tentative signs of positive news in the composition of lettings. As previously outlined, there is a clear hierarchy in how different transaction types feed through to absorption;

1. New Entrants and Expansions in-Situ - At the most positive end of the sale, gross take-up by new entrants and organisations that are expanding within their current buildings feeds-through to net absorption on a 1:1 basis.
2. Expansion by Relocation - Organisations moving to a bigger office also add to overall occupied space. However the net impact of these moves is partially offset by the fact that they are leaving vacated space behind.
3. Ownership Changes – 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 for absorption; The purchase registers as take-up but, again, there is no change in the amount of occupied space.
4. Contraction by Relocation – Downsizing unambiguously subtracts from net absorption. This is because, by definition, more space is handed back than taken.

FIGURE 7: TAKE-UP BY TENANT ACTIVITY



Source: BNPPRE

Figure 7 shows that the share of take-up accounted for by new entrants and organisations expanding in their current buildings has progressively risen from 9.25% in Q2 to 26% in Q4. This clearly boosts the 'conversion rate' between take-up and absorption, and is positive for the market. Conversely, however, the downsizing share of take-up rose to 16% in Q4. A deep dive reveals that more than half of the accommodation that was taken by downsizers in 2023 was BER A-rated. This is consistent with the 'less-but-better' narrative that many corporates are seeking superior space to meet their ESG targets and attract staff back to the office, and are willing to sacrifice quantum to cross-subsidise the quality upgrade.

However, Q4's largest and most interesting deal involved a company downsizing into lower-rated space. In late 2019 Irish AI company Intercom pre-let the entire 10,476 sq m of Cadenza, a BER A-rated new-build in Dublin 2, on 18-year lease at a headline rent of €673 per sq m per annum. Although Cadenza was completed in 2022, Intercom never moved-in. Initially, it assigned 3,645 sq m in the top three floors to US investment firm KKR. That it would seek to offload some space is unsurprising, particularly given the timing of its pre-let just before Covid. However, what happened next challenges the boilerplate narrative that energy ratings now dominate all other considerations. In Q4 2023 Intercom signed another lease for 3,657 sq m of C1-C3 BER rated accommodation in an older block at 124-127 St. Stephen's Green. The company has taken this fitted space without ever moving into Cadenza where the remaining floors are now available by way of assignment.

Several insights can be drawn. Firstly, while modern corporate occupiers undoubtedly favour low-energy buildings, there is a limit to their willingness to pay for them. In this case Intercom benefited from its move to an older building by avoiding new-build fitout costs and getting a slightly lower rent. As vacancy rises and rents for older buildings fall, we should expect other better quality older properties to compete effectively with brand-new space, dragging on prime Grade A rents.

A second insight relates to the enduring importance of location. As well-located as Cadenza is on Adelaide Road, 124-127 St. Stephen's Green is among Dublin's very best pitches. With the St. Stephen's Green LUAS stop on its doorstep, this building ticks many boxes – both from the point of view of attracting staff and, arguably, as a green building in its own right as it facilitates the use of mass transport.

SUPPLY AND VACANCY

At the start of last year over 200,000 sq m of new office space were scheduled to be completed in Dublin during 2023. However, as can happen at year-end, several large blocks that were slated for Q4 delivery did not get signed-off by the close of play. In a small market like Dublin this can dramatically impact the arithmetic and, in the event, only 80,000 sq m of new stock was delivered. On the opposite side of the ledger, almost 50,000 sq m of older space was decommissioned for redevelopment, including the old Garda building at Harcourt Square, the Treasury Building on Grand Canal Street and Blocks 3 and 3a at the Irish Life Centre in Abbey Street. The net result was that Dublin's standing stock expanded at a pedestrian pace in 2023. Despite weak demand conditions, this limited the uptick in the vacancy rate to 13.1%.

RENTS AND LEASE TERMS

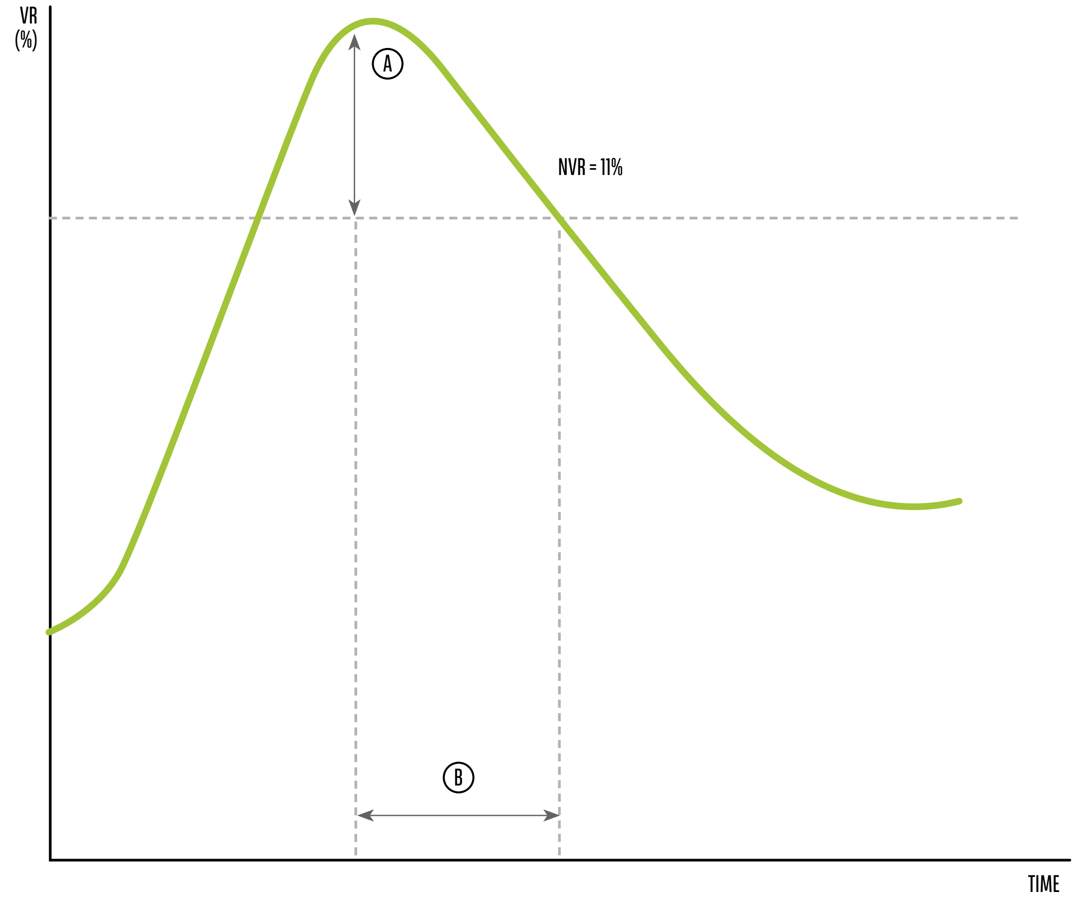
Prime headline rents remained at €673 per sq m per annum in Q4 – unchanged since June 2022. However, with inflation deducting 7.1% from the value of money over the last 18 months, this represents a material reduction in real terms. Moreover, increasing rent-free periods betray the fact that market conditions have moved in favour of tenants.

OUTLOOK

Theory and history dictate that office markets are cyclical, and cycles differ only in two dimensions - their amplitude and frequency. Therefore, when the market is in a downswing, the debate really crystalises into two simple questions; How deep will the downswing be? And how long will it take to get back to level-par?

The first question hangs on peak vacancy which ultimately depends on pipeline construction, demolitions and net absorption. With completion of several large schemes slipping from Q4 2023 into the first half of this year, 2024 office supply will be greater than previously anticipated. Fewer buildings are likely to be taken-out for redevelopment at this stage of the cycle, which will further add to the pace of stock expansion.[3] On the demand side, conditions were more challenging than expected in 2023. Looking ahead, with reserved space edging lower in Q4, sluggish leasing may continue into the early part of this year. Nonetheless, agents are reporting a much busier start to 2024 than to 2023 and a significant number of large requirements, suggesting that lettings will pick-up as the year progresses. This dovetails with a more positive macroeconomic outlook; Over the last three months the debate has switched from whether the terminal interest rate had been reached to how quickly monetary authorities will now move to reduce rates. Reflecting this, most macroeconomic forecasting bodies are predicting stronger growth in 2024 than 2023. In addition, tech stock valuations have improved, potentially unlocking more leasing activity from the ICT sector. Accordingly we are factoring modest take-up and net absorption improvements into our office market modelling.

FIGURE 8: DUBLIN OFFICE VACANCY OUTLOOK



Considering these factors, we are currently projecting vacancy to peak at around 16.6% in 2025. With the natural vacancy rate – the tipping point between positive and negative rental growth – being around 11% in Dublin, this suggests peak over-supply of around 250,000 sq m – see distance 'A' in Figure 8.[4]

Turning to our second question, today's space-per-employee ratio of 3.2 sq m per worker would require the creation of 78,000 extra jobs to absorb 250,000 sq m of surplus space. Converting this into a recovery timeframe (distance 'B' in Figure 8) is an inherently speculative exercise. But, for what it is worth, 49,500 additional office jobs were created in Dublin during 2021 as the economy snapped-back from the Covid shock. However, jobs growth has slowed somewhat since then and, without a recovery in the space-per-employee ratio, it could realistically take more than two years after peak-vacancy in 2025 for the market to return to balance. On the other hand, if the labour market outperformed, and / or the space-per-employee ratio was boosted by a strengthening return to the office dynamic, the recovery period could be significantly shorter.

More than half of the accommodation that was taken by downsizers in 2023
WAS BER A-RATED

The space-per-employee ratio
FELL BY TWO-THIRDS POST-COVID

"All cyclical downswings are defined by two characteristics – their depth and duration. My read is that this cycle will not be particularly deep by historical standards. But remote working could make the recovery process slower than in previous cycles"

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

"Compared with the Global Financial Crisis downturn, Dublin's office market is now much more mature with a range of modern buildings in well-established office locations that will continue to appeal to blue-chip international occupiers"

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

[3] While it is not our central case, two factors may yet lead to an atypically high volume of decommissioned space, given our current point in the cycle. Firstly, there has been much discussion about the adaptive reuse of office buildings for alternative purposes, including residential, educational and hotels. If entry yields rise to a level that makes this viable, the mainstreaming of change-of-use development could drive a reduction in the office stock. Secondly, some well-capitalised developers may seek to demolish buildings at an earlier stage than in the past to get ahead of construction inflation and the risk of legislative restrictions on knock-and-rebuild projects that have been seen in other jurisdictions, including the UK.

[4] 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%.

TOP 10 DEALS Q4 2023

	BUILDING	LOCATION	TENANT	SQ M
1	124-127 St. Stephen's Green	Dublin 2	Intercom	3,657
2	The Exo Building, Point Square	Dublin 1	Yahoo	3,317
3	The Earl Building, Earl Place	Dublin 1	HSE	2,601
4	Building 8 Cherrywood	Dublin 18	Laya Healthcare	2,323
5	La Touche House, IFSC	Dublin 1	CHI	1,861
6	Various Units, Q-House, Furze Road, Sandyford	Dublin 18	Confidential	994
7	Two Dublin Airport Central	Co. Dublin	Greencore	960
8	Riverside 2, Sir John Rogerson's Quay (Penthouse)	Dublin 2	Interpath Advisory	948
9	1 George's Quay Plaza, George's Quay	Dublin 2	Allied World Assurance	716
10	Swords Business Campus, Unit 3B	Co. Dublin	Howden	710

124 - 127 ST STEPHEN'S GREEN
The biggest and most interesting deal of Q4

	CITY CENTRE	SUBURBS
Highest Rents	€640 per sq m pa	€365 per sq m pa
Number of Deals	20	12
Average Deal Size	890 sq m	785 sq m
Typical Lease Term	15 years	10 years
Typical Lease Break	7-8 years	5 years
Typical Rent Free	12-18 months	15-24 months

* 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	3,017	3,344	1,861	9,575	0	0
City Fringe	619	652	0	0	0	0
Suburbs	888	6,208	0	2,323	0	0

BUILDING 8 CHERRYWOOD

Let to Laya Healthcare in the largest suburban deal of Q4.

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