Lisney

OFFICES

05

OFFICE INTELLIGENCE

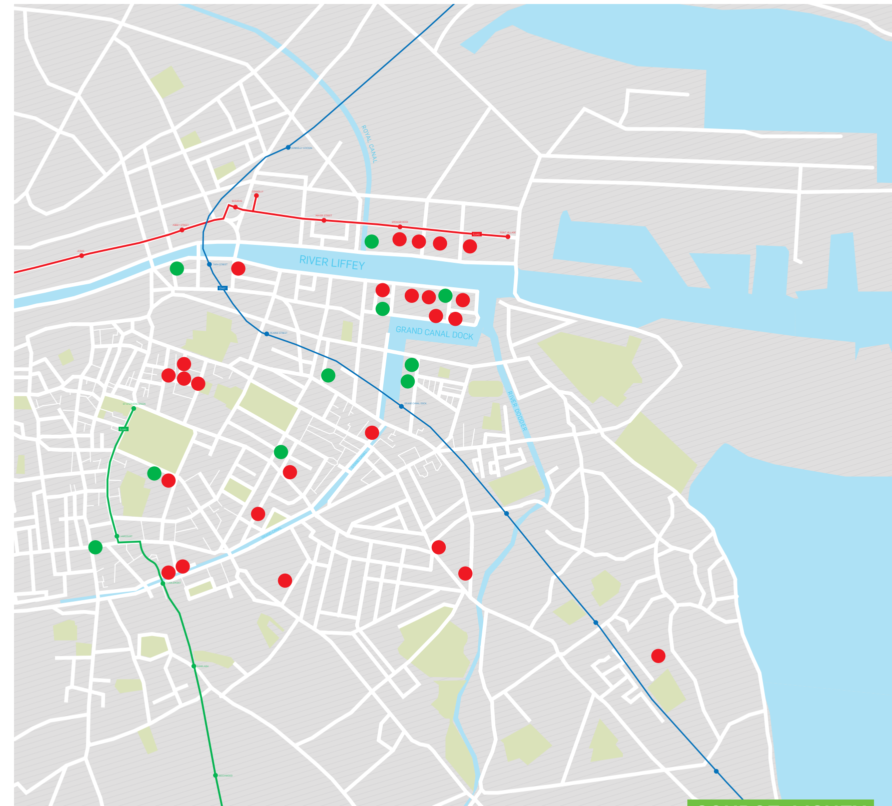
Activity in the Dublin office market continued at very strong levels in 2016.

2016 REVIEW

- The IT sector maintained its significant presence in the market with well-known global firms like Google and Salesforce taking additional space.
- Following a number of years when international occupiers were the dominant players in the market, Irish firms became increasingly present and accounted for almost half of all transactions in 2016.
- Total take up for the year reached a sizable 232,600 sqm. The net absorption for the year was also high at 100,400 sqm.
- The city centre was the most active region in 2016, a trend that has become increasingly dominant in recent years. The working environment and the associated lifestyle benefits remain a selling point for companies attracting highly skilled staff, in a very competitive environment. Enticing and retaining international staff in Dublin means having a city centre office; particularly for larger IT companies. Many companies have been very successful in attracting young mobile staff who wish to spend a few years in Dublin gaining experience in a specialised field, while also benefitting from an attractive lifestyle.
- Rising rents and falling vacancy rates remained key characteristics of the Dublin office market in 2016. Significantly, the overall Dublin vacancy rate fell below 10% for the first time in 16 years and at the end of the year stood at 9.5%. However, the main feature of the year was the volume of new supply in the pipeline. Just 14,800 sqm of new space was completed in 2016 and this is essentially the first wave of development to be delivered into the market since 2008.
- Prime city centre rents are now in the region of €603 psm (€56 psf). Suburban locations are achieving rents between €178 psm to €269 psm (€16.50 - €25 psf).

WATERLOO EXCHANGE, WATERLOO ROAD, DUBLIN 4

OFFICE NEW BUILD SUMMARY Q4 2016



SOURCE: LISNEY

Under Construction   Pending Development

> The overall Dublin office vacancy rate fell below 10% for the first time in 16 years

OUTLOOK FOR 2017

New office construction will continue to be one of the main talking points in 2017.

Almost 320,000 sqm of office accommodation was under construction at the end of 2016 in the entire Dublin region. Close to 36% (or 113,550 sqm) of this is pre-let, mid-let or being developed by owner-occupiers with a further 6% (or 17,750 sqm) reserved and due to be let in the coming months. The remaining 188,450 sqm is speculative and will be added to supply when completed, if not let beforehand. The future construction pipeline is harder to predict. We estimate construction will commence on a further 46,500 sqm in 2017 / 2018 and complete before 2020. The annual net absorption, or net effective take-up, over the last 10 years averaged 83,000 sqm. Given the pipeline of new supply up to 2020 (potentially up to 235,000 sqm), in addition to any refurbishments that will occur over that period, plus used space coming back to the market, we believe that demand will continue to outstrip supply.

As things stand, and assuming no major external shocks, we do not see any basis for negative sentiment about an oversupply.

Finance for speculative office development remains virtually impossible to get from Irish banks, which appear only interested in schemes with pre-letting agreements. Consequently, speculative development finance is coming mainly from international sources such as Deutsche Bank. This is normally at higher rates to reflect the added risk. When it comes to lease negotiations, the financial benefit the developer has from getting a lower rate of finance with a pre-let is effectively shared with the tenant, who receives a much better rental deal. This is in the form of greater rent free periods and/or lower rents.

Given the constraints with development finance, the market will be effectively self-regulated in the coming years. Specifically, not all ready and willing developers will be in a position to start construction when they wish. This means that the supply of new space will be curtailed.

The downturn saw the bankruptcy of a number of prominent Irish developers and an exodus of development expertise. Those currently leading the way in development include Green REIT, Hibernia REIT, NAMA and IPUT. None of these is a traditional-type developer. As the investment objectives of REITs mature, it is uncertain if they will continue to build. Therefore, in the short to medium-term, there is a strong possibility that international developers (and not just investors / financiers) will consider building in Dublin and will fill a potential void.

Unlike many other parts of the economy, Brexit should have a positive impact on the Dublin office market in 2017. There will be increased activity from companies looking to relocate from London and elsewhere in the UK as a result. This is likely to culminate in various deals being agreed towards the end of 2017. In spite of this, it is important not to exaggerate the impact of Brexit on the market. During 2016, a number of deals were incorrectly labelled as Brexit-related. A number of companies are undoubtedly undertaking due diligence and assessing potential relocation options across Europe. Dublin is just one option, but a very real option, given the Irish tax structure and reputation as a relatively easy place to conduct business.

Rental growth will moderate in 2017. With annual city centre increases having been as high as 38% in recent years, we expect the price curve to mature and plateau. Lease terms will remain in favour of landlords with long-term lease commitments of at least 10 years prevailing for prime new developments. Greater flexibility will be available in older secondary buildings and the suburbs. Rent free periods will continue to shorten but will remain lengthy for pre-let deals.

Leases with a rent review due in 2017 will see dramatic rental increases. Those that commenced in 2012 were agreed when prime rents were only €307 psm (€28.50 psf) and tenants have benefitted from very good value over the past five years. However, over that timeframe, such rents have risen by 104% according to the Lisney Commercial Rental Index. As such, reviewed rents will have a significant impact on tenants in terms of a company's cost structure.

As a result of the rental increases in the city centre, tenants may now consider relocating to the suburbs where rents are less than half of the prime city rate. We believe this is possible; however it is more likely to occur if a long-term, 10 year view is taken. This is because the cost of relocating and fitting out a new office is prohibitive and frequently outweighs any rental savings.

Historically, overseas shocks have disproportionately affected the Irish office market. As such, prevailing macro-economy and international events pose the greatest threat to the market in the short-term. Anti-establishment movements have gathered momentum across the globe, with Brexit and the US elections key examples. Such views will also influence European affairs, mainly in Italy and France. Dublin is a gateway to Europe and a strong euro area is good for Ireland and the Dublin office market. In the US, President Elect Trump has pledged to reduce US corporate tax to 15% from 35%. This has the potential to damage Ireland's ability to attract US FDI as the cost / benefit for these companies to locate large parts of their business would reduce, perhaps significantly. The EU Common Consolidated Corporate Tax Base would have a similar effect.

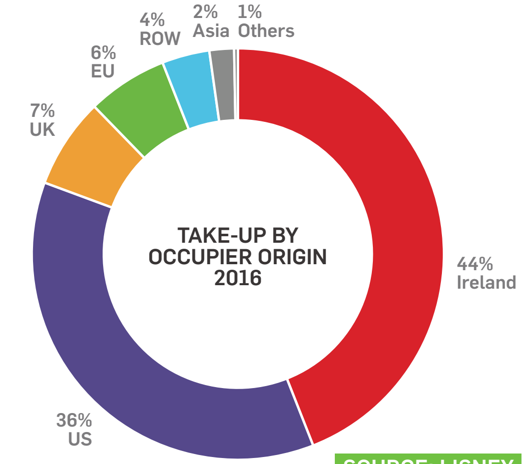
GOLDEN LANE, DUBLIN 8

CENTRAL BANK, DAME STREET, DUBLIN 2

OFFICE RENTS

6.1%

The Lisney index of overall Dublin office rents continued to grow in 2016; however at a slower pace than previous years.



SOURCE: LISNEY