

## Dublin Offices, August 2021

# Is a two-tier market in store for Dublin offices?



There has been a clear flight to quality in the Dublin office market in recent years. Occupier demand has been primarily focused on buildings which promote wellness and better support modern, collaborative office layouts. This has been to the detriment of older second-hand office stock, causing rental growth on prime offices to outpace the rest of the market – a trend that has also been in evidence in other markets including Central London.

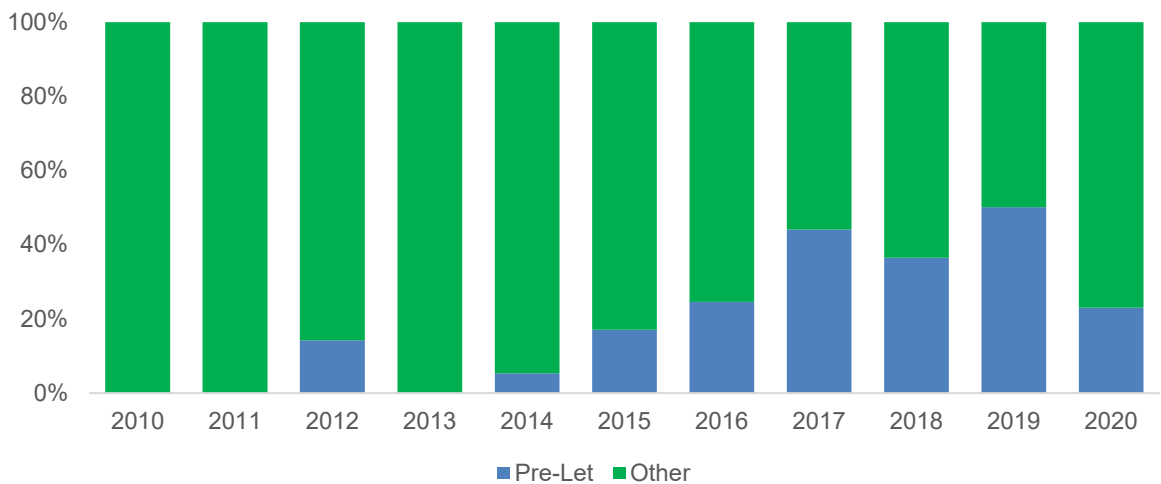
While a flight to quality is not a new trend, the Covid-19 pandemic has accelerated the evolution of office accommodation by several years, speeding up obsolescence and making the need to adapt offices for changing working patterns more pressing. We therefore expect to see a continued, but much more pronounced divergence between prime and secondary office performance as the recovery takes hold.

**FLIGHT TO QUALITY HAS DIMINISHED THE SUPPLY OF TOP QUALITY SPACE**

There has been a clear flight to quality in recent years in the Dublin office market. Occupiers (and in particular multinational employers) have been increasingly using their office space to attract and retain talent with a focus on wellness and amenities. As a result, new and recently refurbished buildings typically designed to meet these criteria have become sought after. New buildings also tend to have better sustainability credentials such as good LEED and WELL ratings, an area where occupier focus is likely to continue to increase.

The flight to quality has been evidenced by second-hand space increasingly dominating availability, above-trend levels of pre-letting activity and - until the Covid-19 outbreak - an increasingly committed development pipeline. Unlike previous cycles in the Dublin office market, the development pipeline slowed in tandem with the weakening in occupier demand witnessed during the pandemic, with Irish construction sites being effectively shut down for long periods. As a result, the increase in vacancy that has materialised in the last 18 months in Dublin has largely comprised secondary accommodation as opposed to new builds.

**Chart 1: Pre-letting activity as a proportion of overall office leasing in Dublin 2010 - 2020**



Source: CBRE Research, 2021

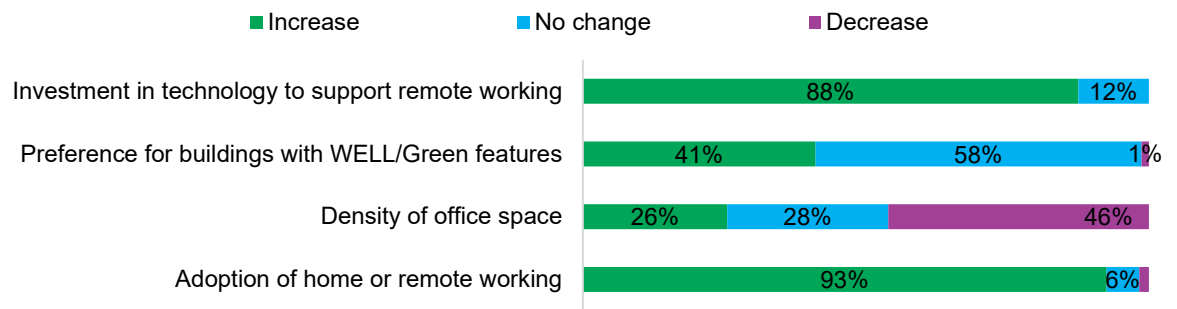
Between 2010 and the Covid-19 outbreak the office development pipeline had become increasingly constrained, from no pre-letting activity being recorded in 2010 and 2011 to an average of 24% of take-up comprising pre-lettings in the subsequent years (chart 1), peaking in 2019 when 50% of all leasing activity in Dublin comprised pre-lets.

At the same time, the proportion of total availability made up of second-hand accommodation increased with the availability of new stock or recently refurbished stock becoming increasingly limited. The outbreak of Covid-19 further exacerbated this trend, with much of the accommodation made available to sublet or assign comprising existing older accommodation as opposed to new accommodation.

**COVID-19 HAS ACCELERATED THE TREND**

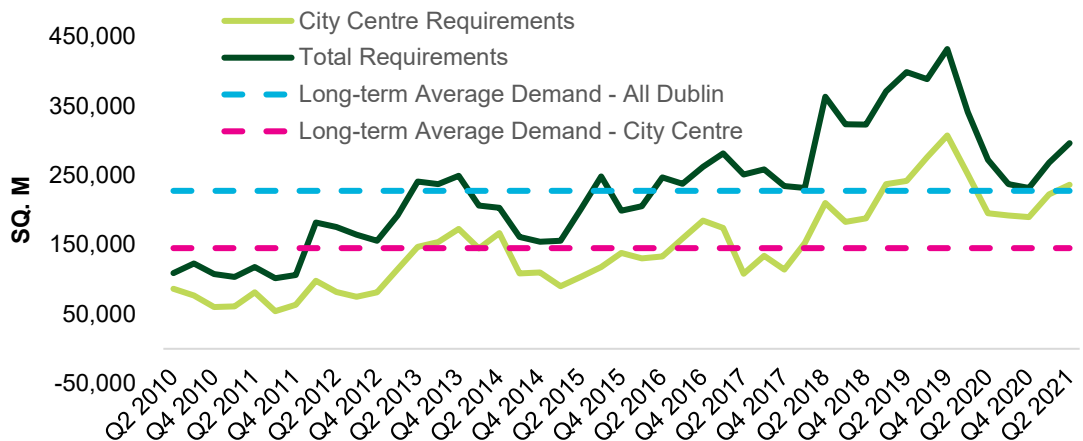
Covid-19 has given further momentum to the drivers behind the pre-existing flight to quality trend. CBRE’s post-outbreak occupier [flash survey](#) shows that occupiers will place greater emphasis on WELL and ‘Green’ features. Offices are also expected to de-densify as adoption of home working grows substantially (for further details, please see CBRE’s March 2021 [ViewPoint](#)). These shifting working patterns mean occupiers will need more collaborative space, breakout and meeting areas and better amenities for employees. Newer space better accommodates these features and so demand at this end of the market has remained more resilient.

**Chart 2: Occupier responses to the question: ‘to what extent do you expect there to be a shift in long term occupier strategy in the following areas after the Covid-19 outbreak?’**



Even with the weakest levels of take-up on record, demand for the very best office accommodation has held firm compared to long term averages for the city. The overall volume of demand for Dublin offices has now begun to increase following a Covid-19 related slump, which bodes well for the latter half of 2021 and into 2022. However, most of this demand is focussed on the best accommodation, with demand highest for new or recently refurbished accommodation and weaker demand for older buildings, which to some degree reflects occupier requirements for space that can accommodate current end user requirements but is also more sustainable from an ESG perspective.

**Chart 3: Demand for Dublin offices over past 10 years**

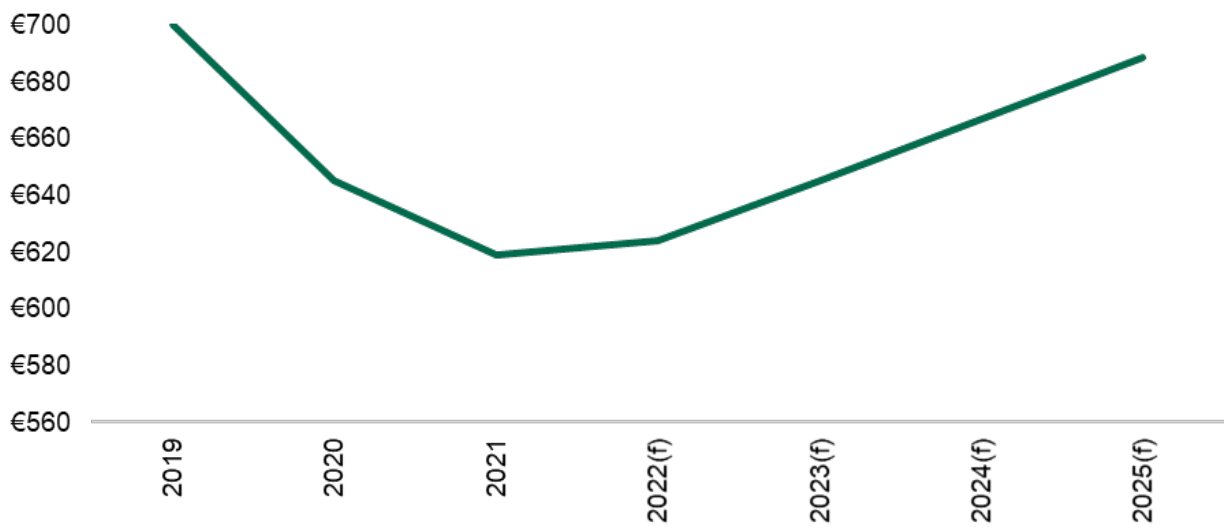


Source: CBRE Research, 2021

**MARKET TO DIVERGE AS HIGHEST QUALITY OFFICES PULL AWAY**

Prime and secondary rental performance was already beginning to diverge following the global financial crisis, particularly as the flight to quality became more pronounced. The Covid-19 pandemic has provided a catalyst for the acceleration of this trend, with the office market forecast to fragment much more pronouncedly as rents recover and as the gap between performance of the most sustainable buildings and others starts to visibly widen. Over the coming years, it is likely that only the highest quality offices will see significant rental growth.

**Chart 4: Dublin office rental growth 2019-2025(f)**



Source: CBRE Research, 2021

*Over the coming years, it is likely that only the highest quality office buildings will see significant rental growth.*

**INVESTORS HOLDING OLDER SECONDARY STOCK MUST ACT**

Will there come a point where the divergence between rental values for modern office accommodation and older buildings is so big occupiers opt for cheaper, lower-quality stock and fit it out themselves? This has been evidenced in some cases, such as in the flexible office sector where operators have been successful in attracting occupiers into older stock. However, in the main, the fundamental structure of a building will dictate the capacity for corporate occupiers to make space work for them – some older buildings are likely to prove incapable of meeting physical requirements and will certainly struggle to meet modern ESG requirements.

Common characteristics of Dublin office buildings where rents are likely to lag include:

- Dated and compromised reception, small and perhaps unmanned
- Poor quality air conditioning and ventilation
- Lifts with small capacity and speed below BCO guidelines
- Poor to no end-of-journey facilities or amenities, e.g. bike storage, showers
- Dated WC's with provision below BCO guidelines
- Poor floor plate configuration such as an awkward shape or many columns
- Compromised natural light and outlook
- Floor to ceiling height of 2.6 metres or below
- Compromised location with a long walk to public transport

While past evidence is thin, poor sustainability credentials such as low BER or LEED ratings could also become a sticking point for occupiers. The ability to monitor and regulate air quality is coming into sharper focus from occupiers as they assess buildings.

Besides weaker rents, this could also mean longer void periods, shorter leases and proportionately larger rent free periods. For many buildings where the physical structure precludes retrofitting space to a high quality, a full-scale refurbishment or rebuild may be the only way to avoid obsolescence, lagging rents and larger incentives.

The CBRE Building Consultancy Team has seen a significant jump in refurbishment enquiries since the start of the Covid-19 pandemic. Investors are looking to re-position obsolete buildings to ensure they are fit for the modern occupier and to improve their sustainability rankings. The re-positioning of existing buildings provides an investor with an advantage from an embodied carbon perspective, with at least 35% lower carbon emissions compared with a typical new build.

The Dublin office market is only now starting to come back to some semblance of normality following a long period of indecision, during which occupiers were not in a position to travel to inspect buildings in any event. Take-up in the Irish capital was subdued during 2020 and the first half of 2021 but there has been a discernible increase in activity over recent months, which will ultimately translate into leasing activity in due course. As this materialises, we expect to see the divergence between the performance of new and older buildings becoming more pronounced. The likelihood is that the flight to core will have become even pronounced as a direct result of the pandemic we have lived through over the last 18 months.

Buildings that will perform best are those that have not only secured the relevant sustainability accreditations in their original design delivery but have a tailored building management regime that ensures these standards are upheld in the day to day operation of the building. In addition to this Landlords who have curated a sense of place within their developments and planned for the long term will win out in the race to secure the best tenants.

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