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Weekend Review

Picture battle

Ron Wood, his former sister-in-law and the paintings that sparked a copyright row. Page 5

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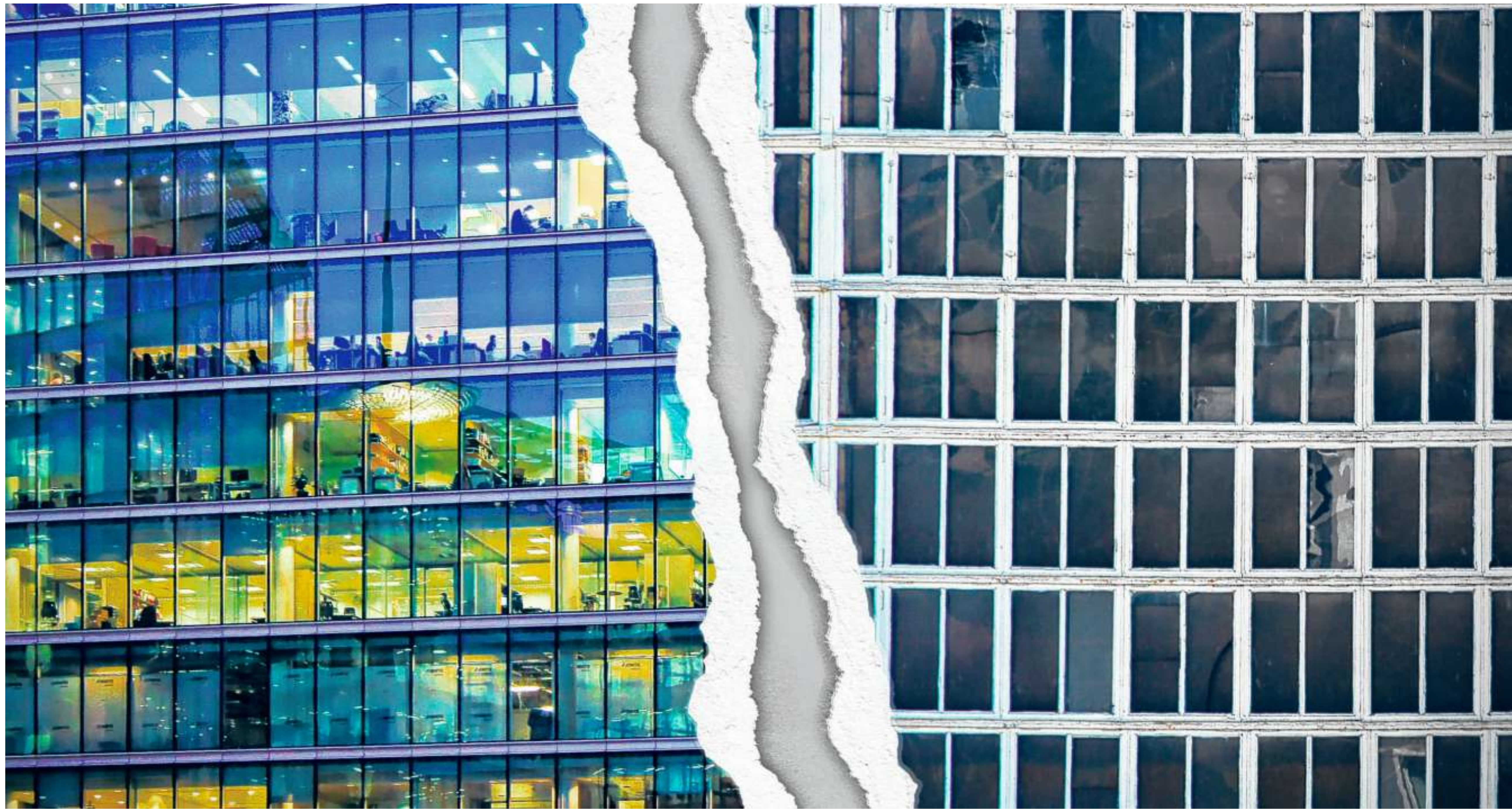

■ **Something has got to give as long as the imbalance between supply and demand persists. Rents are, whatever way you slice it, going to have to come down for the existing stock to be absorbed.** ILLUSTRATION: PAUL SCOTT

OUT OF OFFICE COULD THE MARKET CRASH?

There is more office space than employers need in Dublin city centre just now. But it's not like 2008: levels of office work are increasing, and demand may rise again before long

Ian Curran

A capital city centre festooned with "office to let" signs. A deluge of reports suggesting the office market is in correction mode. A historically understandable scepticism and sense of dread about the property sector in general. Adding all of these together, you would certainly be forgiven if your anxiety levels have risen in recent weeks while reading the business pages.

Commercial property agent HWBC is just the latest industry player to sound alarm bells, this week warning that a "cocktail" of issues has seen the number of vacant offices surge in the first half of the year.

So, is Dublin heading for a 2008-style crash in property values? In the middle of a housing crisis, are we doomed to be haunted by ghost office blocks, like the ghost estates of a past era, as symptoms of a speculative bubble that has popped?

What a difference a year makes. Throughout 2022, the picture presented to the public in various market reports from the research department of commercial property agents was a happy one.

Post-Covid, record levels of investment in the first half of the year coupled with sharp pick-up in demand for space saw office take-up jump sharply with newer, better-quality stock in Dublin city centre a particular focus for would-be tenants.

Headline rents were stable and the volume of vacant office space fell from pandemic highs. While demand for older and suburban stock had softened somewhat, there was reason to think that 2023 would be another year of strong growth and elevated rents, according to the prognosticators.

"Although an easing of demand is expected in the early part of next year until inflation eases," said Savills Ireland in a December report, "the underlying base of demand . . . has remained resilient and will support take-up levels in 2023."

Trouble was brewing, however. In the final three months of 2022, the global tech downturn was beginning to bite as some of some of the behemoths of Silicon Docks such as Meta, Twitter and Stripe among others – also among the larger employers in the city centre – announced swingeing job cuts. Some of the signs manifested even earlier than that. As The Irish Times highlighted in August 2022, social media platform TikTok's decision to pull out of talks to rent 16,443sq m (177,000sq ft) of space at a prime office scheme in Dublin's docklands was a "troubling omen" of what was to come.

The pullback in staffing by tech companies and other factors, including the lingering popularity of remote working arrangements, have "dragged" on the office market in 2023, as BNP Paribas Real Estate Ireland put it in July.

In its report this week, HWBC said office take-up plunged from 87,839sq m (945,500sq ft) in the first half of 2023 to just 62,988sq m (678,000sq ft) this year while the average deal size fell to 696sq m (7,500sq ft). Despite more than 46,451sq m (500,000sq ft) of reserved space, full-year take-up is projected to struggle to reach 139,354sq m (1.5 million sq ft), compared with 215,302sq m (2.32 million sq ft) in 2022 and a 10-year average of 238,732sq m (2.57 million sq ft).

Vacancy rates have surged to 14.4 per cent and could reach as high as 17 per cent this year, according to some estimates. Putting it simply, there is an oversupply of office space relative to the space requirements that Dublin city centre-based employers currently have, a situation that is likely to worsen as even more stock currently under development is delivered to the market this year.

All of this very sounds familiar. But the current situation bears very little resemblance to 2008 and, for some experts at least, it could be relatively shortlived.

"I'm not famous for being an optimist," says John McCartney, director of research at BNP Paribas Real Estate Ireland. "On this, I'm actually quite sanguine."

'Overhang'

So why the positive outlook? There are two good reasons, according to McCartney: supply and demand.

On the supply side, the "overhang" – the relative oversupply of space compared with employer requirements – is decidedly limited, certainly compared with the crash.

"In a market of around 4.5 million sq m, there is probably 400,000sq m, or approximately that, above and beyond what is natural for the market," he explains. "Compare that to what I saw in 2008, when I looked at the pipeline of supply, it was 600,000sq m to 2.5 million sq m of standing stock and the economy had collapsed so that propelled the vacancy rate to 24 per cent."

The other key factor on the supply side of the equation is that beyond next year, the pipeline of new office block developments coming on stream is pretty thin and will peak later this year. "That really reflects banking conditions," McCartney says.

As interest rates have risen over the past 12 months, property companies – and businesses of all sorts – have found it more and more difficult to secure financing. "So the amount of capital available for speculative office development has been very disciplined," McCartney says.

"Even if developers had the instinct to rush in and go big on development, the funding environment just wasn't there to support that."

On the demand side, there are two key variables, one of which is the future of remote working.

Hybrid working is here to stay, whether some employers want it to or not. The only question seems to be to what extent, and here opinions are divided. Figures from Eurostat and BNP indicate that Ireland saw the biggest push towards remote working arrangements in the European Union between 2019 and 2022.

While the Netherlands had the highest percentage of its workforce who said they usually work from home, the number of Irish workers who said the same jumped 18 percentage points to 25 per cent between 2019 and last year. Various surveys have indicated a strong preference among Irish office employees to retain some elements of the arrangements they came to with their employers during the pandemic.

But while the days of commuting to the office five days a week rain, hail or shine have likely gone the way of the fax machine, there is reason to think that office workers will be spending more time in their cubicles than they are now.

For one, big employers across the globe are getting more and more frustrated with low attendance and are escalating their attempts to return to what used to be considered normality.

> **It's just a cycle. They come and they go and some people lose money and some people lose jobs but there is not going to be a severe cycle**
> – John McCartney, director of research at BNP Paribas Real Estate Ireland

In the tech world, companies such as Salesforce are offering a carrot of sorts, promising to donate $10 to charity per day on behalf of any employee who comes into the office, the New York Times reported in June.

Others – like Facebook parent Meta, which is reportedly telling workers they could face the sack if they fail to meet minimum attendance requirements – are offering the stick.

Desperate? Maybe. Counterproductive? Very possibly, according to EY research showing a direct correlation between forced office returns in the US and declining productivity. But in many corporate workplaces, employers are making it more difficult to refuse.

Horse-trading

Undoubtedly, there is going to be some horse-trading between bosses and workers over future arrangements. But it is not unreasonable to imagine a world where staff currently working one or two days in the office a week find themselves spending more time in the workplace in the near future.

The other demand factor, and an important one at that, is the broader Irish economy. In the 1990s, offices in Dublin and other cities were transitioning from a cellular model – in which everyone had their own enclosed cubicle or even separate office – to a more open-plan model.

"If you can believe it, there was a whole debate about that," says McCartney. "The office space per employee ratio at that time, through the 1970s, 1980s and early 1990s was probably about 13sq m per person. When we started going for open-plan offices, the ratio fell because when you don't have to build so many walls, you can squeeze more people into the same office footprint, and the ratio fell to the 10sq m that has been sort of fairly reliable over the last 20 years or 25 years."

The debate was whether this new development would subtract from office demand, "and it did, all things being equal", he says. "But everyone was missing the bigger point, which was that the Irish economy became a jobs machine and jobs growth completely overwhelmed any negative effect from the reduced space."

Fast forward to 2023 and the Irish jobs machine is again churning out the goods. And naturally, more jobs mean bigger space requirement for corporates. Buffeted by global headwinds though it is, the economy – as measured by gross domestic product (GDP) – is expected to grow again this year and next year, albeit at a slower pace than previously thought.

In its latest quarterly economic commentary, the Economic and Social Research Institute (ESRI) trimmed its headline forecast for growth amid a sharp downturn in the global pharmaceutical sector, affecting exports from big multinationals with a base of operations.

But Irish GDP, as we have been repeatedly reminded by international commentators, is the most unreliable narrator in economics. A more relevant measure of the health of the domestic economy is modified domestic demand (MDD), a metric that attempts to strip out the distorting effect of large foreign corporates booking their profits in Ireland.

By this gauge, the domestic economy is continuing to grow "robustly", the ESRI said in June, and is forecast to expand by 3.5 per cent this year and 4 per cent in 2024. Consequently, we are now "beyond" full employment, as the Irish Fiscal Advisory Council put it this week, with scarcities of workers prevalent in a number of key sectors.

Certainly, these figures do mask all sorts of issues within the economy, including rising inequality, material deprivation and the erosion of incomes for the poorest in Irish society, as the ESRI highlighted in a stark report this week.

But the bird's eye view suggests that, barring any big global shocks – which are certainly not outside the bounds in the current environment – the Irish economy remains poised for expansion and will continue to add jobs next year.

Combine these factors – a slowing pipeline of new offices and relatively buoyant demand – and it certainly seems there is strong floor under the Dublin market, McCartney says, and prime city centre offices currently vacant won't remain so for long. "That's why I think we have this fairly benign situation."

Vote of confidence

Some big employers are already taking the longer view of the market. Post pandemic, professional services giants EY and KPMG have both been on the hunt for new offices in the capital to house their armies of consultants and accountants.

EY, which employs 4,500 people in Ireland, has been in expansion mode of late and said in April that it was "well on the way" to filling 900 new roles announced last November, aimed at growing its headcount to 5,100. This is understood to be driving EY's decision in advance of the expiration its Harcourt Street leases in 2027.

Hibernia Real Estate Group, meanwhile, is in the process of delivering a new office complex for KPMG, which will house more than 3,000 of its staff from 2026 on. Industry figures consider both moves to be a strong vote of confidence in the long-term outlook for Dublin.

But something has got to give as long as the imbalance between supply and demand persists. Rents are, whatever way you slice it, going to have to come down for the existing stock to be absorbed. Although rents for older stock have come under pressure in recent months, landlords have been slow to cut prices for newer buildings with better environmental and health standards.

That is almost certainly going to change, says McCartney. "It's just a cycle," he says. "They come and they go and some people lose money and some people lose jobs but there is not going to be a severe cycle."