ESRI Research Note

FDI and the Availability of Dublin Office Space

David Duffy and Hannah Dwyer

Research Notes are short papers on focused research issues. They are subject to refereeing prior to publication.

FDI and the Availability of Dublin Office Space

*David Duffy, ESRI and Hannah Dwyer, JLL[1]

1. Introduction

Foreign direct investment (FDI) is an important component of industrial policy in Ireland. Having pursued this policy for many years, Ireland is one of the most FDI-intensive economies in the OECD. The factors underpinning Ireland's success in attracting FDI have been well documented and include EU membership, native English-speaking, low corporate tax rate, young and skilled labour force and demonstration effects.[2] A recent policy statement on FDI identifies the role of cities as becoming increasingly important in FDI flows and cites the attractiveness of Dublin as a key determinant in Ireland's overall FDI performance (Department of Jobs, Enterprise and Innovation, 2014).[3]

While there has been much focus on the impact of the recession on the housing market it is also the case that the domestic commercial property market suffered as severe an impact. The JLL Capital Value Index shows that values fell by 67.2 per cent between a peak in Quarter 4, 2007 and trough in Quarter 3, 2011. As a result of the downturn in the commercial property market, the level of stock under construction fell dramatically between 2008 and 2010 and there was no office space construction activity in the Dublin market between 2011 and 2013. As a result, no new office space has been delivered to the Dublin market for the last five years.

Data for Quarter 2, 2015 show that the vacancy rate for Dublin office space has fallen and is now at its lowest level since JLL began measuring the vacancy rate in 2001. There is variation in the vacancy rate across Dublin, with a lower vacancy rate in the city centre and in Dublin 2. Concerns have been expressed about the ability to continue to attract service sector FDI in the absence of appropriate office space. According to JLL research, close to 70 per cent of the take-up of office space in the first half of 2015 was by new and existing FDI companies. This

1 Hannah Dwyer is Head of Research at JLL Ireland.

2 There has been extensive research published on this topic, see for example, Barry and van Welsum (2005), Barry (2006), Crafts (2014) and European Commission (2014).

3 Policy Statement on Foreign Direct Investment in Ireland, July 2014.

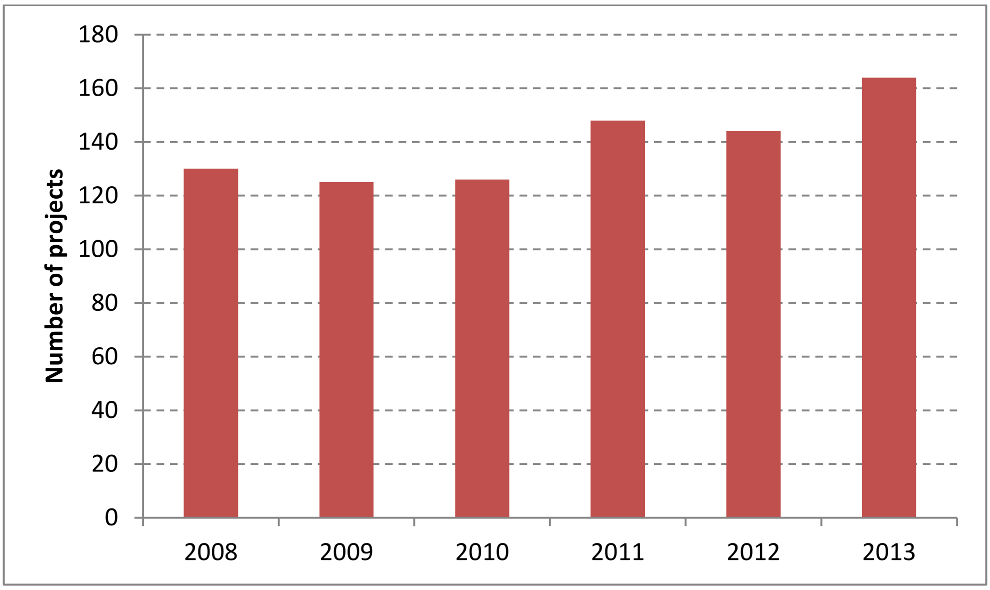
* david.duffy@esri.ie; hannah.dwyer@eu.jll.com

note looks at the Dublin office market and, using data from JLL, examines the take-up of office space by service sector FDI and how this has evolved, and discusses the impact of the relative lack of current supply on future FDI.

2. The Importance of FDI in Ireland

Although the Irish economy suffered a sharp economic downturn, and entered and successfully exited an EU-IMF programme, Ireland continued to be successful in attracting FDI. Data from the Forfás *Annual Employment Survey 2013* show employment in foreign agency-assisted companies declined between 2006 and 2010, but has since grown and by 2013 had returned close to the 2007 level. Although there have been job losses over the past decade, losses in foreign-owned manufacturing have been offset by increases in foreign-owned service sector employment. Estimates by the CSO for the gross valued added (GVA)[4] by foreign-owned multinationals for 2013 shows that sectors dominated by foreign-owned multinationals accounted for 24.6 per cent of GVA in 2013, amounting to approximately €38.6 billion in real terms. The strong performance of the foreign-owned sector over the period in part reflects increased output and value-added in the pharma-chem sector. Figure 1 shows the number of FDI projects, (greenfield, expansion, and research, development and innovation investments) by IDA client companies since 2008.

FIGURE 1 Number of Investments Approved by IDA Ireland



Source: Based on data from IDA Ireland Annual Reports.

4 GVA measures the contribution to the economy.

In a comparison of employment in business sectors between Ireland and the EU15, Barry and Bergin (2015) show that Ireland has a high share of employment in market services. In the case of the service sector foreign affiliates account for over a quarter of Irish employment. In addition, they show that Irish service exports are predominately from non-traditional sectors with ICT services accounting for around 40 per cent of service exports, 'other business services' almost 30 per cent and finance and insurance almost 20 per cent, with most service sector exports coming from the foreign-owned sector.

Barry and Bergin (2015) also look at the relative importance of the foreign multinational sector by evaluating the extent of backward linkages per job. For the foreign-affiliate services sector expenditure per employee on Irish-sourced services is high, estimated at €140,000, when compared with either manufacturing industry or indigenous service sector companies.

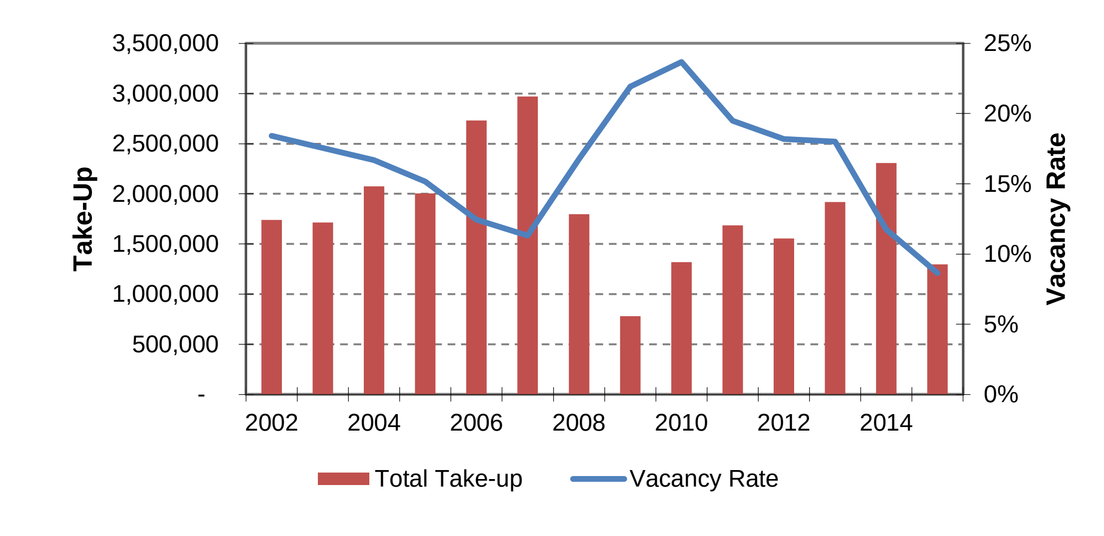
3. Overview of the Dublin Office Market

Dublin is a 40 million sq.ft. market of modern office stock, which is comparable in size to UK regional cities like Manchester, and European mid-sized cities such as Rotterdam. Dublin has the advantage of being a capital city, in an established and open economy. Over the period 2008 to 2012, choice within office space was high, reflected in a 24 per cent vacancy rate and rents that were 50 per cent lower than the peak in 2007.

The Dublin office market has performed steadily for the last number of years, and has been the most stable of the main three commercial property sectors. Whilst the economic downturn in 2008 impacted economic and property markets significantly, it also inadvertently created some favourable conditions for attracting FDI occupiers to Ireland in terms of competitiveness, the availability and affordability of commercial property, and flexibility in lease terms. Whilst many of the big international companies have been here for numerous years, most of the current wave of high profile FDI companies have all located and expanded here since 2008.

In the last 10 years, demand for office space has been strong, particularly from FDI. Average annual take-up totals were 1.9 million sq.ft. between 2004 and 2014 which is in line with trends for a market of Dublin's size (see Figure 2). In terms of location, there is a strong preference for city centre locations and Dublin 2 is the dominant sub-geography. This core location has consistently been the focus of occupier demand for the last 10 years, accounting for approximately 30 per cent of take-up per annum. Within this location, demand is focused on prime quality, Grade A[5] buildings. Occupiers have also shown a preference for locating to areas where similar occupiers exist. For example, we have seen the emergence of the docklands area in Dublin 2 in the last number of years as a preferred location for technology and new media companies.

FIGURE 2 Take-Up and Vacancy rate, Dublin Office Market



Source: Based on JLL data at Q2, 2015.

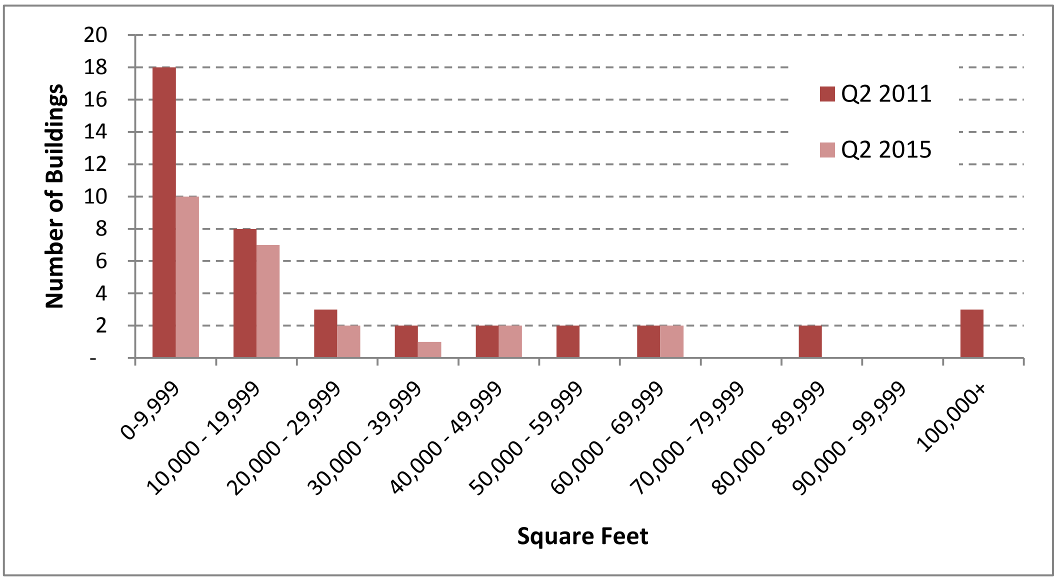
Although large-scale deals such as the purchase of the Montevetro building in 2011 attract a lot of attention, the market in Dublin is dominated by smaller-sized deals of less than 10,000 sq.ft. Anything greater than 50,000 sq.ft. is considered a large office building in Dublin with limited transactions of this size category per annum. In 2014, there were 6 lettings, (just 3.1 per cent of lettings) greater than 50,000 sq.ft. compared to 10 in 2013, and in the first two quarters of 2015, there have been three lettings greater than this size, 2.5 per cent of lettings in total.

With strong demand and limited construction activity, the vacancy rate has decreased significantly since 2010. In terms of actual space, availability has fallen from 8.3 million sq.ft. to 3.3 million sq.ft. This equates to a fall in the overall vacancy rate from 23.7 per cent to 8.6 per cent. Only 31 per cent of the vacant stock is in the city centre where the vacancy rate is at 5.3 per cent, while in Dublin 2 it is just 3.6 per cent.

5 Grade A refers to prime quality buildings with the highest specification features (e.g. air conditioning, raised access floors etc).

Reduced choice of available properties is the greatest issue for the sector at the moment, with limited availability in certain size categories for prime space in core locations. Below, Figure 3 illustrates the availability of space by size category in the city centre. There are currently only two buildings greater than 50,000 sq.ft. that are completed, available and vacant.

FIGURE 3 City Centre, Grade A Office Availability



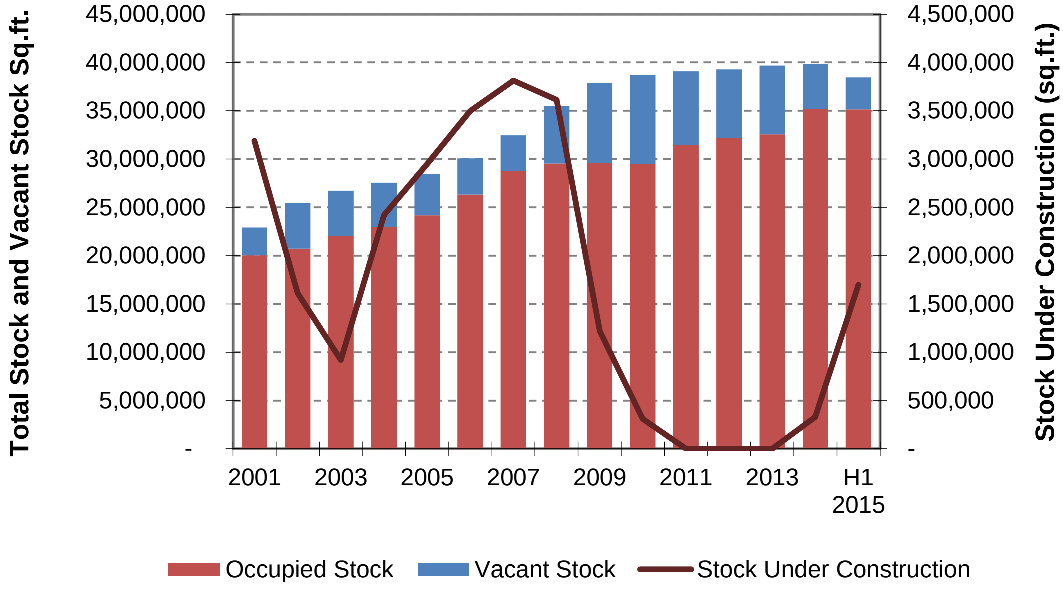
Source: Based on JLL data at Q2, 2015.
Note: City Centre defined as Dublin 1, Dublin 2 and Dublin 4.

There are a number of schemes where building activity has started, with 1.4 million sq.ft. currently under construction in the city centre, of which 40 per cent is pre-let. The first new office building is likely to be delivered in Q1, 2016, and this is already pre-let. The market needs an increase in speculative development to meet the strong demand, with JLL forecasting take-up of 1.6 million sq.ft. per annum for the next five years.

In addition, there is 0.7 million sq.ft. under refurbishment, of which almost 0.1 million sq.ft. is reserved. Refurbishments are offering a quicker solution, as depending on the level of refurbishment needed these could be delivered in six months.

A number of office schemes are also either in the pre-construction phase with planning in place, or in the pre-planning phase. This should help to bring additional supply to the market. In the city centre, in addition to the space currently under construction, there is potentially 1.6 million sq.ft. of space that could be delivered in 2017 and 2018 (see Figure 4). This is the equivalent of one years' worth of lettings or eight large lettings per annum.

FIGURE 4 Occupied Stock, Vacant Stock and Stock under Construction, Dublin Office Market

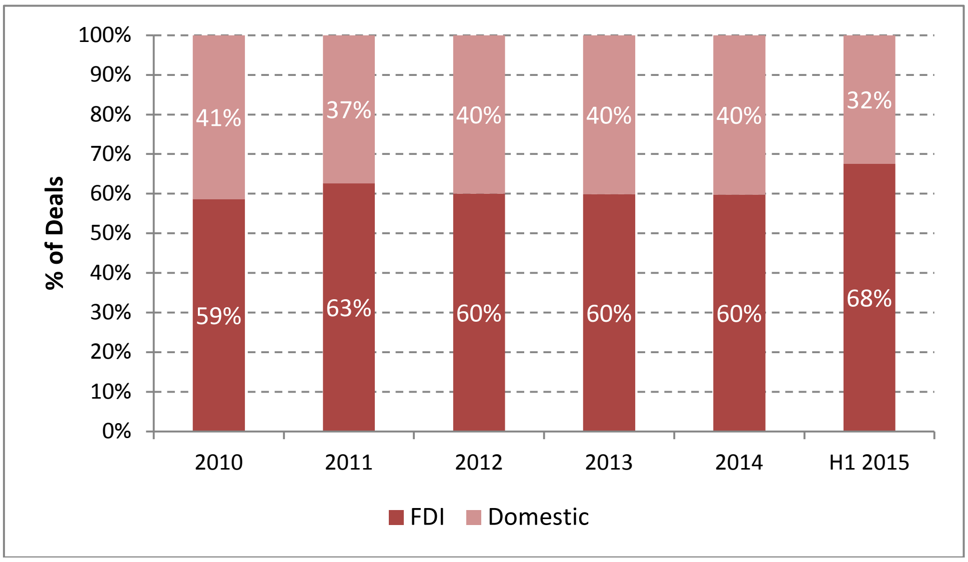


Source: Based on JLL data at Q2, 2015.

4. Take-up of Office Space by FDI in Dublin

In the last five years, FDI has accounted for an average of 60 per cent of office take-up per annum. This is a combination of existing FDI companies expanding or new FDI entering the market. During this period, tech companies have performed particularly strongly, with global names such as Google, Facebook, Amazon, Salesforce, LinkedIn, Yahoo, Twitter, Microsoft and MasterCard all actively relocating to or expanding in Dublin. This trend continues, with FDI accounting for almost 70 per cent of take-up so far in 2015.

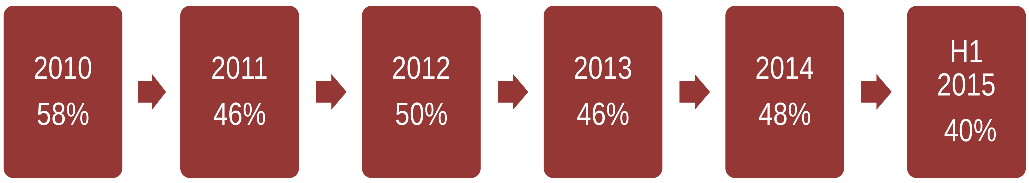
FIGURE 5 Take-Up of Office Space, Dublin Market, Domestic and FDI companies



Source: Based on JLL data at Q2, 2015.

FDI companies have a preference for south Dublin city centre locations, particularly the Dublin 2 and Dublin 4 geographies. Williams et al. (2012) mapped IDA supported FDI data and showed concentrations in the inner core of Dublin city. They find that many new creative industries are choosing city centre locations. In particular they have clustered around the South Docks part of the city, with Google and Barrow Street at the epicentre of activity. Take-up by FDI companies in Dublin 2 and Dublin 4 totals an average of 513,479 sq.ft. per annum in the last five years, or 664,742 sq.ft. in the last two years.

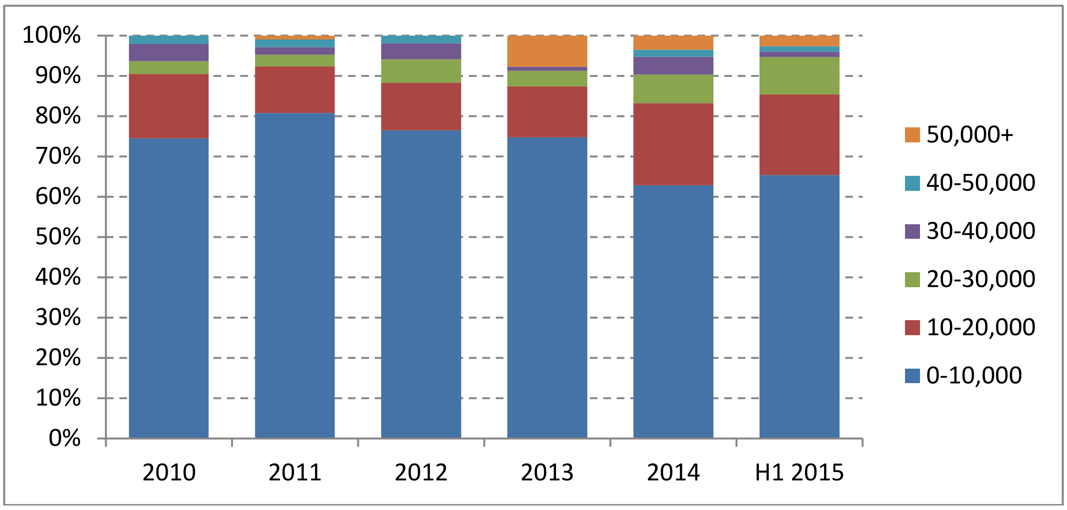
FIGURE 6 Per cent of FDI Take-Up in Dublin 2 and Dublin 4



Source: Based on JLL data at Q2, 2015.

Figure 7 shows take-up by size by FDI companies from 2011. In terms of size, the majority of FDI companies initially focus on space less than 10,000 sq.ft. Between 2010 and 2014, an average of close to 74 per cent of FDI deals were for office space less than 10,000 sq.ft.

Figure 7 FDI Office Deals by Size, Dublin Market



Source: Based on JLL data at Q2, 2015.

A particular trend in the last number of years is an increase in small tech-based companies looking to start up in Ireland. Generally, their initial requirements are for a small amount of space in serviced office centres or short-term leases. In a number of instances, their requirements have quickly evolved to incorporate quick growth and expansion. Speed and timing of expansions is dependent on individual occupiers but in some instances tech-based FDI companies have quadrupled in size by the end of their first five years in Ireland. Given the nature of the expansion by these FDI businesses, and in particular tech companies, the availability of flexible leases would enable them to respond quickly to their growth in size.

This level of quick growth can be evidenced from the behaviours of a number of occupiers. The table below shows four key FDI occupiers in Dublin and their growth in the Dublin market from their inception:

Table 1 Growth in Office Space Requirement of Selected FDI Companies

Google		Facebook		Amazon		Salesforce	
Entered Market	2003	Entered Market	2009	Entered Market	2009	Entered Market	2003
Initial size (sq ft)	4,790	Initial size (sq ft)	20,290	Initial size (sq ft)	14,090	Initial size (sq ft)	7,211
Current size (sq ft)	677,715	Current size (sq ft)	247,943	Current size (sq ft)	100,000	Current size (sq ft)	91,745
Current No. of buildings	9	Current No. of buildings	2	Current No. of buildings	1	Current No. of buildings	2

Source: Based on JLL data at Q2, 2015.

Since Google moved to Dublin in 2003, they have grown from a staff of five to employing more than 2,500 people. Since 2011, Google has spent approximately €280 million purchasing almost 500,000 sq.ft. of office space in Dublin and also leases a further 150,000 sq.ft of space in the city.

There are also a number of FDI companies that have established their European HQ in Dublin. HQ offices vary in size, but generally come after a period of expansion from a small initial requirement that then builds up into larger space.

The low vacancy rate at present suggests that there is now a constraint on companies looking to expand, with these companies being limited in terms of their choice and options when looking for prime space in the city centre. In some instances, companies will have to consider less-prime or less-central locations and take space that does not meet their exact requirements. Some FDI companies have already committed to pre-let space that is under construction e.g. Aercap who are relocating and expanding. However, this generally occurs for larger floor plates. There are 10 sites currently under construction in the city centre greater than 50,000 sq.ft., of these four are pre-let and two of these are FDI companies (LinkedIn and Aercap).

For companies looking for space in the sub-20,000 sq.ft. category, their choice is increasingly limited. In the short term, these companies will continue to struggle to find growth space but refurbishments could offer a temporary solution to their requirements. Some may even be forced to bi-locate in smaller space in the short-term.

5. Conclusion

The analysis in this note suggests that initial FDI requirements for office space are usually small scale. Although choice has become more limited, there are buildings available in this size category at present. However, expansion is common and this requires readily available office space in key locations. As it currently stands, if there was a repeat of any company wanting to set up or relocate to a facility in Dublin for more than 500 people they would now have to wait until approximately Q1, 2017 to occupy a suitable building. In contrast, in 2013 there would have been seven suitable buildings to choose from.

The growth of Google from 5,000 sq.ft. to 650,000 sq.ft. is an example of how quickly occupier expansion can happen in Ireland. We are seeing other occupiers like Facebook, Salesforce, and Amazon potentially showing similar patterns of growth.

There are other tech occupiers entering the market now that may become the next big growth company, or established companies in Ireland that are now starting to show growth that will also be looking for space in the short-term. These companies may not want to sign long leases. It is important that the market is able to facilitate this type of occupier demand.

The recent economic downturn resulted in a number of years in which no commercial property construction was undertaken. Dublin is the only European capital city where this was the case in the last few years. With the return to growth in the Irish economy, new construction is now underway, with development funding available through REITs[6] and overseas funds. Ireland has been successful in continuing to attract investment. However, there is concern that the lack of construction during the crisis could act as a constraint to new FDI and to the expansion of existing FDI. Ireland is still one of the top countries in Europe for attracting investment with good talent, tax and a track record. For Ireland to remain in this position, it is imperative that future growth is not constrained by the availability of commercial property.

6 Real Estate Investment Trusts.

REFERENCES

Barry, F. (2006). 'Foreign Direct Investment and Institutional Co-evolution in Ireland', UCD Centre for Economic Research Working paper No. WP06/03.

Barry, F. and A. Bergin (2015). The Irish Business Sector over the cycle, mimeo.

Barry F. and D. Van Welsum (2005). 'Services FDI and offshoring into Ireland', paper prepared for the OECD Directorate for Science, Technology and Industry Panel Session on Offshoring, June.

Crafts, N. (2014). 'Ireland's medium-term growth prospects: a phoenix rising?' *Economic and Social Review,* Vol. 45, No. 1, Spring.

Department of Jobs, Enterprise and Innovation (2014). Policy statement on Foreign Direct Investment in Ireland, July.

European Commission (2014). 'The Case of Dublin as a European ICT Pole of Excellence: Experts' Insights into Public Policies', Joint Research Centre Scientific and Policy Reports, M. Bogdanowicz (editor).

Horner, R. and Y. Aoyama (2014). Limits to FDI-driven growth in Ireland: a newspaper content analysis for investment, upgrading and divestment. *Irish Geography*, [S.l.], v. 42, n. See http://irishgeography.ie/index.php/irishgeography/article/view/95/87.

JLL (2015). *Dublin Office Market Report Q2 2015*, July.

Williams, B., W. Foley, J. Cudden and H. Shahumyum (2012). 'Dublin's role in the Irish and global economy 2012', Working paper No. 4, Dublin Regional Authority.