

Spotlight Scottish Office Market

Spring 2017



Boulton Brooks acquired The Tun, Edinburgh, for £8.3m during April 2017. Savills acted on behalf of the vendor.

■ The Scottish office market has seen stable levels of take-up during the first quarter of 2017. Total take-up for the Scottish cities reached 573,718 sq ft, in line with the quarterly average.

■ Savills forecast office take-up for the key Scottish markets to reach a combined 1.7m sq ft for 2017, 17% above the total take-up during 2016, driven largely by an improving Aberdeen market, with stable levels in Edinburgh and Glasgow.

■ We expect top rents to remain stable in the Glasgow and Aberdeen markets at £30 per sq ft and £32 per sq ft respectively. Edinburgh is forecast to see a 1.5% rise to £34 per sq ft by the end of the year, driven by new product coming onto the market.

■ Scottish office investment reached almost £125 million during the first quarter of 2017, around 31% down on the five year quarterly average, with a balanced spread across the key Scottish cities.

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 “We expect a number of larger, high profile office buildings in Glasgow to become available during the course of 2017, and we anticipate a more balanced investment picture across the Scottish cities.” Stuart Orr, Director, Investment, Glasgow

The Scottish office market has brushed aside concerns of Brexit and Indyref2 during the first quarter of 2017 to record a strong quarter of take-up.

Economy

The UK economy has started 2017 fairly modestly, with 0.3% growth recorded for the first quarter. Weak Sterling has added upward pressure on inflation which is squeezing output in consumer-facing subsectors- first signs that Brexit is beginning to bite. PMI figures indicate the services sector has started the second quarter more strongly, however, with economic growth forecast to reach 1.7% for 2017.

This has ultimately had a staggered effect on the employment market, and office based employment growth in Scotland is set to grow by 1.8% over the next five years, according to figures from Oxford Economics. The Professional, Science and Tech sector is expected to be one of the largest contributors at 5.2%, benefitting from particular growth in Edinburgh and Glasgow.

Occupational

The Scottish office market has seen stable levels of take-up during the first quarter of 2017. Total take-up for the Scottish cities reached 573,718 sq ft, in line with the quarterly average (Graph 1). 52% of the take-up came from the city centres, below the long term average of 65%.

This was in part driven by a return to confidence in the **Aberdeen** market, which saw take-up jump to 181,000

sq ft, comparable with the total volume of deals during 2016. This was largely driven by Total taking 108,000 sq ft at Arnhall Business Park, the largest Scottish deal since the EU referendum. Marathon Oil also took 31,668 sq ft of space at the Hill of Rubislaw towards the end of the quarter.

Despite wider market availability reaching a record level of 2.1m sq ft in Aberdeen, there remains a shortage of Grade A office space, which currently stands at 750,000 sq ft, approximately 2.8 years of supply. Marischal Square and The Silver Fin Building will provide a further 287,000 sq ft of speculative space in the second half of the year.

Glasgow city centre take-up reached 100,282 sq ft during the first quarter, boosted by engineering firms, Mott Macdonald and Wood Group taking 34,515 sq ft and 17,249 sq ft at St Vincent Plaza respectively. A further 79,566 sq ft of space was taken in the out of town market, which we expect to gain further momentum as the first phase of Magenta at Clyde Gateway takes shape.

DWP are currently under offer for 80,000 sq ft at 3 Atlantic Quay which is undergoing a comprehensive refurbishment. There are a number of large requirements currently in the market, with the Scottish Courts, Lloyds Bank and Virgin all looking for space.

Top refurbished space is currently achieving £27 in the city centre. With top rents at £30 per sq ft and no newbuild product coming onto the

market, we expect upward pressure on refurbished rents to close the gap between new build. Refurbishments will provide the majority of Grade A space in Glasgow city centre, after new Grade A stock fell to only 74,795 sq ft.

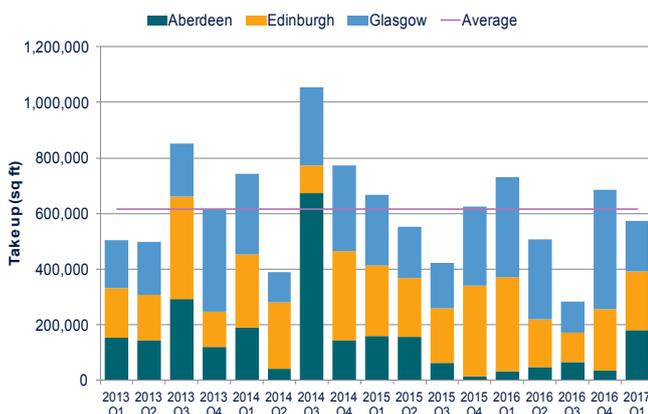
Edinburgh's office market remained stable during the first quarter of 2017, with take-up reaching 129,000 sq ft in the city centre and a further 84,000 sq ft in the out of town market, marking a total of 213,000 sq ft, in line with the five year quarterly average.

The key deal was chip designer Cirrus Logic taking 22,500 sq ft of space on the fifth floor of Quartermile 4. We have since seen the second quarter of 2017 start strongly, with State Street Bank pre letting 66,000 sq ft at Quartermile 3, where there is only one lower floor remaining.

Availability in Edinburgh city centre has remained stable since end 2016 at 1.25m sq ft, following the arrival of One Lochrin Square. This has boosted Grade A supply to 333,000 sq ft and provided much needed space for Edinburgh's growing tech sector. With 605,000 sq ft of known lease expiries occurring between 2019 and 2021, we expect occupiers to be turning their attention to pre-lets in the second half of 2017.

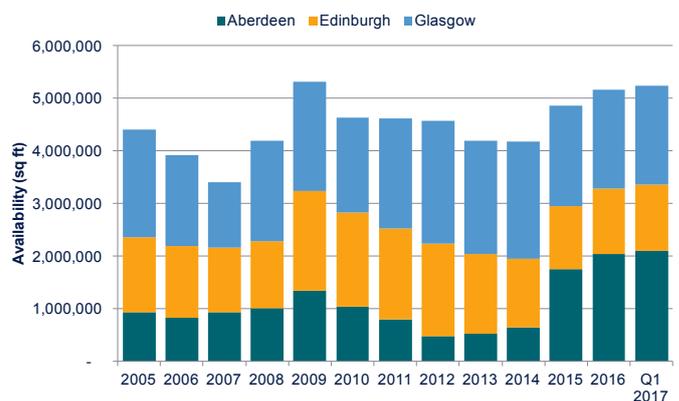
Scotland remains well positioned to attract startups into the key cities. NESTA's most recent Business Incubators and Accelerators report indicates that Scotland has the highest provision of incubators and accelerators per 1,000 new

GRAPH 1 Office take-up remains in line with average



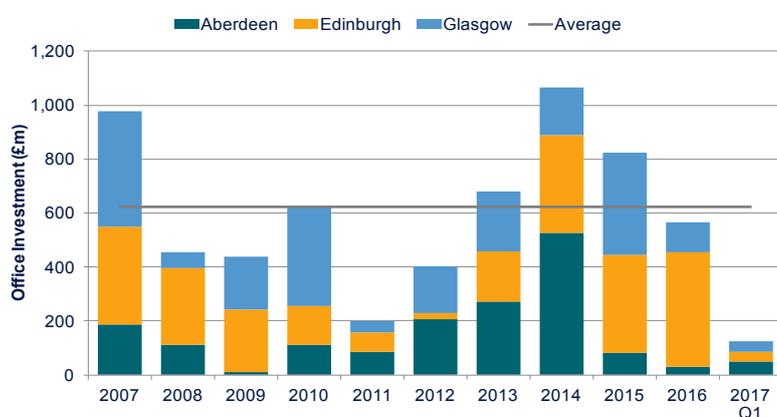
Source: Savills

GRAPH 2 Supply is limited in Edinburgh and Glasgow



Source: Savills

→ GRAPH 3
Office investment reaches £125m during Q1 2017



Source: Property Data

businesses of all the UK regions.

However, 83% of these incubators and 55% of accelerators are based in Eastern Scotland and we have subsequently seen higher levels of take-up on lot sizes below 3,000 sq ft in Edinburgh than in Glasgow and Aberdeen combined over the last five years, the largest proportion of which has come from the tech sector.

Behind this success has been the £323 million of venture capital investment that has been ploughed into Edinburgh since 2013. It is these start-ups which we expect to be requiring office space further down the line. Savills believe that incubator provision has been essential in attracting talent and nurturing start-ups within the Edinburgh market.

Investment

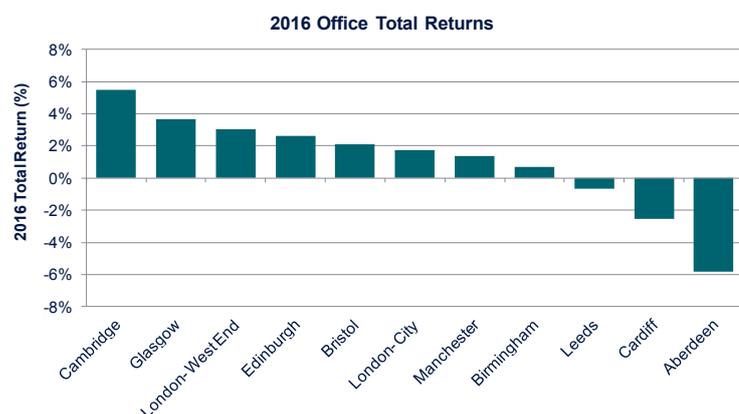
Scottish office investment reached

almost £125 million during the first quarter of 2017, around 31% down on the five year quarterly average, with a balanced spread across the key Scottish cities (Graph 3).

Aberdeen witnessed the largest deal with LCN Capital Partner's £41 million acquisition of Lloyds Register Building at Prime Four Business Park, which boosted office investment to £49 million during the first quarter.

Edinburgh and Glasgow's transactional volumes were reasonably balanced. An Indian client of HSBC Private Bank acquired Exchange Place 2&3 in Edinburgh for £36 million, whilst Boulton Brooks RE acquired the Tun, Edinburgh (cover image) for a fee of £8.3m, as property companies remain particularly active in the market. In Glasgow, Credit Suisse purchased Cuprum on Argyle Street for £25 million, whilst Telereal Trillium paid £6.5 million for 7 West Nile Street.

GRAPH 4
Scottish offices performed strongly during 2016



Source: MSCI

BALANCED SPREAD OF INVESTMENT ACROSS SCOTTISH CITIES

Stuart Orr, Director of Investment, Glasgow highlights his key themes

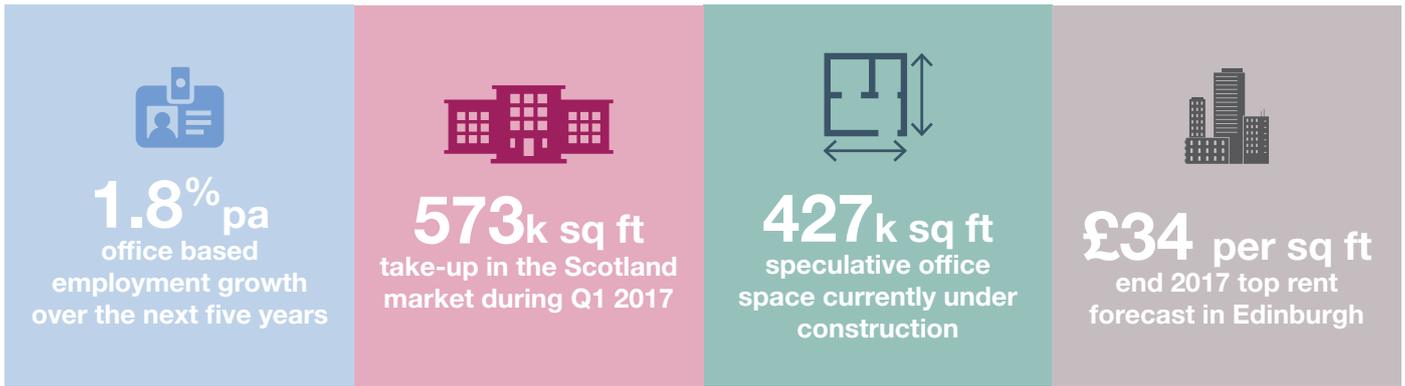
Activity levels in Scotland's commercial investment market throughout 2016 were dominated by Edinburgh offices, accounting for approximately 70% of the total volume. At the end Q1 2017 however, investment activity presents a more balanced picture across Edinburgh, Glasgow and Aberdeen, with in excess of £330 million transacted.

At the time of writing, a further total of approximately £385 million is under offer, of which office assets account for approximately 42%. Of this, 70% of volumes are in Edinburgh, with 30% in Glasgow. We expect a number of larger, high profile office buildings in Glasgow to become available during the course of 2017, and therefore we anticipate this more balanced picture to continue to year end.

The industrial market was the most active market by number of deals in Q1 2017. A total of approximately £83.5 million was traded across seven deals, the most notable of which was Dubai based Rasmala's acquisition of the Amazon unit at Dunfermline for £54 million, reflecting 5.20% net initial yield. Other notable transactions included Legal and General buying the Exel Tradeteam unit at Cambuslang for £9 million.

The overall Q1 performance reflects a drop of around 47% compared to Q1 2016, which is largely as a consequence of the uncertainty caused by the UK Government serving Article 50 to trigger Brexit negotiations and the Scottish Government serving a Section 30 letter in response requesting consent to another referendum on independence, both occurring during Q1.

Since the Brexit vote on 23rd June to the end of Q1 2017, Sterling has fallen against the US dollar by 12.8%. This is clearly welcome news for foreign investors who continue to dominate activity levels in Scotland by as much as 70% in Q1. We envisage that the Scottish market will continue to be dominated by overseas investors in the year ahead, who are attracted by the widening yield divergence to the rest of the UK pricing set against robust occupier markets, whilst benefitting from the currency play.



→ MSCI's total return figures for 2016 (Graph 4) show Edinburgh (2.7%) and Glasgow (3.6%) were among the top performers. Aberdeen's total return figure reflects yields moving out, though we believe that the worst of the energy market downturn is behind us, and occupier and investor confidence is returning to the market.

Outlook

Savills forecast office take-up for the key Scottish markets to reach a combined 1.7m sq ft for 2017, 17% above the total take-up during 2016, driven largely by an improving Aberdeen market, with stable levels in Edinburgh and Glasgow.

There is currently 427,000 sq ft of speculative development under

construction across Aberdeen and Edinburgh, with no new space in Glasgow.

We expect top rents to remain stable in the Glasgow and Aberdeen markets at £30 per sq ft and £32 per sq ft respectively. Edinburgh is forecast to see a 1.5% rise to £34 per sq ft by the end of the year, driven by the pre-letting of new product coming onto the market during construction.

On the investment side, enquiries remaining strong and a number of deals are under offer in the second quarter of 2017. There remains a mismatch on pricing between purchasers and vendors, with returns set to be income driven over the next 12 months.

One concern for the wider Scotland market that remains is the "spectre" of a second referendum on Scottish independence. The UK General Election may also see investment levels dip during May and June, but we expect this to be compensated for by more activity during the second half of the year. This being said, the currency markets have responded positively so far, with the Sterling rising 4% to the dollar since the announcement.

Scottish offices remain attractive relative to other regional cities, and Edinburgh's prime yield continues to sit 25-50 bps above that of comparable English cities. We see yields holding firm through 2017, with sustained investor demand from domestic and overseas buyers. ■

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