

# Spotlight Scottish office market

May 2016



Image: Atria, Edinburgh - Purchased on behalf of Deka Immobilien

## SUMMARY

■ The outlook for office based employment growth in Scotland's three main office markets is reasonably good, at 4.3% over the period 2015-2021.

■ This equates to a need for 1.3m sq ft more occupied office space than today.

■ The imbalance between supply and demand in Glasgow and Edinburgh has become slightly less acute over the last six months. However, we do not expect to see a significant rise in the availability of Grade A office space over the foreseeable future.

■ The office leasing market in Aberdeen is forecast to stay quiet until confidence returns in the oil industry, but market expectations are much more positive than they were six months ago.

■ Tenant demand for CBD office space will remain steady in all three cities, and demand for more affordable out-of-town space in Glasgow and Edinburgh is expected to rise.

■ Scottish office investments still look cheap in comparison to the English cities. This, and the solid rental growth story, will continue to attract investor interest in the prime office markets.

.....  
 “The next two years look like an interesting period for developers looking at refurbishment opportunities in Edinburgh and Glasgow, as well as for tenants looking to trade up in Aberdeen.”  
 .....

## Economy

Generally the Scottish economy has come through the excitement of its referendum in reasonably good shape. Indeed, its comparative position compared to other UK regions is broadly similar to how it was before the referendum campaign started. However, this comes against a background of a generally weaker outlook for the UK as a whole, and this has had a knock-on effect on the prospects for Scotland.

According to the latest regional forecasts from Oxford Economics, the Scottish economy is forecast to grow at a rate of 2.0% per annum over the period 2016-2026, slightly behind the UK and the North West (2.4% and 2.2% per annum respectively). There is also a similar story for overall employment growth, with Scotland's total employment forecast to grow by 0.2% per annum, around half the rate of the broadly comparable North West region. However, when we zoom in and look at the prospects for office-based employment growth in the three main cities, the story is a little stronger (Graph 1). This is primarily due to the fact that the overall employment numbers are weakened by further job losses in manufacturing and the public sector, while sectors that Glasgow and Edinburgh are stronger in (Professional services, Administration & support) are forecast to grow well.

Total office based employment, which is the key driver of office take-up, is forecast to grow by 4.3% between 2015 and 2021, an increase of nearly 16,000 jobs. At a relatively dense ratio

of 1:8 sq m this points to 1.3m sq ft more occupied office space in 2021 than today.

The largest absolute increase in demand will be in Glasgow, closely followed by Edinburgh. However, Aberdeen is also forecast to see a 5% rise in office-based employment over that period.

## Leasing and development

2015 was generally a weaker year for the take-up of office space in total across the three main centres, with the overall volume of leasing activity falling by 23% on the previous year to 1.45m sq ft. However, this is almost exactly in line with the long-term average, so perhaps not a particularly worrying indicator of market sentiment. Edinburgh however had its best ever year for leasing activity in 2015.

A variety of factors contributed to this year-on-year slowdown in leasing activity. Firstly, there was the very sharp slowdown in leasing activity in Aberdeen, due to the collapse in global oil prices in 2014 and 2015. The total take-up in Aberdeen in 2015 was 394,473 sq ft, which is 47% below the long run average for the City and 61% down on the admittedly very strong previous year.

The other major reason why overall leasing activity in the three main Scottish centres was down, was lack of supply. This trend, which has been brewing for a number of years, is particularly an issue in the traditional office cores of both Edinburgh and Glasgow, where lower than normal

levels of development activity in 2008-2014 and a bulge in both lease expiries and inward investment, has combined to limit the amount of Grade A space of all sizes that has been available in both markets. Edinburgh's strength in 2015 was a reflection of both the strong demand for that market, and the fact that the development pipeline in Edinburgh reacted a little earlier than in Glasgow - with the major lettings of last year being in newly developed projects such as Quartermile 4.

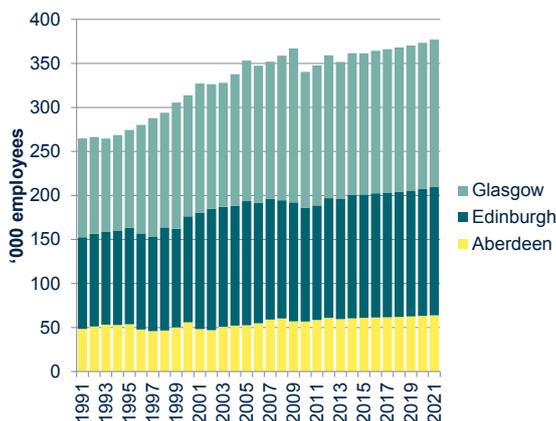
Take-up in Glasgow in 2015 was a little down on the previous year, though exactly in line with the long-run average for the City. The few newly developed projects in the City let well, with significant deals in both 1 West Regent Street and St Vincent Plaza.

The major sources of demand were broadly unchanged in 2015 (Graph 3), with Glasgow and Edinburgh benefitting from improving confidence in the Banking and Financial Services sectors, as well as continuing steady demand from the TMT sector.

As Graph 2 shows, 2016 has started with a roar, at least in Glasgow and Edinburgh. Indeed, Glasgow's Q1 2016 total of just under 300,000 sq ft is more than half of last year's full year total. Similarly in Edinburgh, while the first quarter of 2016 was down on the record fourth quarter of 2015, just under 324,000 sq ft was leased in the first three months of this year making it the second strongest quarter for leasing activity since 2013.

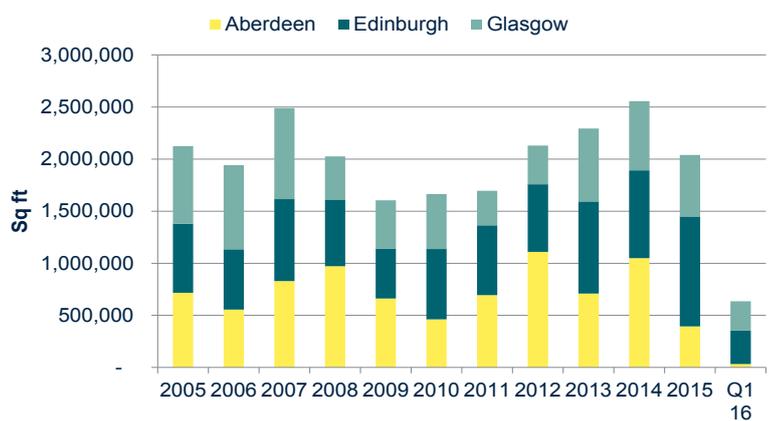
The story on the supply-side in Edinburgh and Glasgow remains

GRAPH 1 Outlook for office based employment



Source: Savills, ONS, Oxford Economics

GRAPH 2 Office take-up



Source: Savills

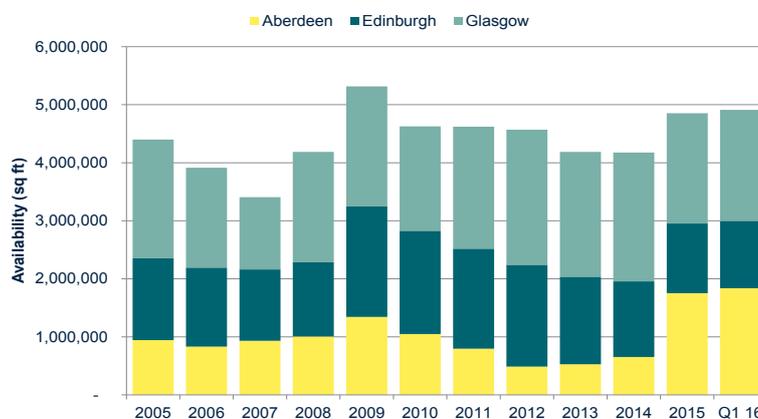
→ one of falling availability, particularly of Grade A space. Total supply in Glasgow is now below two million square feet for the first time since 2011, and only just over 500,000 sq ft of this is of the best quality.

In Edinburgh the level of availability has been on a steadily falling trend since its peak in 2008, and it fell particularly sharply in Q1 2016. We estimate that there is now only 2.1m sq ft of available office space in the CBD and OOT market, of which only 365,000 sq ft is Grade A.

In broad trend terms Aberdeen has perhaps unsurprisingly been the exception, with a dramatic rise in the amount of office space being marketed between 2014 and 2015. This overall level of availability has risen further during the first quarter of 2016, to 1.8m sq ft. However, it is worth noting that in common with Edinburgh and Glasgow less than half of the vacant office space in Aberdeen is Grade A.

18 months ago both the Glasgow and Edinburgh office markets were facing a bit of a perfect storm of a bulge in lease expiries and very restrained development pipelines. This picture has changed slightly since then, with the lease expiry bulge having passed, and a small uptick in the level of development activity. Another interesting trend that has emerged in both cities is a pick up in occupational activity in the out-of-town markets. This has been driven by the tight CBD markets, and the increasingly attractive rental differential between there and out-of-town. In Glasgow there are significant requirements for OOT

GRAPH 4  
**Office availability**



Source: Savills

space from Virgin and Balfour Beatty amongst others, and in Edinburgh both Edinburgh Park and the South Gyle Business Park have seen a pick-up in activity.

The primary driver of this demand is the rise in rents that the CBD markets have seen over the last five years, with Edinburgh's, Aberdeen's and Glasgow's prime headline rents now all in excess of £30/sq ft. While these levels are still very attractive to inward investors from London, we believe that longer standing local occupiers will increasingly be attracted to out-of-town locations at £14-20/sq ft.

**Investment**

While the Scottish cities might have missed out on the sharp hardening in yields that their English peers saw in 2014, this probably acted in their favour and may well continue to do so. Certainly investment volumes have

stayed healthy, with just over £811m transacted in 2015, 33% above the long run average. Interestingly, 44% of the purchases of office investments last year were by non-domestic investors, and this has continued into 2016 with 89% of the purchases this year being by non-doms. This is both a function of the UK institutions being both quiet in the run-up to the EU referendum, and overweight in Scotland due to recent levels of development activity. Furthermore, the national trends do seem to point to non-domestic investors being less concerned about the out turn of the EU referendum, and in many cases seeing it as a buying opportunity.

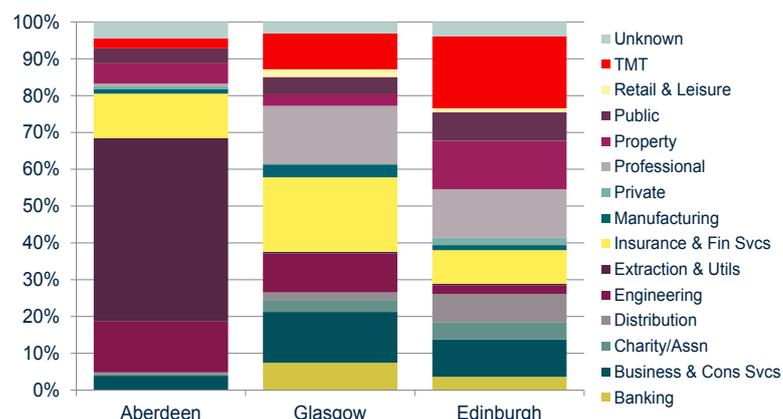
With just over £300m transacted in the three cities in the first quarter of this year, there seems to be some evidence that investor demand for the Scottish cities has been less affected by the Brexit debate than other locations.

Prime yields have fallen in Edinburgh and Glasgow, leaving both markets at 5%. However, Aberdeen's recent leasing malaise has seen yields there rise by 100 basis points to 7% over the last two years.

**Outlook**

Generally we believe that the leasing markets in Edinburgh and Glasgow have a healthier balance between supply and demand than they have had for a number of years. In both cities, while there is currently a healthy level of requirements, there is also suitable space to satisfy the majority of those requirements either in or out-of-town. Furthermore, the success of

GRAPH 3  
**2015 take-up by business sector**



Source: Savills

→ recently completed projects such as 110 Queen Street and Quartermile 4 has given local and national developers a bit more confidence to consider bringing forward new build and refurbishment projects speculatively.

The Aberdeen office market, while by no means out for the count, is likely to stay quiet until the oil and gas sector is feeling more confident. It is clear that market expectations there are more positive than they were six months ago, and that there will continue to be some lease event driven tenant demand in the City, particularly if businesses perceive that the next two years might be a good moment to secure high quality space on competitive terms.

In all three cities we expect to see continuing demand for prime CBD space, though the story will differ when we come to the secondary and refurbished market. In Edinburgh and Glasgow the next two years looks like an interesting period for refurbishment opportunities, as recent demand trends are pointing to a rise in occupier interest in characterful refurbishments in the mid £20s rental range. However, the less buoyant market in Aberdeen

will probably lead to a situation where properties with a 'wrinkle', be it in terms of quality or location, will prove harder to let as tenants realise that they can maybe trade up more easily.

As we mentioned earlier there is definitely a feeling in both Edinburgh and Glasgow that the out-of-town markets are both about to experience a bit of a resurgence in popularity. This is both function of the rental differential to the core, as well as some significant new development and regeneration projects that will change the profile of their submarkets. In both cases we expect to see a bit of migration in demand to more affordable locations over the next few years.

The outlook for the office investment market in Scotland is reasonably benign. While the prime yield differential to the English cities was pointing to a potential for further yield hardening 12 months ago, it is now more likely to act as a safety net going forward. With prime yields in the English cities ticking up a quarter point in the first quarter of 2016, Scotland still looks more reasonably priced in relation to its rental growth prospects, and thus we believe that prime yields

in all three Scottish cities are likely to remain stable at their current levels for the remainder of 2016 and into 2017.

The outlook for rental growth in the CBD markets in Edinburgh and Glasgow is pretty much in line with that for comparable English cities. We are forecasting that net-effective rents will continue to rise faster than headline, as there is still a little more room for incentives to tighten. The strongest rental growth may well be in the out-of-town markets of both cities, where we believe that rents in the early £20's will probably be achieved in the next few years. This will be driven both by a lack of Grade A space in the core, and a rising degree of rent sensitivity amongst tenants in the face of economic uncertainty.

The next spike in the Edinburgh and Glasgow CBD markets is likely to be in line with the next bulge in lease expiries (2018-19), and we expect to see the supply-side gearing up in anticipation of that pick-up in tenant demand.

## Savills Scottish offices team

Please contact us for further information



**Keith Dobson**  
Edinburgh Agency  
0131 247 3801  
kdobson@savills.com



**Nick Penny**  
Edinburgh Investment  
0131 247 3803  
npenny@savills.com



**David Cobban**  
Glasgow Agency  
0141 222 4101  
dcobban@savills.com



**Bruce Patrick**  
Glasgow Investment  
0131 222 5873  
bpatrick@savills.com



**Simpson Buglass**  
Aberdeen Agency  
01224 971 133  
sbuglass@savills.com



**Kate Graham**  
Edinburgh Agency  
0131 247 3821  
kgraham@savills.com



**Dan Smith**  
Aberdeen Agency  
01224 971 134  
dan.smith@savills.com



**Mike Barnes**  
Research  
0203 107 5459  
mbarnes@savills.com



**Mat Oakley**  
Research  
020 7409 8781  
moakley@savills.com

**Savills plc**

Savills is a leading global real estate service provider listed on the London Stock Exchange. The company established in 1855, has a rich heritage with unrivalled growth. It is a company that leads rather than follows, and now has over 700 offices and associates throughout the Americas, Europe, Asia Pacific, Africa and the Middle East.

This report is for general informative purposes only. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent. Whilst every effort has been made to ensure its accuracy, Savills accepts no liability whatsoever for any direct or consequential loss arising from its use. The content is strictly copyright and reproduction of the whole or part of it in any form is prohibited without written permission from Savills Research.