UK Commercial – Summer 2020

SPOTLIGHT
Savills Research

Scotland Offices

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Supply • Technology • Renewable Energy

Cover: Capella, Glasgow. Savills are acting on behalf of the landlord.

509,212 sq ft
Take-up in core Scotland during H1 2020

19%
Proportion of Grade A take-up during H1

Top sectors
Public Services, Education & Health (28%), Extraction & Utilities (22%), TMT (13%)

£35.50+
Rents above £35.50 per sq ft are now achieved in Edinburgh city centre - the highest in core Scotland

Investment Overview

Scotland's commercial property investment market has been heavily affected by the Covid-19 pandemic. During the first half of the year, Scotland saw total commercial investment volumes of £331 million, reflecting a 73% decrease from the same period last year and a 59% decrease on the H1 10-year average. The retail sectors saw the largest levels of investment accounting for 39% and totalling £129 million.

Office investment totalled £60 million, an 88% decrease from H1 2019 and 81% below the H1 10-year average. Typically, around 50% of Scotland's office investment comes from overseas investors. Therefore, the global disruption caused by Covid-19 during H1, has likely had a significant impact on Scotland's office investment volumes.

Furthermore, the UK-wide lock-down which required most offices in the UK to become temporarily closed, came into effect at the end of Q1. This caused further disruption and almost certainly reduced both domestic and international confidence in Scotland's office market.

The majority of office investment occurred within Edinburgh (75%), which is likely due to it being the capital. In times of economic uncertainty investors often favour capital cities as they are typically viewed as a safer option.

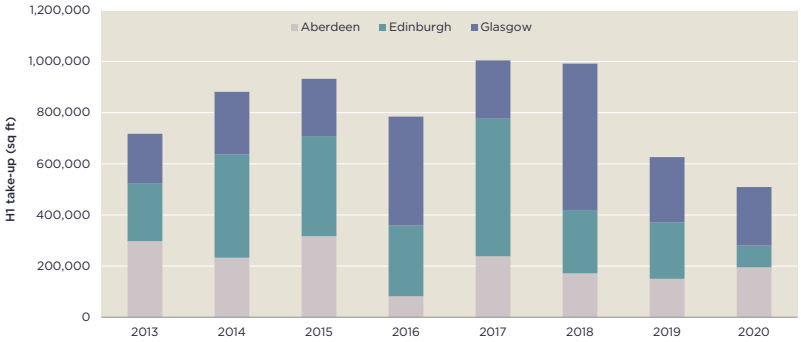
Although volumes were significantly down, a number of key transactions took place. Most notably, KanAm purchased 4North, Edinburgh for £30 million reflecting an impressive 4.3% yield. The building, which underwent complete refurbishment in 2019, is fully-leased to Computershare.

Other Key deals included the sale of 4-5 Lochside Avenue, Edinburgh, for £7 million reflecting a 7% yield and the purchase of Aspect House, Hamilton, for £15 million with a 6.5% yield.

Prime yield in Aberdeen is currently 6.75%, Glasgow 5.25% and Edinburgh 4.75%. Uncertainty caused by the Covid-19 pandemic has seen yields in Aberdeen, Edinburgh and Glasgow shift outward by 25 basis points.

H1 core Scotland Take-up

Disruption has caused take-up in core Scotland to be limited throughout the first half of the year.



Source Savills Research

As expected, lockdown results in significantly lower levels of H1 take-up but levels of underlying latent demand remain positive

2020 got off to a strong start in Scotland, which saw Q1 core market (Aberdeen whole market, Edinburgh city centre and Glasgow city centre) take-up 87% up on Q1 2019 and 7% above the five-year Q1 average.

However, during the second quarter, Covid-19 and the accompanying UK-wide lock-down brought significant disruption to all three core office markets. Q2 saw just 66,521 sq ft of office space signed for across core Scotland reflecting an 85% decrease on the five-year quarterly average. H1 take-up therefore totalled 509,212 sq ft, 19% below H1 2019 and 41% below the H1 five-year average.

Although take-up was down from 2019 and the five-year H1 average, a number of key transactions took place. In Glasgow, serviced office provider Orega signed for 14,035 sq ft at 220 St Vincent Street. Handelsbanken signed for 3,581 sq ft of Grade A office space at Edinburgh's Waverley Gate and Prosafe Offshore Ltd took 6,079 sq ft at Aberdeen's Grade A Silver Fin building.

Aberdeen was the only market to see increased take-up levels, with total H1 take-up 30% above H1 2019 and 2% above the H1 five-year average. This was largely due to the strength of Q1 in which 171,609, sq ft of office space was signed for. Q2 showed a significant decrease with take-up totalling just 23,472 sq ft reflecting a 75% decrease on the five-year quarterly average.

In Glasgow, H1 totalled 229,182 sq ft reflecting a 10% decrease from the same period in 2019. Q2 was the period that resulted in levels being down, during this time, significant disruption caused by the UK-wide Covid-19 lock-down saw Glasgow's Q2 take-up 85% below the five year quarterly average. Similarly in Edinburgh, Both H1 and Q2 take-up volumes were significantly below average levels with H1 take-up totalling 84,949 sq ft in which 14,322 sq ft occurred during the second quarter.

19% of deals were for Grade A space significantly below the annual average proportion of around 50%, highlighting the lack of Grade A space across all markets. Currently, there is just 914,812 sq ft of Grade A office space available in core Scotland reflecting a 9% decrease since the end of 2019. Total supply has reduced by 4% and now sits at 3.8 million sq ft.

The Public Services, Education & Health sector accounted for a significant proportion of take-up (28%) totalling 141,775 sq ft. A key deal to this sector included Visit Scotland, which signed for 3,270 sq ft at 90 St Vincent Street, Glasgow, during the second quarter. The Extraction & Utilities and Technology, Media & Telecoms sectors were also key contributors accounting for 22% and 15% of take-up respectively.

Despite currently reduced levels of take up, many medium/longer-term property searches are still progressing. Additionally, with a likely increased trend towards accommodation that caters to staff well-being, the pandemic may drive other occupiers to consider relocations in the medium term and favour landlords with better quality accommodation.

Rents above £35.50 per sq ft have now been achieved in Edinburgh city centre, although as many transactions are subject to NDA's full details are not available. Prime rents in Aberdeen and Glasgow are both now £32.50 per sq ft.

Scotland is still in a period of lock-down due to the Covid-19 pandemic. Savills, therefore, expects activity in the Scottish occupational market to increase significantly once this period has come to an end. It should be noted, however, that take-up is a lag indicator and may take some time to reflect renewed levels of activity.

With continued flight to quality, office stock in Edinburgh remains in short supply

A significant level of development is needed in Edinburgh city centre to meet the needs of demand in the market

Edinburgh currently has the lowest supply of available office space in core Scotland and the second lowest supply within the 'big-6' regional office markets. Total supply in Edinburgh city centre is 599,836 sq ft of which just 335,640 sq ft is Grade A.

Edinburgh's historic city centre and tight planning regulations have seen Edinburgh's development pipeline also remain fairly limited with 229,000 sq ft under construction completing between now and 2022. However, of that, 31% has already been let during construction resulting in there being just under 224,000 sq ft of space under construction that is available to let in Edinburgh city centre.

New research by Savills analysed average rents and vacancy rates across the 'big-six' regional office markets. It was found that since the global financial crash, falling vacancy rates have resulted in rental growth, and during this period, average Grade A rents have not fallen across the big-six markets when the vacancy rate has been below a certain level.

Savills have subsequently created a vacancy rate forecasting model to uncover whether vacancy rates fall below this threshold before 2023. The model factors in a number of conservative assumptions to reflect the current economic environment.

When the model is applied to Edinburgh's market data, it shows that despite the potential impacts of Covid-19 and any subsequent fall in occupier demand during 2020 and 2021, vacancy rates of quality city centre stock are still likely to fall to critically low levels. This presents an opportunity to speculatively develop new stock or refurbish existing buildings to take advantage of the supply shortfall in Edinburgh in order to meet the demand in the market.

There are currently a number of exciting schemes under construction in Edinburgh as well as future planned schemes. However, our model shows that there is still significant scope for further office development within Edinburgh city centre.

Outlook: Mike Irvine, Business Space, Edinburgh.

It was no surprise that Q2 take-up in Edinburgh city centre was significantly below average levels. The Covid-19 pandemic has caused take-up across all major UK office markets to fall below previous norms, with both UK regional and central London office take-up over 65% below their long-term Q2 averages.

It is therefore expected that the number of deals transacted in Q3 will also be significantly below what is typical, as there is still a high level of uncertainty in sentiment due to the ongoing pandemic.

In times of uncertainty, occupiers (and landlords) often delay making any long-term decisions. As a response to this, we may see a flurry of 1-2-year lease extensions in Edinburgh city centre. While landlords may have not previously been interested in offering this type of flexibility, in the current climate, it can successfully suit the short-term needs of both landlords and occupiers.

However, we are confident that once a level of certainty is returned to the UK market, occupier activity in Edinburgh will resume to its normal level. While there are myriad views regarding the future of offices, one of the few consistent messages is that occupiers will continue to improve the quality of accommodation which is good news for those that refurbish or develop good-quality stock.

The Haymarket, Edinburgh. Savills are acting on behalf of the developer.

84,949 sq ft
Edinburgh city centre H1 take-up

33%
Proportion of Grade A take-up during H1

Top sectors
Public Services, Education & Health (23%), TMT (22%), Insurance & Financial Services (18%)

£35.50+
Rents above £35.50 per sq ft are now achieved in Edinburgh city centre

> "Edinburgh currently has the lowest supply of available office space in core Scotland and the second lowest supply within the 'big-six' regional office markets."

229,182 sq ft
Glasgow city centre H1 take-up

10%
Proportion of Grade A take-up during H1

Top sectors
Public Services, Education & Health (53%), TMT (18%), Serviced office (6%)

£32.50
Glasgow prime rent

Cadworks, Glasgow. Savills are acting on behalf of the developer.

Outlook: David Cobban, Director, Business Space, Glasgow.

Glasgow is attractive to many businesses for a number of reasons, and as a result, more high-profile firms are announcing or have announced plans to set up hubs in the city, spurring office investment and development.

Since 2018, Glasgow has seen some of its strongest ever take-up, and although Covid-19, has caused this to slow, there is still a significant level of demand in the city. Even with disruption from Covid-19 Glasgow's H1 wider market take-up exceeded H1 2019 by 18%, and we are expecting total city centre take-up to reach circa 500,000 sq ft by the end of the year.

Glasgow's development pipeline presents a strong opportunity for rental growth, and while the current headline is £32.50, we are expecting to see lettings complete at rents in excess of this, as construction recovers from delays caused by the pandemic.

The disruption in the market hasn't reduced the number of requirements in Glasgow. However, we have witnessed the size of requirements fall, which will likely reduce the quantum of demand. Even so, demand is still strong, and many high profile companies are still looking to open offices in Glasgow.

Technology at new developments will support Glasgow's return to the office

The implementation of app-based control in Glasgow's new developments provides many smart solutions to facilitate the return to the office

The Covid-19 pandemic has seen office workers across the UK switch to home-working, and while in England some office workers are now able to return to their office, the extended lockdown in Scotland means that, for now, the majority of offices in Scotland remain closed. In Glasgow, landlords and developers have been preparing for the return to the office in a number of ways. The use of one-way systems, touch-less entry and enhanced hygiene systems will soon be common.

However, some new developments in Glasgow are looking to use smart solutions to make further safety adjustments, as well as increase socialisation inside the office while maintaining social distancing.

A great way to do this is with the use of a workplace app. Workplace apps have previously been used for simple tasks such as booking meeting rooms and finding available hot desk space. But, in a post-Covid-19 world, their features are being updated and enhanced. Workplace apps can now check if capacity is low enough to facilitate distancing and reduce the amount of physical touch workers have with their office by allowing for app-based control of lifts, doors and security gates.

Some apps are even being developed to geolocate employees and inform them if they come into contact with a colleague who has tested positive for Covid-19. Office apps can also enhance the community within an office, which is more important than ever as most office staff have been working from home since March. This allows users to write posts and communicate with others inside, thus facilitating greater networking opportunities within the building both between teams and organisations.

At 177 Bothwell Street, the property's existing intelligent building technology will be further enhanced to simplify how people use and interact with the office. For example, visitors' mobile devices will be pre-accredited, allowing them to operate security gates and lifts with an app, while touchless, app-activated lighting will remove the need to physically operate switches.

Upon its completion, Cadworks will also have its own office app that will allow for control of the building as well as enhance the community inside. It will do this by giving occupiers the opportunity to view the environmental performance of the building as well as link up with others inside to create groups such as cycling and running clubs.

> **"Some apps are even being developed to geolocate employees and inform them if they come into contact with a colleague who has tested positive for Covid-19."**

The renewable energy sector is future-proofing Aberdeen's economy

Aberdeen is in a strong position to become a global hub for the renewable energy sector

Aberdeen has been considered as the oil capital of Europe since the mid-20th century and the number of jobs created by the energy industry in and around Aberdeen has been estimated at half a million.

However, with increased pressure on corporations and individuals to make sustainable decisions along with government policies such as Net Zero and the Paris Agreement the demand for oil and gas is on a gradual decline, with the movement towards renewable energy alternatives. This fall in demand was accelerated this year by the Covid-19 pandemic which saw oil prices fall to record lows. Aberdeen's combination of on and offshore infrastructure, energy companies, a global supply chain, track record of research and development, and a highly skilled workforce means that Aberdeen is at the forefront of making energy transition ambitions a reality.

Earlier this year the Scottish Government set up a £62 million Energy Transition Fund to help the energy sector recover from the duel economic impacts of Covid-19 and the oil and gas price crash. This fund will support businesses in the oil, gas and energy sector over the next five years as they grow and diversify and will attract private sector investment to the region, with its main focus being for the North East. The investment underpins the region's ambition to become a world leader in the transition to net zero and major projects which will be considered for funding include a Global Underwater Hub, Net Zero Solution Centre projects, a Hydrogen Hub, the Acorn Project and an Energy Transition Zone.

The proposed Energy Transition Zone in Aberdeen aims to create a physical place for research and development, test and demonstration and manufacturing activities in an exemplar net zero environment. It will become the focal point for the development of the new energy transition industry cluster in the region. The ambition is to accelerate the delivery of net zero solutions focusing on offshore wind (fixed and floating), hydrogen and carbon capture, usage and storage, catalysing the transition of Aberdeen from a global oil and gas capital to a globally integrated energy cluster. This will help anchor a broad energy supply chain, create and secure high-value jobs, drive export growth and deliver net zero.

In Aberdeen, the electricity, gas, steam and air sector is forecast to see an employment reduction of 9.4% over the next 10 years, which will create a significant availability of highly skilled workers in Aberdeen. This highly skilled workforce and Aberdeen's strong reputation in the energy sector is acting as a significant pull factor for occupiers within the renewable sector.

Earlier this year Equinor signed for 15,000 sq ft at Aberdeen's Prime Four Business Park. Equinor claim that their extensive history and expertise in the oil and gas industry is helping them to create reusable alternatives, including wind farms and turbines, and emission-free natural gases. Savills expects that the renewable sector will be a significant driver of office take-up in Aberdeen over the next few years, as occupiers take advantage of government policies and the availability of talent in the area, as well as cluster with similar occupiers within all areas of the energy sector.

> **Savills expects that the renewable sector will be a significant driver of office take-up in Aberdeen over the next few years**

195,081 sq ft
Aberdeen wider market H1 take-up

Top sectors
Extraction & Utilities (53%), Property company, Development & Construction (16%), Engineering (14%)

£32.50
Aberdeen prime rent

Outlook: Dan Smith, Business Space, Aberdeen.

Q4 2019 recorded the best take-up in a single quarter since 2014, and we were anticipating a continuation of this performance into 2020. However, the duel implications of Covid-19 and the subsequent impact on the oil market has substantially suppressed office activity in the city.

2020 started well, with take-up in Q1 falling marginally behind the impressive numbers from the previous quarter. However, the demand collapse and oil pricing crash (a direct result of Covid-19 restrictions) has seen cancellation of a large amount of capital expenditure planned for this year and next, and many projects have been delayed and cancelled. We have seen staff rationalisation and redundancy across the energy sector, and that is expected to increase when the furlough scheme comes to an end in October.

Market uncertainty drives the need for flexibility, and in the short term, we expect to see a continued drive toward flexible lease arrangements. The development pipeline will continue to suffer as a consequence. There will be a continued flight to quality, with occupiers taking advantage of favourable market conditions to improve the quality of their office stock. The requirement to limit capital expenditure will result in increased demand for "plug and play" and partially fitted out office options.

The "Energy Transition" and how Aberdeen can position itself in that particular process will have a major impact in the medium/long term fortunes for the city's office market. There are numerous ongoing initiatives aiming to diversify the local economy, and we are expecting to see increased activity from renewables, hydrogen, carbon capture and life sciences sectors over the coming years. The new life sciences BioHub on Aberdeen's Foresterhill Health Campus has now begun on site and aims to attract new occupiers to Aberdeen as well as retaining some of the homegrown talents from that sector.

Marischal Square, Aberdeen. Savils are acting on behalf of the landlord.

Key Market Data

The table below outlines the key data points from H1 2020 for the core Scottish markets.

	Aberdeen	Edinburgh	Glasgow
H1 take-up	195,081 sq ft	84,949 sq ft	229,182 sq ft
H1 Grade A take-up	43,816 sq ft	28,203 sq ft	22,554 sq ft
Availability	2,498,000 sq ft	599,800 sq ft	841,200 sq ft
Grade A availability	384,900 sq ft	335,600 sq ft	194,300 sq ft
Vacancy rate	24.1%	6.6%	6.1%
Prime rent	£32.50 per sq ft	£35+ per sq ft	£32.50 per sq ft

Source: Savills Research
Note. Aberdeen includes wider market data while Edinburgh and Glasgow are city centre only.

Savills Commercial
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