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Spotlight
Scottish Office Market

February 2018

Marischal Square, pictured above provides 177,000 sq ft of Grade A space in Aberdeen

- Wider Scottish office market take up reached 2.4 million sq ft during 2017, 14% above the previous 10 year average.

- Edinburgh city centre marked a record year of office take up during 2017, reaching 787,000 sq ft. One threat to Edinburgh's strong levels of take up going forward, is the record shortage in supply.

- With no speculative space currently under construction in Glasgow, we expect 2018 to be "the year of the pre-let".

- Brent Crude Oil is now hovering at around $70 per barrel, providing the Aberdeen market with a much needed confidence boost.

- Scottish office investment reached £608m for the final quarter of 2017, the highest quarter on record. This boosted total office investment in 2017 to £1.02 billion, a 50% increase on the previous 10 year annual average.

- We expect serviced office operators to increase their footprint across the Scottish cities during 2018 as occupiers hunt for a "flight to flexibility".

"Occupiers are increasingly in search of more flexible lease terms amid geopolitical uncertainty and in 2017, average lease length fell by 6% on the previous year," Savills Research

2017 marked a strong year in both the Scottish office occupational and investment markets with positive sentiment being carried into 2018.

Occupational

The wider Scottish office market enjoyed a solid quarter of occupational deals during Q4 2017, with take up for the wider market reaching 613,000 sq ft. This pushed take up for the full year to 2.4 million sq ft, 14% above the previous 10 year average.

Aberdeen wider office market take up reached 75,000 sq ft during the final quarter of 2017, with take up for the full year reaching 403,000 sq ft, 120% above the level recorded during 2016 and the strongest year since 2014.

Unsurprisingly, this boost in take up has been witnessed most apparently in the Engineering and Extraction and Utilities sectors, which saw combined take up reach 259,000 sq ft, 64% of the total take up, up from only 17% last year. Oil and gas operators have resumed making occupational decisions following the recent surge in the price of Brent Crude oil. This key indicator is now hovering at around $70 per barrel, providing the Aberdeen market with a much needed confidence boost.

There remains a two tier market, with landlords who have committed oil and gas operators into long RPI-linked leases and footloose occupiers who are able to take advantage of attractive rent free periods.

Availability has now peaked in Aberdeen following the completion of Marischal Square (pictured, cover) and The Silver Fin Building during 2017. With enquiries from the oil and gas sector gathering further momentum, footloose occupiers are being encouraged to act sooner rather than later. Grade C space will need to reinvent itself or continue to struggle for the foreseeable future.

Glasgow city centre saw a bumper end to 2017, with take up reaching 334,000 sq ft for the final quarter, bringing the full year total to 625,000 sq ft, 1% above the five year average.

The largest deal during the final quarter was the Department for Work and Pensions (DWP) signing for 85,000 sq ft at 1 Atlantic Quay. Scottish Courts also signed for 80,000 sq ft at 3 Atlantic Quay, which Savills subsequently acquired on behalf of Legal and General for a price of £50m.

With no speculative space currently under construction, we expect 2018 to be "the year of the pre-let" in Glasgow due to a number of 2020/21 lease events. There is currently only 452,000 sq ft of Grade A space in Glasgow city centre, enough for only 18 months of Grade A take up at average levels.

Should a speculative development be announced, we would expect this to achieve in excess of £32 per sq ft by the time it is delivered, which would re-rate the market.

In the meantime, we expect competition for refurbished space to remain high. 191 West George Street will provide 82,500 sq ft once delivered and could achieve up to £30 per sq ft as Grade A space remains scarce.

Aberdeen headline rent £32 per sq ft

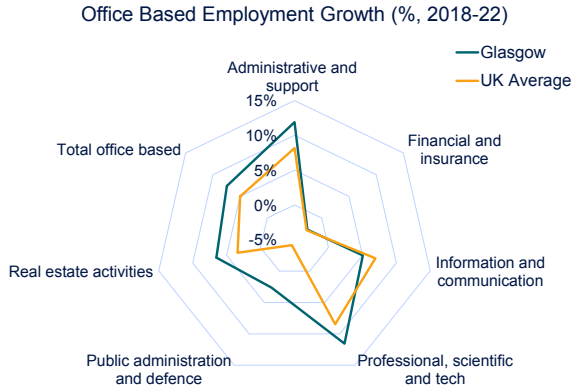
Edinburgh city centre marked a record year of office take up during 2017, reaching 787,000 sq ft, 21% above the five year average. The final quarter saw a more modest 91,000 sq ft of space taken, with only one deal recorded in excess of 10,000 sq ft. Take up in the wider market reached 1.1 million sq ft last year, again the strongest on record.

One threat to the strong levels of take up we saw last year, is the record shortage in supply. At end 2017, there is only 1.1 million sq ft of available space in the city centre, down 14% from end 2016. With only 220,000 sq ft of this considered Grade A supply, there is less than one year's worth of supply at average Grade A take up levels. We expect this shortage of space to increase top rents to £34 per sq ft by end 2018.

2 Semple Street (40,000 sq ft) will ease pent up demand on its expected completion during Q2 2018, whilst The Mint Building (60,000 sq ft) and Capital Square (122,000 sq ft) will complete in 2019 and 2020 respectively. With a limited pipeline remaining, we expect further speculative developments to be announced during 2018.

GRAPH 1

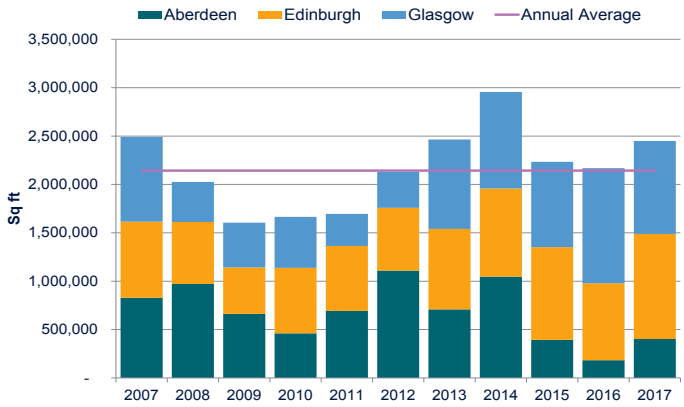
Glasgow is forecast to see office based employment outperform the UK average



Source: Oxford Economics

GRAPH 2

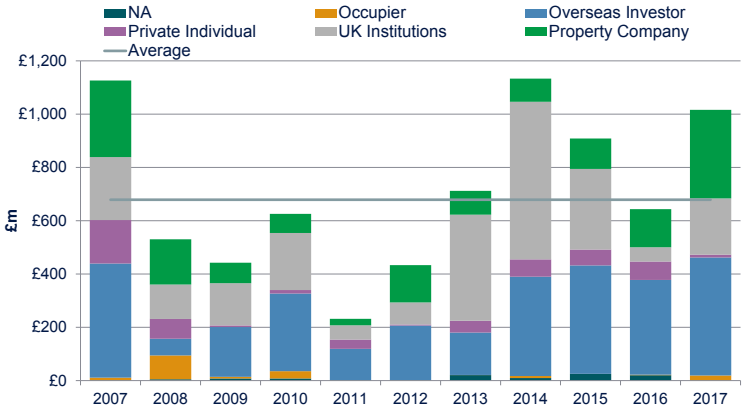
Wider Scotland take up reached 2.4 million sq ft, 14% above the previous 10 year average



Source: Savills

GRAPH 3

Scottish Office Investment exceeded £1bn during 2017, 50% above the previous 10 year average



Source: Property Data

Edinburgh continues to expand as a tech hub, with a 19% increase in data scientists employed in the city centre over the course of 2017, according to data from Stack Overflow. Scottish Government backed incubators, such as The Data Lab was set up to help the Scottish industry capitalise on the growth of data science.

Savills Skills Talent and Labour Mobility report indicates that the first time buyer house price to earnings ratio stands at 10.2 in London, above the Scotland average of 3.3. As one of workers' key priorities is "climbing the housing ladder", it is no wonder that anxiety levels are significantly higher in London than in Scotland, according to ONS figures. We expect more skilled UK tech workers to be relocated north of the border in 2018.

Investment

Scottish office investment reached £608m for the final quarter of 2017, the highest quarter on record. This boosted total office investment in 2017 to £1.02 billion, a 50% increase on the previous 10 year annual average (Graph 3).

Overseas investment reached a record £443 million during 2017, exceeding the previous record of £428 million in 2007 by 3%.

European investors were the most active overseas subtype, accounting for 36% of overseas investment. Far Eastern investors marked a record year in Scotland, with £102 million invested across 122 Waterloo Street, Glasgow and 2&3 Exchange Place, Edinburgh, and accounted for 23% of the total overseas investment.

The falling likelihood of Indyref2 has brought UK institutions' attention back to Scotland during the second half of 2017. Graph 4 indicates the prime yield compression across the Scottish cities during 2017. Glasgow and Edinburgh's prime yields both moved in 25 basis points to 5.5% and 5.25% respectively.

Meanwhile, the recovery in Brent Crude oil prices has driven yields for the very best space in Aberdeen down 75 basis points to 6.25% during the second half of 2017. Overseas investors in particular have been drawn to the attractive yields on offer, evidenced by LCN Capital Partner's acquisition of Prime Four business park, representing a yield of 6.25%.

Aberdeen prime yields remains 150 basis points above that of the prime regional yield, which itself has seen a 50 basis points inward movement during 2017 to 4.75%. Investors are increasingly searching outside London for more attractive yields in an environment where total returns are likely to be income driven.

2018 Outlook

Occupiers are increasingly in search of more flexible lease terms amid geopolitical uncertainty and in 2017, average lease length across the UK regions fell by 6% on the previous year. This has provided a platform for growth for the serviced office market across the regional cities.

JOB GROWTH AND COMMUTER TRENDS WILL INCREASE COMPETITION FOR SPACE IN GLASGOW

Mike Barnes, Research Analyst highlights his key themes

Glasgow is forecast to see office based employment growth of 7.4% over the next five years, significantly outpacing the UK average of 5%, Oxford Economics' latest forecasts indicate (Graph 1). This translates to 1,300 net additional jobs for the city over the next five years.

At sector level, the Administrative and Professional, Science & Tech sectors are both forecast for 12% growth over the next five years, outperforming the UK average of 8%. The other real contributor is the growth of the public sector. Whereas the UK public sector average is bracing itself for job losses of 4.1% over the next five years, in Glasgow, public sector employment is expected to expand by 2.6%.

This comes off the back of 179,000 sq ft of public sector take up recorded in Glasgow during 2017, 159% above the city's five year average. We expect the hotly anticipated Government Property Unit (GPU) deal at Atlantic Square to complete during 2018, which will provide a further boost to the Glasgow office market.

This will intensify competition for city centre office space in the city centre as workers want their offices to be well located. Savills What Workers Want survey indicates that 85% of Glasgow's workforce consider the length of commute to work to be of "high importance", though only 63% are satisfied with their current length of commute to work. Glasgow Central, for example, is the UK's second busiest rail station outside London, with over 32 million passenger entry and exits during 2017, a 7% increase from the previous year.

Landlords are also increasingly considering wellness factors to draw occupiers to their schemes through 2018, including improving on-site amenity, community engagement programmes and open green space.

In order to accommodate job growth and retain Glasgow's existing talent pool, we expect to see a pick up in speculative development in close proximity to Glasgow's main transport nodes during 2018.

7.4%
Glasgow office based employment growth over the next five years

613k sq ft
take-up across Scotland during Q4 2017

222k sq ft
speculative office space currently under construction in Edinburgh

6.25%
Aberdeen prime office yield

However, the only serviced office deal across the Scottish city centres during 2017 was Spaces signing for 30,000 sq ft at One Lochrin Square, Edinburgh, accounting for less than 2% of take up in the Scotland market. Birmingham and Manchester, conversely saw serviced offices account for 21% and 10% respectively last year. Serviced office operators are now increasingly looking outside London and the South East in search of regional centres and we expect further serviced office deals to sign during 2018.

GRAPH 4

How did prime office yields adjust during 2017?

Source: Savills

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