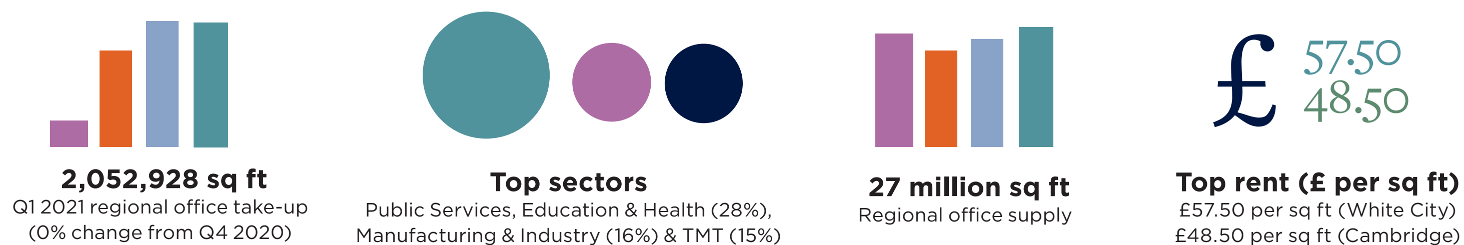
UK Commercial – Spring 2021

SPOTLIGHT
Savills Research

UK Regional Offices

Occupational ● Investment ● Sustainability



2,052,928 sq ft
Q1 2021 regional office take-up (0% change from Q4 2020)

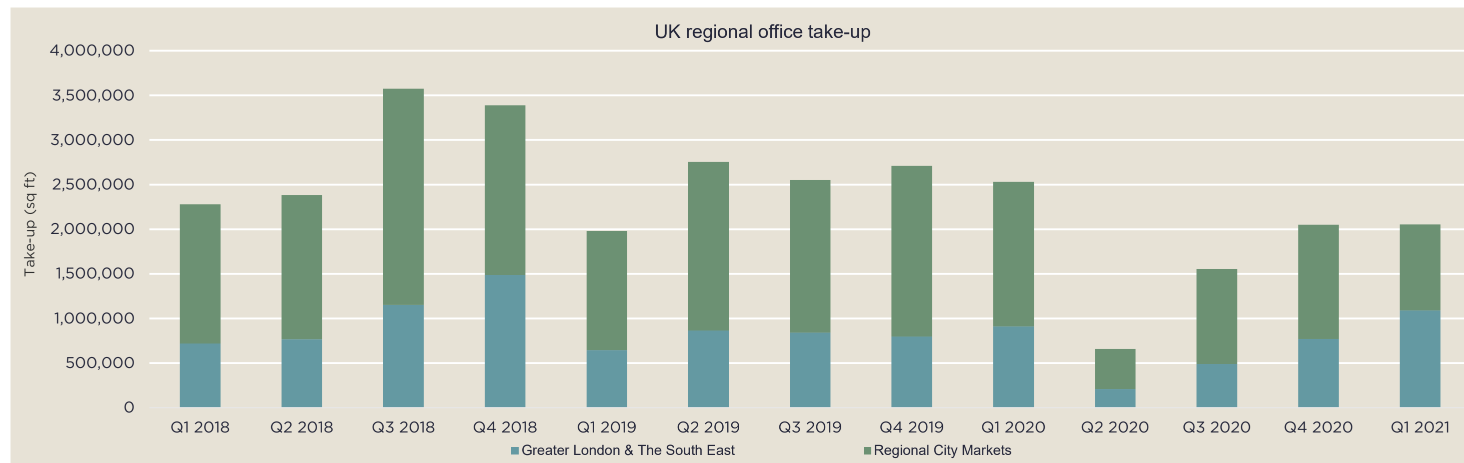
Top sectors
Public Services, Education & Health (28%), Manufacturing & Industry (16%) & TMT (15%)

27 million sq ft
Regional office supply

Top rent (£ per sq ft)
£57.50 per sq ft (White City)
£48.50 per sq ft (Cambridge)

UK regional office take-up (sq ft)

Take-up has increased significantly since the second quarter of 2020.



Source Savills Research

There are strong signs of recovery in the market

Economic sentiment was high throughout Q1, with Deloitte's latest CFO Survey showing a significant increase in optimism among UK CFOs, rising to the highest level in the 13-year history of the CFO Survey, far surpassing previous peaks seen after the global financial crisis and in the wake of the December 2019 general election. Deloitte's Chief Economist in the UK, Ian Stewart, commented, "on the results of the latest CFO Survey, the UK is heading for a strong recovery".

Although take-up remained restricted throughout Q1, quarterly take-up has shown a significant increase since the lowest point of the Covid-19 pandemic (Q2 2020). Q1 2021 regional office take-up (including Greater London & the South East) totalled 2.05 million sq ft, showing little change from Q4 2020 (2.05 million sq ft). However, this reflected an increase of over 200% when compared to Q2 2020, demonstrating that the regional office markets are in the process of recovering from the disruption caused by the pandemic. The regional city markets saw take-up totalling 962,117 sq ft, while in Greater London and the South East, take-up totalled 1.09 million sq ft, reflecting an impressive 35% increase on 10-year average take-up for the first quarter.

Over half (54%) of take-up was for the highest quality space above the 10-year average of around 47%. This was due to the Greater London and the South East market experiencing a significant spike in Grade A office lettings, with Grade A space accounting for 68% of take-up, significantly up from the 10-year average figure of 52%.

There were two key Grade A deals in excess of 100,000 sq ft in the Greater London and South East market; Unilever pre-let 267,000 sq ft at the Hive and Honey Building on Eden Park in Kingston-upon-Thames, which was the largest regional office deal of the quarter. Unilever plans to consolidate its workforce from five existing sites in London and Surrey to The Hive and Honey Buildings by winter 2023/24, bringing 2,000 jobs into Kingston town centre. Also, the telecommunications company Three signed for 116,994 sq ft at 450 Longwater Avenue in Green Park, Reading. In the regional city markets there were no deals in excess of 100,000 sq ft. However, Leeds saw the largest deal with DLA Piper UK LLP leasing an 83,000 sq ft pre-let at City Square House, which began onsite this month.

The Public Services, Education & Health sector accounted for the largest proportion of regional office take-up (28%), accounting for 564,660 sq ft of office space throughout the first quarter. This was due to significant activity from the Department For Work and Pensions, which signed for a combined 371,613 sq ft across 20 deals, 16 in Greater London & the South East, as well as individual deals in Birmingham, Bristol, Cardiff and Leeds.

Due to Unilever's large deal in Kingston, the Manufacturing & Industry sector saw the next highest level of take-up, totalling 323,844 sq ft (16%). Other deals in this sector included ADC Therapeutics signing for 11,750 sq ft at iHub, White City, and Polypipe Ltd letting 11,750 sq ft at 4 Victoria Place in Leeds.

Significant activity also came from the Technology Media & Telecommunications sector, which accounted for 15% of take-up, totalling 306,625 sq ft. The largest deal in this sector was Three in Reading. However, a number of other significant transactions took place, with the majority of deals occurring in the regional city markets (83%). Huboo Technologies let 18,882 sq ft at 41 Corn Street, Bristol, and Alchemie Technology signed for 16,500 sq ft at Duxford Business Centre, Cambridge.

A reduction in letting activity throughout 2020, due to disruption caused by the pandemic, along with significant development in Manchester has seen supply in the UK regional office markets increase. Although supply has increased, it is currently 12% below the 10-year annual average level. This equates to a 6% decrease in the regional city markets and an 18% decrease in Greater London and the South East. Total supply in the UK regions totals 27 million sq ft with 13 million in Greater London and the South East and 14 million in the regional city markets. While total supply has increased, Grade A supply levels have decreased slightly since the end of 2020, with total Grade A availability at 10.4 million sq ft, with 6.3 million sq ft in the South East and 4 million sq ft in the regional city markets.

Despite economic uncertainty, rental growth on the top space has continued. Throughout 2020, almost all regional markets experienced prime rental growth. Most notably, Oxford and Birmingham saw growth of 17.5% and 7.2%, respectively. This continued into the first quarter, with Manchester seeing growth of 2.7% as prime rents reached £38.50 per sq ft at Landmark and, in Leeds, prime rent increased by 1.6% to £32.50 per sq ft.

Prime yield remains static, with limited stock traded in Q1 2021

Overseas investors were particularly active in the UK regions during the first quarter of 2021 - accounting for 58% of investment

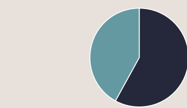
Investment volumes in the Greater London and South East and regional city market reached £1.07 billion at the end of Q1 2021, which represented a 25% fall from the total recorded in Q1 2020 and a 32% decrease in the long-term average turnover for the first quarter of the year. Limited stock was traded, which was reflected in the fall in transactional volumes. The number of deals recorded in the first quarter was 52% below the long-term average. The fall has been notable amongst the smaller lot sizes, with the number of transactions recorded below £20 million being 62% below the long-term average for the first quarter.

The prime regional office yield moved out by 25 basis points to 5.00% in April 2020 in response to the investor caution arising from the Covid-19 pandemic and has remained at this level. Investor demand is currently split into three main categories: long income, life sciences and market-priced value-add opportunities. The demand for assets which are single let with over 10 years of income, has been strong, and there are examples of assets which match this criteria being traded at yields below 5.00%.

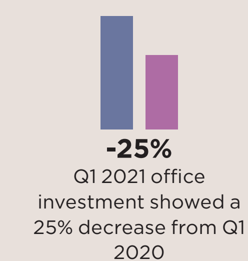
This was evident in Bristol in Q1 2021, where Aberdeen Standard Investments acquired Temple Quay House for £75 million, which reflected a yield of 3.95%. The building was let to the UK Government for 16 years.

Overseas investors have remained the most active investor group in the market,accounting for 58% of investment in Q1 2021. The activity from non-domestic investors has been building in the market with the proportion of total investment from the investor type increasing each year since 2018. UK institutions have sought to increase liquidity in their retail funds, which has resulted in them being the most active sellers in the market. It is expected that the rate of disposals from retail funds will slow as the year progresses. Furthermore, it is expected that overseas investors will continue to be active, with a number of new entrants seeking to invest into the UK regional office market.

UK regional office investment key stats



58%
Overseas Investors accounted for 58% of office investment in Q1



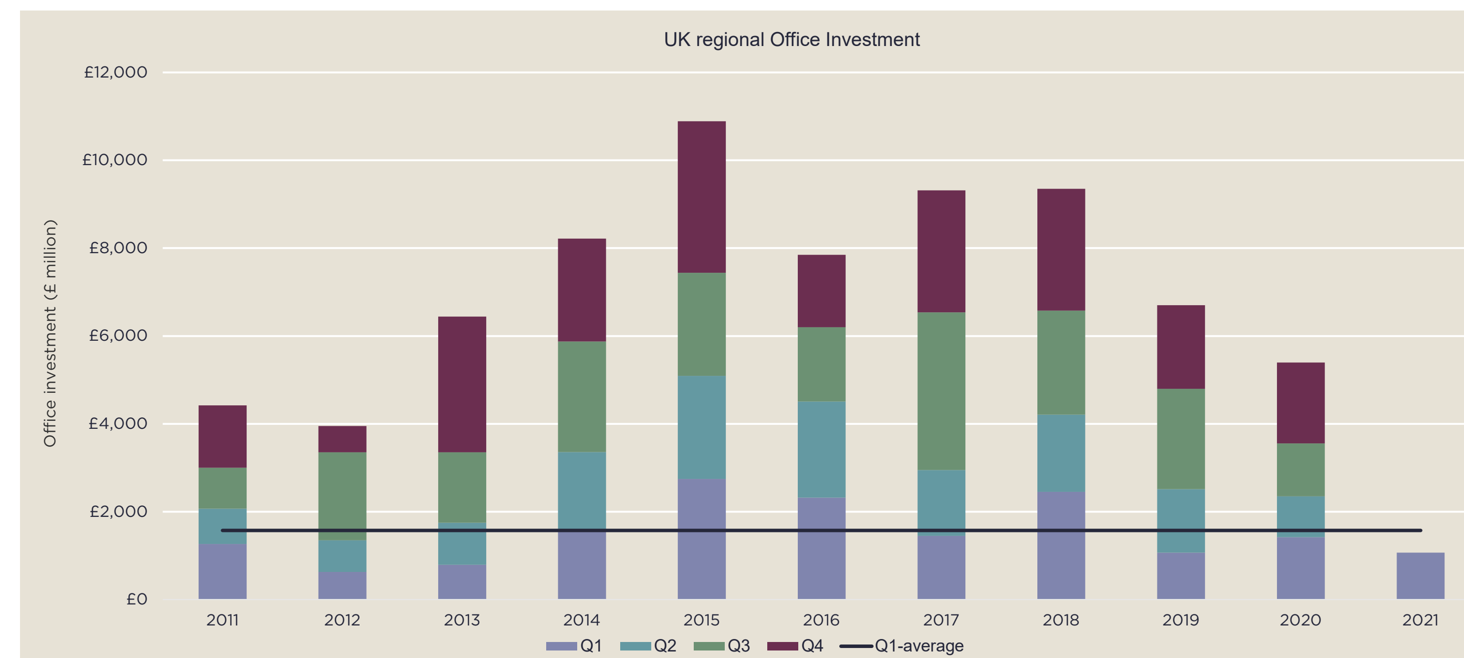
-25%
Q1 2021 office investment showed a 25% decrease from Q1 2020

%

5%
Prime regional office yield

UK regional office investment (£m)

Q1 2021 office investment volumes were 32% below the long-term Q1 average.



Source Savills Research

> As the UK emerges out of lockdown there are encouraging indicators that regional office markets will get stronger through the course of 2021. Already this year we have seen record rents achieved in many markets and with higher quality office schemes now being delivered, leading on ESG and wellness, there is growing evidence that occupiers are prepared to pay top rents for this newly defined version of "Grade A" office space. - Jon Gardiner - Head of National office Agency

Green with envy - the growth of sustainable office developments in UK cities

Awareness of the climate emergency is at an all-time high, but there is work to be done.

We now need to embark on a decade of urgent action and the property sector has a huge role to play, with the office sector in particular needing to reduce its energy demand by an average of 60 per cent by 2050.

Implementing Green initiatives not only reduce a building's environmental footprint and improve occupant satisfaction, they also make sense from a business perspective; certain sustainability efforts, like environmentally friendly building materials and the use of energy-efficient lighting as seen at the 'R plus' office building in Reading, which uses energy efficient luminaires and roof mounted solar panels, can reduce expenses by up to 30%, according to the Morgan Stanley Institute for Sustainable Investing.

Regional Cities are making leaps and bounds in this area, with game changing developments like Aurora in Bristol and Landmark in Manchester, both achieving BREEAM Outstanding certification. North of the border, Cadworks – a 94,000-square foot speculative office development in Glasgow – is being billed as "Scotland's most green office building". The building is coated with an anti-viral, air purifying paint that according to Fore Partnership "eats pollutants and viruses for lunch" - leading to lower Co2 emissions.

According to Historic England, the use of more historic buildings that offer some form of heritage and cultural belonging that links to a place with history can also improve a sense of well-being - creating spaces that enhance the physical and mental health and well-being and connect us to our community. In fact, a new survey from Millennials and Historic Preservation: A Deep Dive Into Attitudes and Values, shows nearly all (97%) of millennials, the nation's largest generation, appreciate the value of historic preservation. In Glasgow, 24 St Vincent Street, which was completed in 1889, has undergone an extensive refurbishment, turning it into one of the city's most contemporary and environmentally friendly office spaces.

As well as helping the UK achieve its net zero carbon target, making buildings healthier and more attractive places to work will support employee retention. Millennials are 81% less likely to move jobs in the next year if their employer focuses on sustainability and employee well-being, according to a recent Gallup-Healthways poll. According to the Environmental Protection Agency improved indoor air quality can result in up to 11% gains in productivity with biophilia documented to improve mental and physical health, increase productivity and reduce carbon footprints.

The bottom line is that by being at the forefront of the climate movement, green buildings will not only attract the investors and the occupiers they need to benefit from the ongoing flight to environmental quality but will also help to encourage workers back to the office when the pandemic begins to ease. The brand enhancement that comes with putting sustainability at the heart of business will help companies attract and retain the best talent and clients, save money from efficiencies, and develop new products and services that get them ahead of the curve.

> **"Millennials are 81% less likely to move jobs in the next year if their employer focuses on sustainability and employee well-being."**

The future of the office looks bright

Following 15 months of remote working, the race back into the office is upon us

Although the remote-work model gained significant traction throughout the pandemic, it is clear that not all companies are embracing it. There is no doubt that we crave the physicality of working together and that the virtual world cannot replace our need to be physically present with our colleagues. Denied to us for so long, the idea of the office and the role it plays in our lives is now more important than ever. Deloitte's latest CFO Survey showed that 95% of UK CFOs are expecting the bulk of their firms' workforce to return to working in the office this year, with almost half believing Q3 to be the key quarter for staff returns.

Initially, it was said that the technology companies would lead the way on the office exodus, as they were the best equipped for remote working. However, many of the large technology companies have clarified that not to be true and believe that company culture and collaboration is vital to productivity, with Amazon telling their employees: "Our plan is to return to an office-centric culture as our baseline. We believe it enables us to invent, collaborate, and learn together most effectively".

In the Financial Services sector, one of the least adaptable industries to homeworking, the urge to get back into the office is increasingly evident. Andrew Monk, chief executive of investment bank VSA Capital, recently told BBC Radio Five Live, "In the financial services industry, you need to discuss ideas and discuss what's going on. People working from home miss out on an awful lot of the activity in the office because we don't have time to tell them".

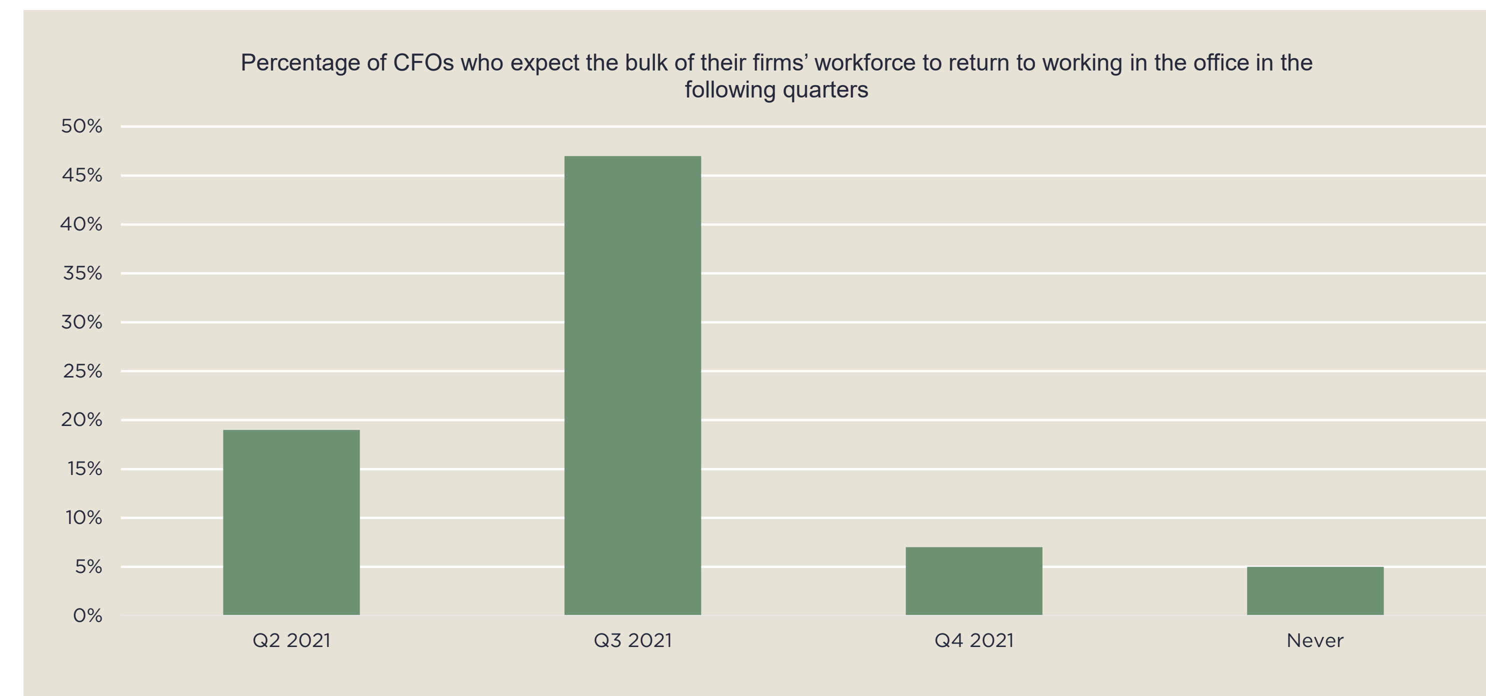
JP Morgan Chase, which allowed workers to return to the office from 29 March, recently announced that more workers would be returning to their London and Bournemouth offices from 21 June, taking them up to a 50% occupancy rate. Goldman Sachs was one of the first big banks to put an end to remote working, when on 4 May, they asked both their UK and US employees to return to working in the office in June. In fact, Goldman Sachs' faith in the office is so strong, it plans to open a new one in Birmingham later this year.

While it is widely accepted that many employees will work from, or closer to, home more frequently, as is the case with Spotify, which, announced its transition to a permanent flexible-work model with its Work From Anywhere policy, employers need be careful to not take the option of the office away completely, as those with unsuitable living arrangements and those who need to learn on the job, such as graduates, by working with more experienced colleagues, will appreciate being back in the office. We believe that offices that facilitate collaboration, creativity and community will be in highest demand from employees. Matt Hammond, the Midlands' head of PwC, calls this the 'work home': a location as much about culture, learning, and connectivity as it is about productive output.

It should also be remembered that we are social creatures and, therefore, popular patterns will likely develop among those who are choosing to work at home some of the time. For example, many people will want to work from home on Mondays and Fridays - which were already popular days for homeworking before the pandemic - leading to others adopting the same schedule to enable them to collaborate with their colleagues. Occupiers should therefore be extremely cautious to equate working from home with a corresponding reduction in office space. While we expect there will be fewer people travelling to city centre offices each day, those that do will have a greater number of interactions, making those offices even more important to those occupiers and their employees.

Deloitte CFO Survey

The results of Deloitte's Q1 2021 CFO Survey found that 47% of CFOs are expecting the bulk of their firms' workforce to return to working in the office during the third quarter of the year.



Source Deloitte

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