SPOTLIGHT
Savills Research

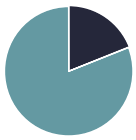
UK Commercial – Summer 2020

UK Regional Office Market Report

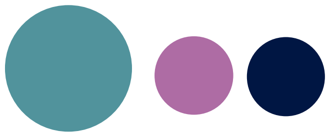
savills

Technology ● Covid-19 ● Flexible offices

2,061,968 sq ft
H1 2020 regional office take-up (36% decrease on H1 2019)



39%
Proportion of H1 take-up Grade A



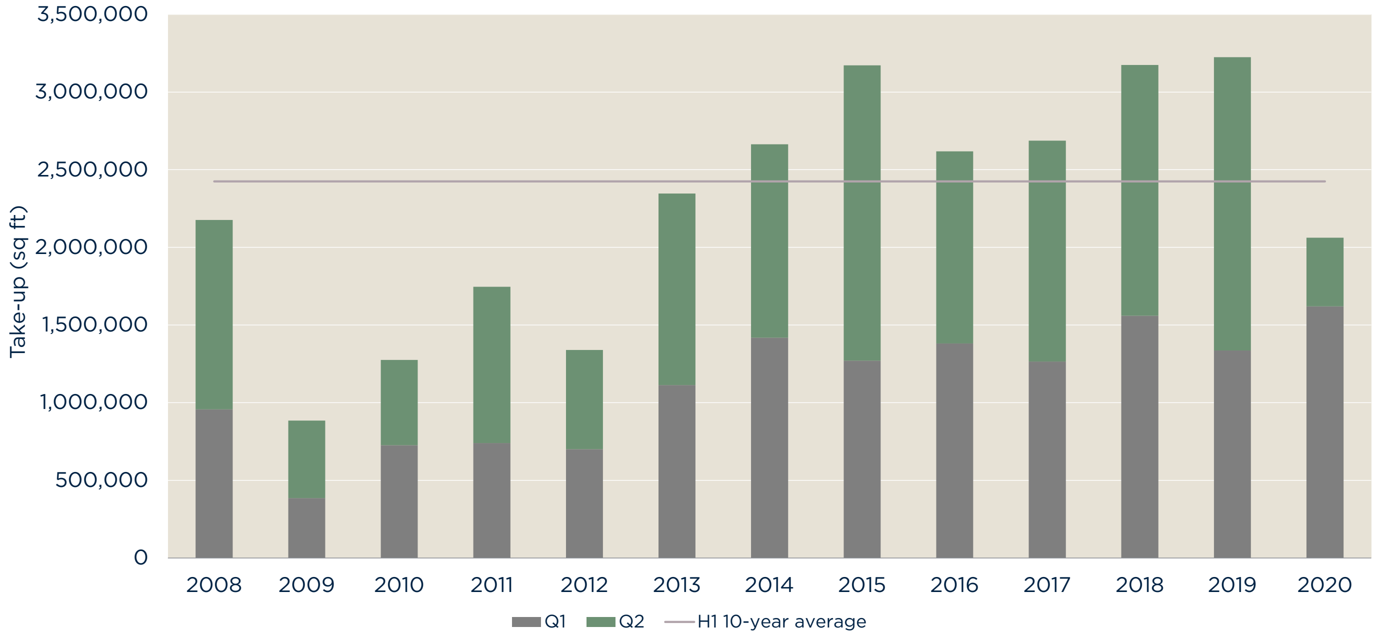
Top sectors
TMT (31%), Public Services, Education & Health (16%), Insurance & Financial Services (9%)

£

£46.00 per sq ft
Prime headline rent – achieved in Cambridge

UK regional office take-up (sq ft)

Disruption has caused office take-up across the UK regions to be limited throughout the first half of 2020.



Source Savills Research

Covid-19 significantly restricted activity in Q2

2020 got off to a strong start, with Q1 regional office take-up 21% above both Q1 2019 and the 10-year quarterly average. However, during the second quarter, the UK-wide lockdown which saw most offices across the UK become temporarily closed, had a significant impact on take-up. Q2 2020 take-up, therefore, totalled 441,436 sq ft, reflecting a 73% decrease from the five-year quarterly average. Total H1 take-up totalled 2,061,968 sq ft, reflecting a 36% decrease from H1 2019 and a 31% decrease from the H1 five-year average.

Bristol and Aberdeen were the only regional office markets which experienced an increase in H1 take-up from the same period last year.

In Bristol, H1 take-up totalled an impressive 272,425 sq ft, a 16% increase on the same period last year, and 2% up on the ten-year H1 average. This was driven by an exceptionally strong Q1 in which 219,491 sq ft of office space was let. Similarly, in Aberdeen, total H1 take-up was 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 transacted.

So far this year, the Technology, Media and Telecoms (TMT) sector has accounted for the majority of take-up, which has been typical in the UK regions since 2018. The sector signed for a total of 645,571 sq ft of office space which equated to 31% of total take-up. Key deals from this sector included telecommunications giant BT which signed for 283,073 sq ft at Three Snowhill, Birmingham during Q1, the largest regional office deal so far this year.

Hilti, which creates software, design and products for the construction industry leased 42,559 sq ft at 1 Circle Square, Manchester, during the first quarter and online betting company Bet365 took 25,029 sq ft at Core, Manchester.

Significant activity also came from the Public Services, Education & Health Sectors, and the Insurance & Financial Services sectors which accounted for 16% and 9% of take-up, respectively.

Overall, 39% of deals were for Grade A space demonstrating the occupier preference for high-quality office space in the UK regions. However, due to a lack of supply, this requirement cannot always be met.

During the global financial crisis, there was over 20 million sq ft of office supply in the UK regions, equating to a significant oversupply. Today, the situation is very different, as there is an undersupply of office space. In 2009, the regional vacancy rate was 18%, and currently, it is just 10%. It looks, therefore, as though rents in the regional office markets are less exposed to downward pressure arising from the current economic climate.

Currently, there is a total available office supply of 11.3 million sq ft in the UK regions, reflecting a 17% decrease since the end of 2019. However, of that, just over 3 million sq ft is Grade A, reflecting a 4% decrease since the end of 2019. When this is compared to average annual take-up levels, this reflects only enough supply to meet the demand for 11 months of take-up, reflecting a severe undersupply of Grade A office space. In some markets the situation is more acute than others: Birmingham, Bristol, Glasgow and Leeds all have less than six months of Grade A supply available demonstrating a critical need for speculative office development in these markets to keep up with average demand.

The limited take-up and disruption caused by Covid-19 has given occupiers more leeway to negotiate and secure competitive rents. However, in Leeds and Oxford, there was rental growth during H1. In Leeds, top rents increased by 7% from £30 per sq ft to £32 per sq ft. While in Oxford, top rents increased by 6% from £40 per sq ft to £42.50 per sq ft.

The overall top rent within the regional office markets is £46 per sq ft, which has been the top rent in Cambridge since 2019.

A lack of sellers in the market sees investment volumes fall

Regional offices provide an attractive yield gap to central London

The coronavirus pandemic and the subsequent lockdown restrictions have resulted in investor caution in the market. This culminated in weaker transactional activity taking place in Q2 2020. Investment volumes in the regional office markets (excluding Greater London & South East) were, therefore, 36% below the long-term average.

After combining Q1 2020 and Q2 2020, investment volumes in H1 2020 were 56% below the long-term average.

The short-term investor caution arising from Covid-19 in the market has been reflected by prime yields for regional offices moving out by 25 basis points, and they currently stand at 5%. This is, however, a 100 and 125 basis point discount when compared to City and West End prime yields, which stand at 4% and 3.75% respectively, highlighting the value the regional office market can provide.

The investor appetite for prime assets and medium- to long-term income remains strong. This was exemplified by Tesco Pension Fund acquiring Halo, Bristol for £69.4 million which was partly pre-let to Osborne Clarke who leased 74,000 sq ft at the new development. Legal & General have continued to invest in urban regeneration schemes across the regional cities and have invested £150 million in Sheffield City Council and Urbo's West Bar Square development in H1 2020.

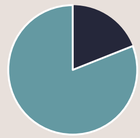
Sale and leaseback opportunities have also proved attractive to investors who are seeking medium- to long-term income, and occupiers who are seeking capital injections. The most notable sale and leaseback transaction in H1 2020 was BA Pension Fund buying Next Headquarters in Leicester for £48 million.

Despite the weaker economic environment there are limited distressed sellers in the market, and there is currently a pricing mismatch between buyers and sellers for value-add opportunities which has resulted in limited transactional activity in this part of the market since the lockdown.

UK institutions have been the most active investor in H1 2020; they have accounted for 40% of investment volumes. This has partly been driven by Legal & General's £150 million investment in West Bar Square, Sheffield.

It's expected that throughout the rest of the year, UK institutions and overseas investors will continue to be active in the market, most notably in Q4 2020.

UK Regional office investment key stats



40%
UK funds accounted for 40% of investment in H1 2020

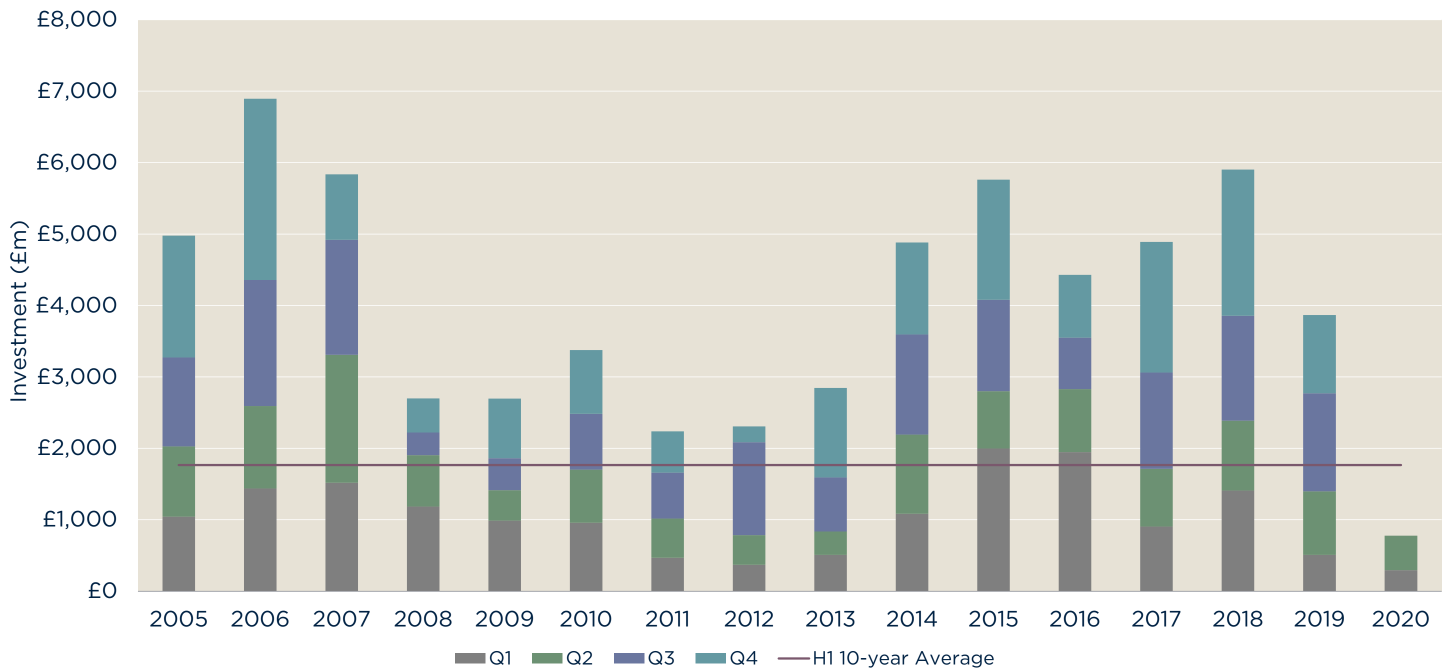
66%
The sub £10m lot size accounted for 66% of deals recorded in H1 2020

%

5.00%
Prime regional office yield

UK regional office investment (£m)

Q2 2020 office investment volumes were significantly below the quarterly average.



Source Savills Research

> "The investor appetite for prime assets and medium- to long-term income remains strong, this was exemplified by Tesco Pension Fund acquiring Halo, Bristol for £69.4 million"

Technology is driving office take-up within the UK regions

Take-up levels have continued to rise from the technology sector in the regional office markets

In recent years, the technology sector has experienced significant growth within the UK regions. So far this year, take-up from the TMT sector has accounted for 31% of total take-up, significantly up on the preceding five-year average figure of 18%. The UK's technology sector is continually innovating and growing, with the total number of technology companies in the UK rising by 14% during 2018 alone. Much of this growth comes from startups which often base themselves in the regional cities to save on rent costs, as well as cluster with similar occupiers.

Although economic disruption from Covid-19 poses risks to the UK's technology startup scene, we do expect to see a wave of new businesses focused on e-commerce, healthcare, gaming and cloud computing starting up in the next few years. Savills believes that each of these sectors are likely to grow as social distancing restrictions redefine how we spend our time. Ultimately, the UK tech sector will remain strong and will play a vital role in helping put the UK economy back on track following the pandemic.

Venture capital raising can often be a key indicator of future demand for office space requirements, as when companies receive significant funding they often use this investment to increase their headcount, and therefore require upgraded office space. So far this year, the South West region has received 20% of the total UK share of venture capital to the technology sector, totalling £4.3 billion, beaten only by London which accounted for 55%. Interestingly, all other regions, excluding the South East, accounted for less than 3% of the total share highlighting just how far ahead the South West is this year.

The South West region is home to over 10,000 technology companies and benefits from an internationally recognised and mature tech ecosystem. Bristol has facilitated the significant growth within the region as it has become known as a hub for both established and startup technology companies in recent years.

Early this year, fintech start-up ClearBank signed for 4,000 sq ft at Bristol's Prologue Works, their first office letting in the city. Last year, ClearBank raised an estimated £35 million in venture funding and was also named as BusinessCloud's UK 'number 1 FinTech Disruptor'.

However, activity is in no means limited to the South West; neighbouring Wales has seen a recent wave of activity from technology occupiers. In Cardiff, during 2019, challenger banks Starling and Monzo both acquired city-centre office space: Starling Bank took 14,000 sq ft at Brunel House, its first letting in Cardiff, and Monzo Bank signed for an additional 6,000 sq ft at 2 Kingsway. Monzo Bank's original decision to move into Cardiff in 2017 successfully put the city on the map as a potential UK fintech hub. Starling Bank's decision to follow Monzo indicates that a new wave of fintech firms could now be on their way into Cardiff, presenting new and exciting prospects for the city's economy. It's therefore expected that technology occupiers will be a key source of office demand within Wales and the South West region over the next few years.

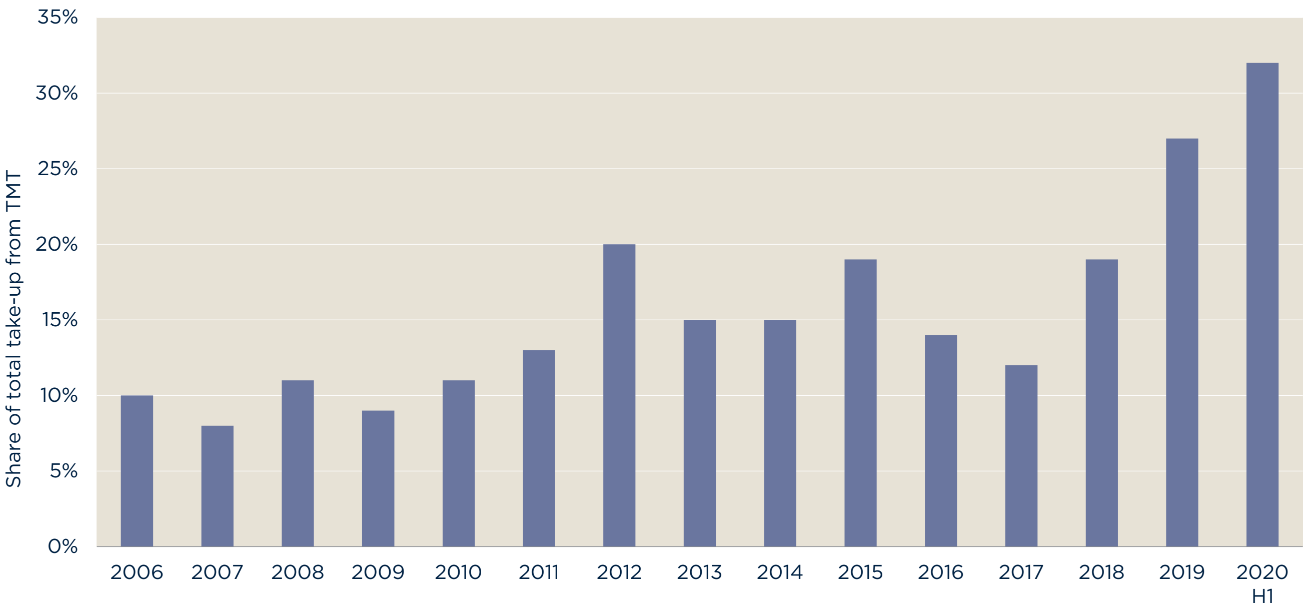
The West Midlands is home to one of the largest tech clusters in the UK, with Tech and Digital companies contributing over £1.6 billion to the West Midlands economy, and in Birmingham, there are rapidly growing hubs emerging around Aston Science Park and Digbeth, which have both been a catalyst for the growth of this sector within the city.

Manchester is also home to one of the largest tech clusters in the UK which hosts more than 62,000 skilled workers. Their new tech 'neighbourhood' Bruntwood SciTech's Circle Square development will be a key location for this sector to develop and expand going forward.

Ultimately, the growth of the technology sector shows no signs of slowing and the UK's regional office markets present many attractive opportunities for both startup and established tech firms looking for high-quality office space surrounded by similar occupiers.

Proportion of regional office take-up to the TMT sector

Technology has quickly become the main driver of UK regional office take-up, with TMT accounting for 32% of regional take-up so far this year.



Source Savills Research

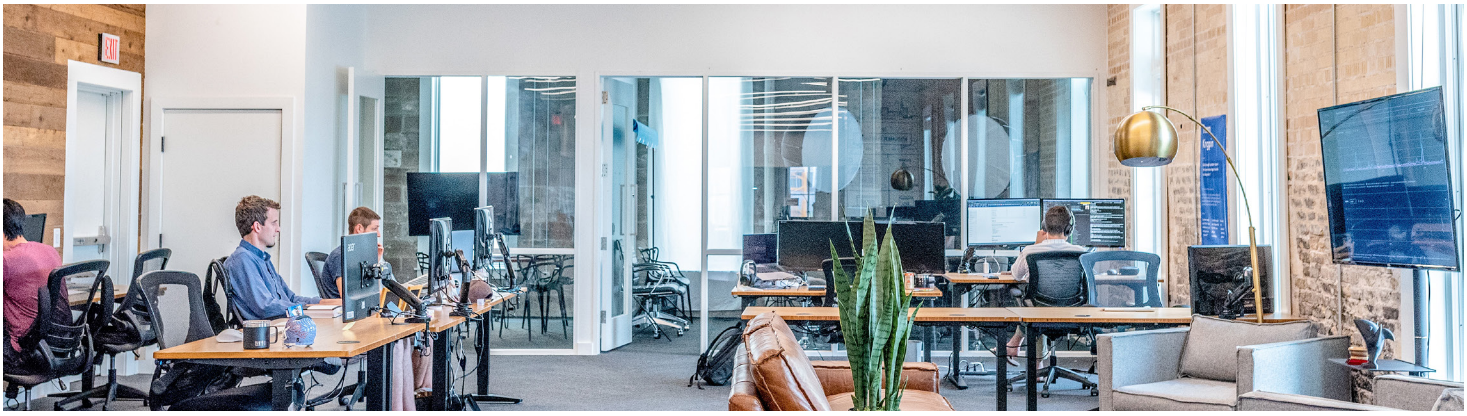
> "So far this year, the South West region has received 20% of the total UK share of venture capital to the technology sector totalling £4.3 billion"

44,000 sq ft
Serviced office take-up in H1 20

2%
Share of regional take-up for serviced offices in H1 2020

14,692 sq ft
The average deal size in H1 2020

£450
The highest average monthly desk price outside of London is Cambridge



Flex embraces innovation

The speed of response of serviced offices and coworking spaces to Covid-19 was testament to how flexible and adaptable they are. Flexible offices implemented safety features and new protocols in a matter of weeks. This had a clear positive effect, encouraging workers to return to the office in a safe manner. Now the emergency response has largely been dealt with, flexible offices can focus on innovating and adjusting to the new environment.

A number of flexible office operators revisited their business models and have started offering even more flexible membership packages to cater for the new environment. For example, WeWork is piloting a pay-as-you-go programme in New York where members can book workspaces by the hour. Convene has introduced a video meeting service that aims to recreate as much as possible the feel of attending a conference. This is only the start. There will be more innovation to come, and this will play to one of the key strengths of flexible offices: their ability to adapt and innovate.

Jess Alderson. Global Research, Workthere

Flexible office operators remain optimistic

After a record year of demand in 2019, demand has softened in H1 2020. Operators remain positive on the outlook for the sector with flexibility remaining of high importance to occupiers

After the strongest demand ever recorded in the regional office market from the flexible office sector in 2019, demand has softened in 2020. This can be attributed to Covid-19 and the strong levels of expansion from the sector in recent years. There was 44,000 sq ft let by the sector in H1 2020 across three transactions. The largest deal being Hana leasing 27,000 sq ft at Windmill Green, Manchester. The sector has expanded exponentially in the regional market in the last three years with the highest recorded level of take-up from the sector being broken in consecutive years from 2017–2019. This culminated in 784,000 sq ft being let to the sector in 2019, resulting in 24 new centres opening in the regional market.

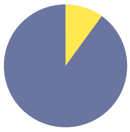
Since 2017, the majority of regional demand from flexible office operators has been concentrated in Birmingham and Manchester. Combined the markets account for 63% of take-up recorded across the regional market from the sector in this time period. This has been primarily driven by large lettings to operators; there have been nine lettings over 50,000 sq ft in this time period.

The initial impact of Covid-19 on the flexible office market has resulted in occupancy falling in centres while the lockdown restrictions were imposed. Workthere has reported that building occupancy is rising though and on average across the UK was 23% in July. Sentiment in the sector is positive, which was uncovered by Workthere's July Flexible Office Sentiment Survey. The UK, in fact, had a hugely positive outlook for the sector on a global basis with 88% of respondents stating they were optimistic or very optimistic on the outlook of the sector in the next 12 months.

There has been much debate in the property press on whether there may be a rise in the adoption of a hub and spoke location model for corporate occupiers. This involves a large office (hub) and various smaller offices (spokes) in locations closer to employees' homes, which is further explained in the next section of the report. There has also been debate on whether this may impact the flexible office sector with there being a greater demand for flexible office space in suburban locations. This could potentially benefit both the regional office market and South East office market with flexible offices providing an opportunity for occupiers to adopt or trial this model without committing to a long-term lease.

> **"Operators are optimistic for the outlook of the sector. Flexible offices can add diversity and resilience to an occupier's portfolio"**

11.3 million sq ft
Total regional office supply



9.6%
Regional vacancy rate

3 million sq ft
Grade A regional office supply

1.6
years of regional supply

Despite economic disruption the longer-term rental growth outlook is robust

The property market fundamentals of the regional office market in 2020 are markedly different when compared to the last recession in 2009. This is most notable when analysing the supply market dynamics. Availability across the regional office market has fallen every year from 2009 to 2019, and current supply (11.3 million sq ft) is 44% below the peak in 2009 when 20.4 million sq ft was available. The supply constraints in the market are evident with Leeds and Glasgow having the lowest amount of Grade A space available in the last ten and five years, respectively. A combination of limited development activity and poor quality Grade B and C buildings being converted to alternative uses under permitted development rights has created the current low supply environment.

The overhang of available Grade B and C space in 2009 resulted in rental growth stagnating, whilst the longer-term outlook for rental growth in the current market is far more robust. Savills analysis has uncovered that average Grade A rents across the 'big six' regional cities since 2007 have not fallen when the vacancy rate is below 13%. The current vacancy rate is 7.5% across the 'big six' regional cities which is the lowest on record. Savills forecast vacancy rates across the 'big six' cities to remain below this 13% threshold from 2021–2023 after adopting conservative assumptions which reflect the immediate weaker economic environment. It is unlikely that the supply constraints across the market will be alleviated in the short term with the 61% of the development pipeline under construction across the 'big six' already pre-let or let under construction.

The suburban shift

Could a desire for more non-core office locations lead to a more hub and spoke approach?

The effects of a country-wide lockdown, combined with a greater desire for a more satisfying work-life balance, have made us all a little more selective about where we want to spend our working days.

With new ways of working, a city-based job in the time of Covid-19 may potentially be less of a factor in home buying decision-making; however, full time working from home may not work for either the business or individual in the long term.

Facebook has been in the news recently eyeing offices in cities like Dallas, Atlanta, and Denver to act as hubs to support 50% of its workers who have decided to continue working remotely.

Could this hub and spoke approach, with corporate headquarters envisaged as smaller hosting spaces for clients, supported by a more localised multi-office strategy, be the future?

There's good reason for this approach, with research from CareerBuilder showing 56% of employees who described themselves as satisfied in their jobs citing work-life balance as a key factor, with short commuting times significantly increasing satisfaction.

Savills new *Office FiT* survey, which looks at the needs and wants of office-based workers before and after the Covid-19 lockdown, also showed that those with the shortest commute (under 30 minutes) are the ones most eager to get back to the office.

Savills Office FiT survey also shows the important role of the office in providing a sense of community and belonging. However, it also shows that most people want a mix of working from home and being in the office: just because people no longer need to go into 'the office' doesn't mean that they won't want to go into 'an office' at some point.

Ultimately, flexibility will be the new requirement for the office sector, with occupiers and their employees demanding comfortable, accessible spaces that can be easily adapted as required. This isn't anything new, but where these spaces are located and how they are designed is worth thinking about.

For those new escapees from urban centres, missing the office environment and their interactions with co-workers, a hub provides the perfect space to continue to connect and work collaboratively with colleagues and clients when required.

With an abundance of appealing regional, suburban and rural locations, combined with an increased demand by office workers to live outside of cities, the future of work could actually be brighter and more profitable.

Beyond attracting and retaining talent, which remains the biggest focus for any business, a decentralised hybrid office approach also offers businesses, landlords and developers exciting investment opportunities.

With an already significant demand for satellite co-working spaces, the Covid-19 crisis may accelerate this growth even more. A more balanced and regional focus may also assist with helping the UK economy bounce back, invigorating smaller towns and assisting in the creation of new local businesses. Work now has the ability to become even more local.

> “Ultimately, flexibility will be the new normal for the office sector.”

Has Covid-19 created lasting changes to UK offices?

The working world moved rapidly from business as usual to a mass exodus from offices to homeworking. How will this impact the future of offices?

No one knows what the new normal will look like, but what we can agree is that life will never be quite the same again. Covid-19 has been a fast acceleration into a future that many expected, but perhaps not at this speed.

The UK's crash course in Zoom is already showing that not all businesses need to be able to provide workspaces for all their staff. With teams now more used to working virtually, the possibility of work becoming geographically more fluid is also becoming a fast reality. Covid-19 is teaching us that there is freedom for us to reimagine what work looks like, and where it is located.

As we start to enter a 'new normal', it is very likely that some office requirements will start to retract in size as companies realise that employees can work at home, for at least part of the time. Ultimately, occupiers will demand more flexibility. Some occupiers will require shorter leases, and maybe we'll see core space on a more traditional lease whilst occupiers add extra floor space on more flexible arrangements. Nothing is certain yet; however, many employees are now tired of working full time from home, at least in some capacity. Working in makeshift offices in cramped environments, possibly with children to home-school, has not made life easy for a huge proportion of the population.

With so many studies showing how engaged and productive the average remote worker is, it would be remiss of businesses and organisations to not allow employees to continue to work flexibly. However, when we're forced to be apart from each other, physically isolated, it is clear that we need a balance between the virtual and physical worlds. 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.

Some businesses may be considering that they no longer need the space, but we would urge caution. Although we all like to put those 'light bulb' moments and meetings of minds down to serendipity, many forward-thinking companies are now working towards creating more intentional physical opportunities for social collisions by rethinking their office design.

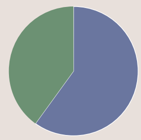
The ability to spend part of the working week connecting with colleagues, clients and collaborators in a thoughtfully designed space and then enjoy the dynamic environment that a city offers, is likely to be a compelling reason to physically come to work – for part of the week at least.

> "The role the office plays in our lives is now more important than ever"

Savills Office FiT survey

Savills new FiT survey looks at the needs and wants of office-based workers before and after the Covid-19 lockdown.

89%
of respondents believe the office will remain a necessity

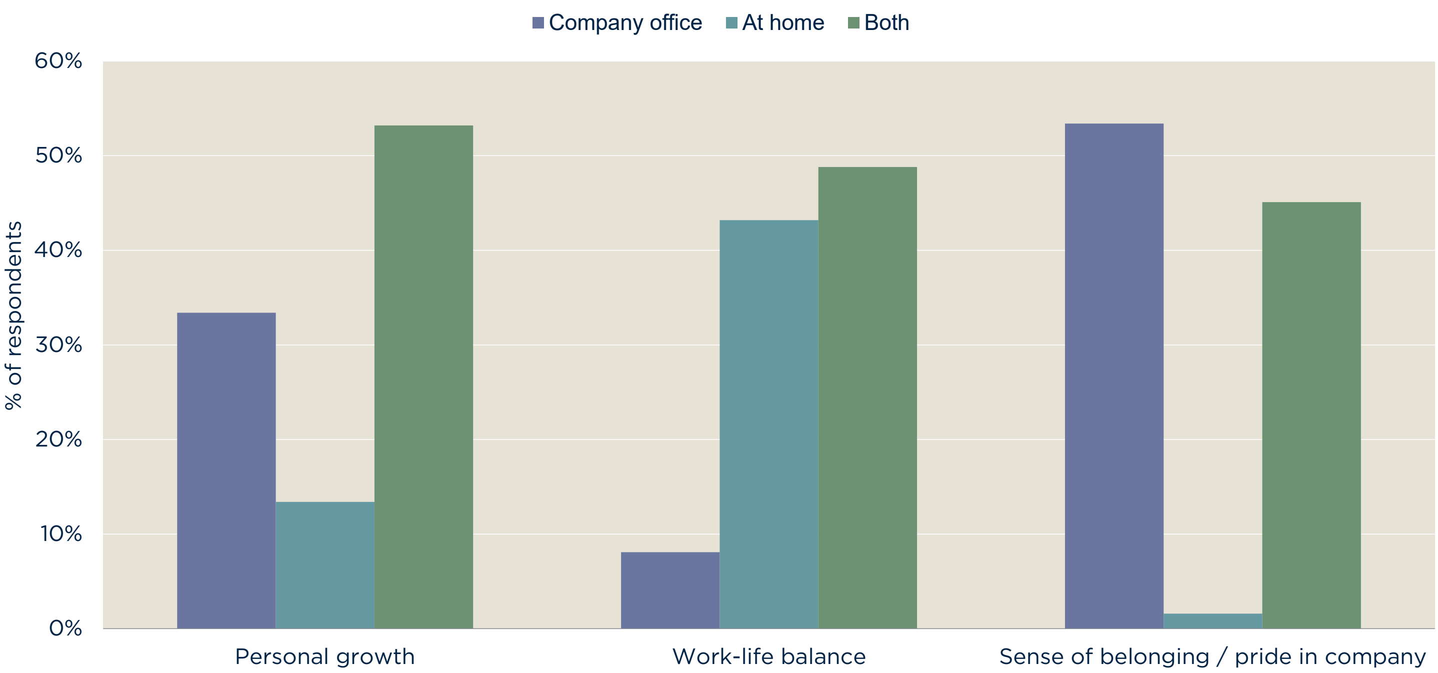


60%
believe the office is best placed for colleague collaboration

18–24
year olds prefer working in the office to help to learn, be seen, network and collaborate

Savills Office FiT survey

The results of our survey found that a company office is the best place for employees to feel a sense of belonging and pride in their company



Source Savills Research

Savills Commercial
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team

Office Agency

Jeremy Bates EMEA Head of Occupational Markets 020 7409 8813 jbates@savills.com	**Jonathan Gardiner** Head of National Office Agency 020 7409 8828 jgardiner@savills.com	**Dan Smith** Director Aberdeen 01224 971 134 dan.smith@savills.com	**Nick Williams** Director Birmingham 0121 634 8401 nwilliams@savills.com	**Ben Thacker** Director Birmingham 0121 200 4561 ben.thacker@savills.com
Chris Meredith Director Bristol 0117 9102 216 cmeredith@savills.com	**Rob Sadler** Director Cambridge 01223 343 209 rsadler@savills.com	**Gary Carver** Director Cardiff 02920 368 963 gcarver@savills.com	**Mike Irvine** Director Edinburgh 0131 247 3817 mike.irvine@savills.com	**Hugh Rutherford** Director Edinburgh 0131 247 3816 hugh.rutherford@savills.com
David Cobban Director Glasgow 0141 222 4101 dcobban@savills.com	**Paul Fairhurst** Director Leeds 0113 220 1207 pfairhurst@savills.com	**James Evans** Director Manchester 0161 277 7238 jevans@savills.com	**Charles Rowton-Lee** Director Oxford 01865 269 030 crlee@savills.com	**Martin Hastelow** Director Southampton 023 8071 3989 mhastelow@savills.com
Phil Dennis Associate Director Chelmsford 01245 293 216 pdennis@savills.com				

Investment

Richard Merryweather Joint Head of UK Investment 020 7409 8838 rmerryweather@savills.com	**Nick Penny** Head of Scotland Investment 0131 247 3803 npenny@savills.com	**Matt Jenns** Director Birmingham 0121 634 8447 mjenns@savills.com	**Andrew Phillips** Director Bristol 0117 9102 352 adphillips@savills.com	**Ross Griffin** Director Cardiff 02920 368 961 rgriffin@savills.com
James Emans Director Cambridge 020 7409 8132 jemans@savills.com	**Rod Leslie** Director Edinburgh 0131 247 3812 rleslie@savills.com	**Stuart Orr** Director Glasgow 0141 222 4144 sorr@savills.com	**Simon Lister** Director Leeds 0113 220 1208 slister@savills.com	**Oliver Foster** Director Manchester 0161 277 7212 ofoster@savills.com

Research

Steven Lang Director Commercial Research 020 7409 8738 slang@savills.com	**Clare Bailey** Director Commercial Research 020 7409 8863 cbailey@savills.com	**Simon Preece** Associate Commercial Research 020 7409 8768 spreece@savills.com	**Pearl Gillum** Research Analyst Commercial Research 020 7535 2984 pearl.gillum@savills.com