Spotlight - Winter 2018

SPOTLIGHT
Savills Research

Aberdeen and North East Property Market

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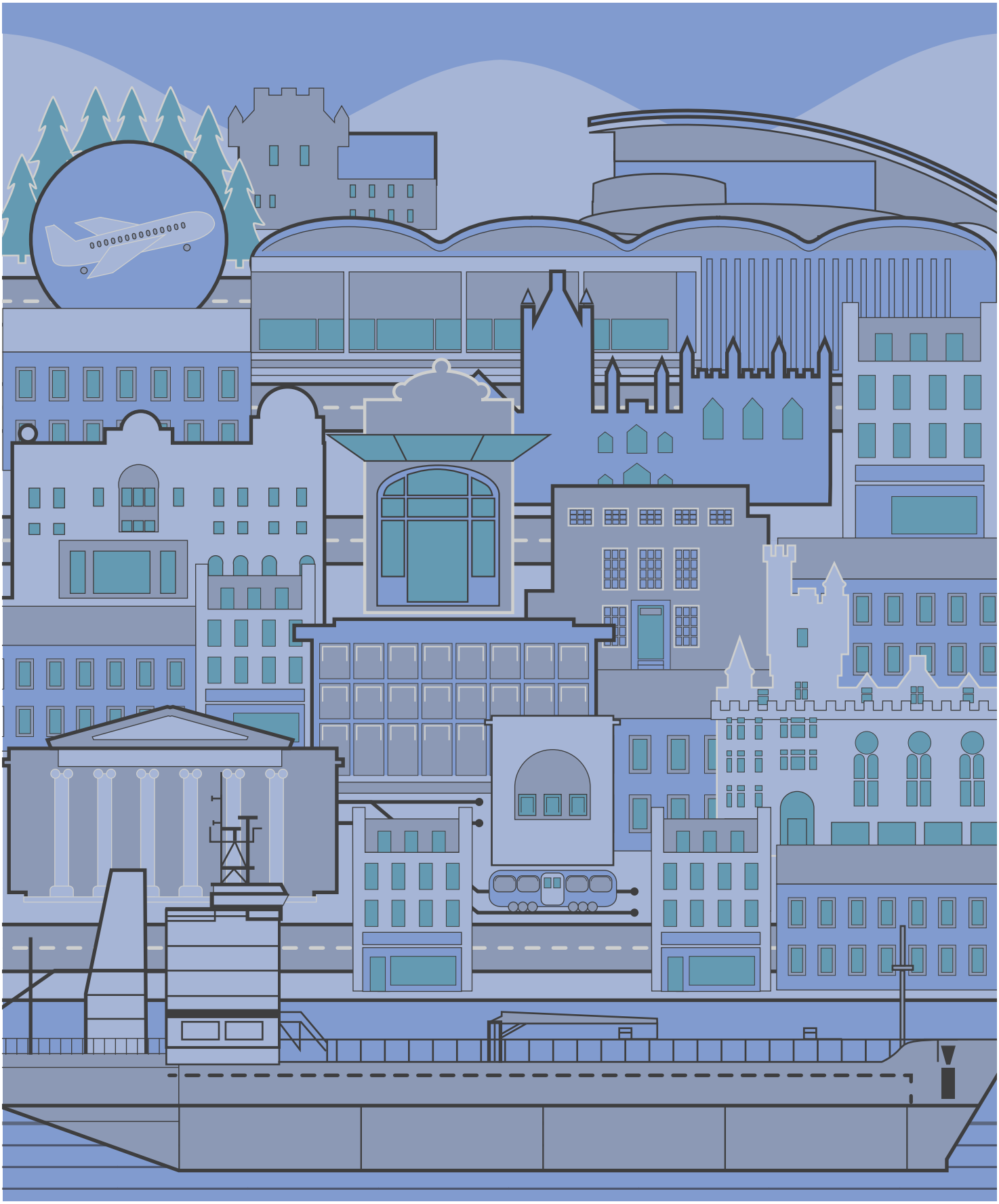

Residential market outlook • Developer survey findings • Commercial and Rural update

Introduction

Four years on since the oil price crash, the Aberdeen area residential market has undergone a period of severe adjustment. From peak to trough, the annual number of residential transactions fell by 31% and the average house price in Aberdeen City dropped by 20%.

There are signs of cautious optimism. An increase in the price of oil has supported a stable residential market for much of 2018. With hopes of moderate economic growth over the next few years, the market is ripe for recovery.

Aberdeen faces a huge challenge to diversify its economy and reduce its reliance on the oil and gas sector. But there are already signs of more activity in the local development market, with Aberdeen City Council implementing the majority of our recommendations in the Savills City Living report.

Moreover, Aberdeen's commercial property market continues its road to recovery, with the supply of high quality accommodation remaining constrained.

Aberdeen should take heart from the fact that the rest of Scotland's residential market is enjoying its strongest conditions in a decade. Now is the time for Aberdeen to catch up and shine again.

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4%

Aberdeen area house prices to grow by 4% over the next five years

The market is ripe for recovery

There is more optimism as property prices and transaction numbers continue to stabilise

The Aberdeen area was not immune from the effects of the extreme weather across Scotland earlier this year. There was an 11% drop in transactions, from 3,819 during the first six months of 2017 when market recovery commenced, compared to 3,400 during the same period in 2018.

However, activity has picked up again in the second half of 2018 and average prices have remained stable in recent months. Despite the stability, the overall market will remain fragile until we see a sustained period of stable transaction and pricing levels.

While the overall market remains challenging, some sections are seeing more activity. Second hand transactions above £500,000 in Aberdeen City during the year ending September 2018 were on a par with the number during the year ending September 2017.

In Aberdeenshire, the second hand market between £300,000 and £500,000 and also above £700,000 witnessed a modest recovery over the same period. Transactional activity across all price bands in Aberdeen City's new build market also improved, supported by incentives.

Residential values annual change forecasts

We expect price drops in Aberdeen easing in 2019, subject to a further reduction in stock levels

	2019	2020	2021	2022	2023	5-year compound growth
UK mainstream	1.5%	4.0%	3.0%	2.5%	3.0%	14.8%
Scotland mainstream	2.5%	5.0%	3.5%	2.5%	3.5%	18.2%
Aberdeen area mainstream	-1.0%	2.5%	1.5%	0.0%	1.0%	4.0%

Source Savills Research

> "Properties offered to the market in good condition and correctly priced continue to attract strong interest"

14% reduction in available prime stock above £400,000 since 2016

New build market stimulating overall recovery

The recovering new build market is stimulating the second hand market in some parts of the city. These include the traditional hotspots of Bieldside, Cults and Milltimber, where a 34% annual increase in new build transactions supported a 4% increase in second hand transactions. The Cove Bay area in the south of the city, where new build transactions almost doubled, also witnessed a modest recovery in second hand activity.

In Aberdeenshire, the strongest growth in transactions last year took place in locations that are within easy reach of Aberdeen, particularly those with train connections and amenities. These include Alford, Inverurie and the Kincardineshire hotspot of Stonehaven.

Stock levels beginning to peak

The high level of available stock remains a key barrier to Aberdeen's long term market recovery. The number increased by 12%, from 5,016 in November 2017 to 5,627 in November 2018. But the number has slightly dropped since July this year, when 5,674 were available. With the exception of the market up to £100,000, all other bands have seen stock levels beginning to ease.

Supply is less saturated above £400,000 in particular, and this is being reflected in improved transactional activity in some areas. Whilst just over half of the overall stock has been unsold for a number of years, there are now more realistically-priced mainstream properties being launched.

Properties offered to the market in good condition and correctly priced continue to attract strong interest. However, the market remains challenging for remote houses in poor condition. For these properties, significant price adjustments or upgrading will be a necessity.

Outlook for prices

High stock levels have impacted house price performance in the Aberdeen area. However, prices are beginning to find their level, with the monthly average in Aberdeen City and Aberdeenshire staying around the £160,000 and £190,000 level respectively for most of 2018, according to the UK House Price Index. But prices are currently around 4% lower than 2017. Therefore, an expected overall annual drop of 4.5% in Aberdeen area prices at the end of 2018 should not come as a surprise. We expect price drops easing in 2019, subject to a further reduction in stock levels. This will enable a recovery from 2020. Prices will follow a similar trend to the rest of Scotland from 2020 onwards, with 4% growth over the five-year period between 2019 and 2023.

Angus leads the wider North East

Whilst the overall number of transactions in the North East locations outside the Aberdeen area slightly dropped during the year ending September 2018, Angus bucked the trend, witnessing a 3% increase. Meanwhile, prices, particularly in Dundee and Moray, continue to grow, supported by more higher value activity.

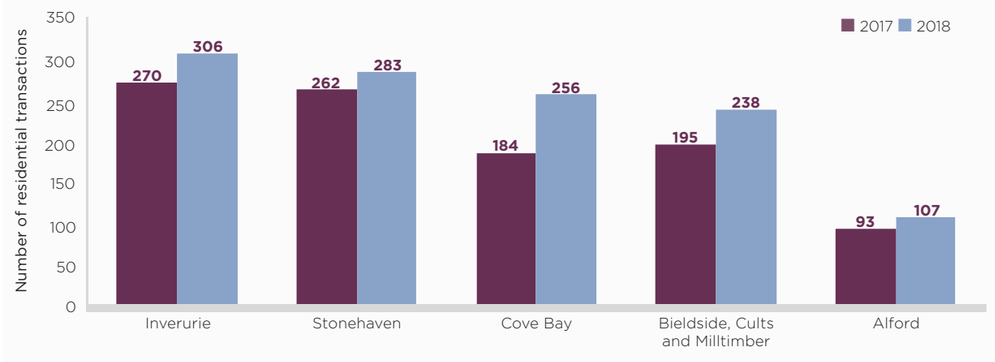
The market in Angus has grown mainly up to £500,000 with improved second hand activity in Brechin and around the periphery of Dundee, and also more new build activity in Arbroath.

Transactional activity in Dundee City fell annually by 2% over the last 12 months, mainly due to constrained supply below £300,000. Above this level, transactions increased from 103 during the year ending September 2017 to 122 during the year ending September 2018, which led to a 3% annual increase in average prices over the same period.

A similar trend was witnessed in Moray, where transactional activity fell annually by 7%, due to constrained mainstream supply. Above £300,000, transactions increased from 72 during the year ending September 2017 to 90 during the year ending September 2018, which led to a 4% annual increase in average prices over the same period.

Annual number of residential transactions (year to September)

The market is buoyant in traditional hotspots and locations that are within easy reach of Aberdeen



Source Savills Research

6.5%

At 6.5%, annual prime value growth in Edinburgh was the highest in the UK during 2018Q3

Room for further growth

Short supply in popular, well-connected neighbourhoods is driving up prices

Across Scotland, transactional growth in the higher price bands continues to lift prices, with the average reaching £177,519 during the year ending September 2018; an annual increase of 4%, compared to the year ending September 2017.

The prime market above £400,000 led transactional activity, with the number growing by 8%, from 4,696 during the year ending September 2017 to 5,070 during the year ending September 2018.

Meanwhile, the number of transactions above £1 million reached 197 during the year ending September 2018, up 15% from the 172 during the year ending September 2017.

Edinburgh & Lothians

Edinburgh currently has the fastest growing prime market in the UK, with annual price growth of 6.5% during 2018Q3, according to the Savills prime index.

The average prime values in cities such as Cambridge, Oxford and Bath have grown since 2008 by 30% over the last decade, while the figure in Edinburgh has just reached the level before the housing market downturn. With a thriving financial sector and being a globally recognised tech hub, the market is catching up with the other prime University cities around the UK.

Market strength from Edinburgh continues to spread out to the surrounding Lothians, where prime transactions above £400,000 increased annually by 25% during the year ending September 2018.

Greater Glasgow

Prime activity across Greater Glasgow reached 1,240 during the year ending September 2018, an annual increase of 15% compared to the year ending September 2017.

More higher value activity resulted in 5% annual growth in the overall average transaction price during the year ending September 2018. Prime transactions in the city area of Glasgow were led by the hotspots of West End, Park, Partick and Jordanhill.

Meanwhile, the prime market in the hotspots of Bearsden and Milngavie was led by a strong second hand market and more new build sales above £400,000.

A similar trend was also witnessed in the sought-after locations of Clarkston, Giffnock and Newton Mearns, where the prime market was supported by a strong second hand and new build market.

Country locations

Scotland's country locations, including the Heartland, the Highlands, Borders, Argyll and Dumfries & Galloway are performing well despite the political uncertainty surrounding Brexit. The oversupply of houses has reduced and there is now a shortage in sought after towns and villages.

The market below £1 million has been less affected by LBTT. The market above £1 million experienced an increase in sales but continues to be fickle and more expensive houses can take longer to sell. Some sellers have had to accept discounted prices.

Outlook

We expect Scottish house prices to perform ahead of the UK average, growing by 18.2% over the next five years. Much like the rest of the UK, growth will be tempered by political uncertainty with Brexit negotiations in 2019, a UK general election in 2022, and the additional factor of Scottish elections in 2021. Yet, Scotland still has room for growth, particularly in popular, well-connected neighbourhoods. In many of these markets, supply falls well short of demand, so competition will drive up values.

Aberdeen City Living

Breathing new life into the high street

Ties between private and public sector stakeholders need to strengthen to increase understanding of each party's role, needs and goals

Savills was commissioned by Aberdeen City Council to provide a strategy to support the effort to revitalise Union Street and Aberdeen's city centre. This was in the context of the council's City Centre Masterplan aspiration to attract 3,000 more residents into the city centre over the next 20 or so years.

Savills identified that demand for city centre housing in the UK is on the increase as part of a global trend, with urban living and lifestyles increasingly popular among young professional workers, families and downsizers. This trend is creating new opportunities for property investors and developers, so long as the appropriate product can be delivered at the right price. This is particularly pertinent in Aberdeen.

The future of Aberdeen's city centre needs to be based on boosting the number of mixed tenure residential units, allowing for a full suite of spending power and age groups that would in turn create a greater vibrancy and stronger night-time economy with more sustainable support of retail, leisure and cultural facilities.

If more people live in the centre and more work in the centre then the combination of the two is going to introduce new spending power that will support, feed and grow the retail and leisure offerings.

We proposed that developers should be offered support to encourage residential conversions of old buildings in the city centre, because of their challenging nature and higher costs. We are encouraged that the council has voted in favour of our key proposal, for a time-limited freeze on affordable housing contribution obligations, with immediate effect. This bold initiative will help to bridge the viability gap that currently exists in the market. It will act as a stimulus, driving private sector investment and bringing forward development. The time-limited horizon is likely to create a sense of urgency to encourage delivery: indeed there are already some signs that the market is starting to react positively.

Creating a regeneration team within other local authorities, focusing on city centre development, has been effective in towns and cities around the UK to identify potential opportunities and provide direct contacts for the development industry. With the establishment of its new City Living Team, Aberdeen is set to do the same.

Sentiment is everything

Following a period of inactivity within the Aberdeen Housing Market Area, is sentiment within the development sector improving?

Savills prepared an anonymous survey to gauge the level of market appetite and gain a better understanding of the key challenges affecting house building in the local market. Our survey attracted answers from niche developers to large housebuilders including those currently active in the market and those expressing an interest.

Performance & forecast

60% of our audience rated the existing Aberdeen development market to be either cool or freezing, with 36% thinking it was neutral and only 4% thinking it was warm. This sentiment is undoubtedly driven by performance, with 89% of active sites performing as or worse than expected.

Looking forward over the next six months, 64% of our audience are of the opinion that the market will remain cool while 20% think the market is going to get warmer. Interestingly, those active in the market were more optimistic than those not.

Of those actively developing in the area and those considering it, uncertainty, market conditions and profit margin were rated as very important factors when considering development opportunities, with technical issues, build cost and planning issues not far behind.

Buyers & incentives

Active housebuilders confirmed that more than 50% of sales were reliant on incentives with payment of LBTT, Part Exchange and Help to Buy being the three most prevalent incentives.

Despite this, purchasers are still motivated by the location and specification rather than incentives on offer. Positively, sites are attracting a range of purchasers including first time buyers, families and downsizers.

Business appetite

Encouragingly, of those businesses active within Aberdeen, the majority plan to scale up their operations in the next few years with 50% looking for new sites. Of those not active, many expressed an interest should market conditions improve. This suggests a more positive outlook in the medium term.

Asking prices for available new build properties

Area	Average price per square foot	Average price per square metre
Aberdeen City	£279	£3,000
Aberdeenshire	£216	£2,325
Angus	£216	£2,330
Dundee City	£224	£2,413
Moray	£181	£1,951

Source Savills Research

Commercial & Rural view

Commercial market on the road to recovery
2018 has seen the Aberdeen commercial property market continue on the road to recovery. This year's figures have been characterised by a larger number of smaller lettings, and a continuation of the 'flight to quality' which Savills identified in 2016.

An increase in the number of lettings would generally tend to point to a less volatile market, and one which is not as susceptible to significant fluctuation.

A settling rural market
The Scottish farmland market is going through a period of settlement following immense growth in values between 2003 and 2013.

Market supply is being outweighed by demand from all corners of the world as Scottish land and estates are currently deemed to be good value for money.

Yet with many unanswered questions such as potential threats associated with Brexit, the possibility of a second Scottish referendum, likely interest rate increases and record levels of farming debt, the future is far from certain and a full review of all rural assets is advised.

Confidence returns to the commercial market

Is the worst of the downturn over due to increased stability in the oil and gas sector?

The effects of the low oil price environment since mid-2014 continue to be felt in Aberdeen's commercial property market. The majority of oil companies and service companies have rationalised their cost bases considerably in order to realign their overheads with reduced activity and turnover.

The market has slightly improved, with both office and industrial take up this year matching last year's performance. The modest recovery has led a growing number of analysts to suggest that the worst of the downturn now appears to be over.

Office take up remains steady

The first three quarters of 2018 witnessed around 270,000 sq ft of office take up in Aberdeen. The level by the end of the year is expected to match the 405,000 sq ft take up during 2017. Take up this year has included a large number of smaller transactions, which portrays a more healthy market that is less susceptible to fluctuation. However, we are unlikely to see a sizeable increase of take up in the medium term, due to the reduced presence of larger office requirements.

There is significant oversupply across the city, extending to around 2.8m sq ft. This is a legacy of the considerable amount of new build and existing office space that was introduced to the market in 2015/2016, just as demand from oil and gas sector occupiers tailed off, following the oil price drop.

Industrial market

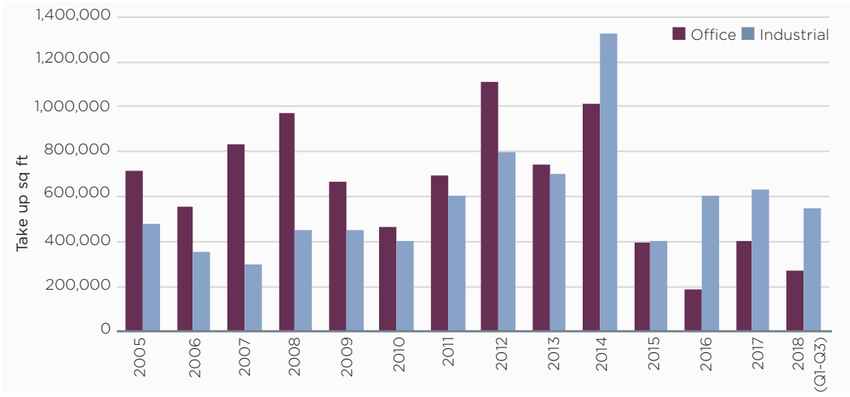
There is relatively more confidence in Aberdeen's industrial market. At around 548,000 sq ft, take up during the first three quarters of 2018 is on target to match the 600,000 sq ft figure from 2017. In a similar trend to the office market, the majority of demand is at the smaller end of the market. Deals done on larger buildings of high quality are at rents close to the level experienced prior to the market downturn, albeit heavily incentivised. Overall, we are finding that those occupiers with lease events in 2019/2020 are shopping early for space in order to secure a good deal now.

The industrial market is also dominated by occupiers with connections to the North Sea oil and gas exploration and production sectors. However, it has not witnessed the same levels of oversupply as the office market. Industrial accommodation has mostly been retained in order to enable continued functionality of the operational side of the businesses. Nonetheless, supply has increased over the last two years, reaching around 2.2m sq ft. However, as with the office sector, it is important to note that there are only a handful of high quality industrial buildings across the city available for immediate occupation.

Outlook

Looking ahead, the market remains weighted heavily in favour of the occupiers, who are most likely to utilise existing space prior to going to the wider market with any new requirements. Moreover, there remains an oversupply of available commercial property of all size, use and specification. But this includes a number of dated buildings that are functionally obsolete and unlikely to be reoccupied. The supply of high quality accommodation remains constrained.

Aberdeen commercial property take up (sq ft) The market in 2018 is on target to match the previous year, with more demand from smaller occupiers



Source Savills Research

Awaiting opportunities

Scottish values are trading at a 15% discount south of the border.

Demand for farms with a variety of income streams will continue, which in turn will support values

The UK Government's recently published Agriculture Bill sets out major post-Brexit policy. But this Bill will not be enacted in Scotland, as rural affairs are devolved. Nonetheless, the House of Commons Scottish Affairs Committee has launched an inquiry to investigate how any post-Brexit agricultural system could meet the needs of Scottish farmers and crofters. As we await announcements to understand to what extent policy will be influenced by Westminster, opportunities will undoubtedly surface, coupled with the pace of change for Land Reform.

Meanwhile, the resilience of farms and rural estates will be tested, particularly those that are heavily exposed to farming and especially in the red meat sector.

Farmland supply rises

Across Scotland, 41,200 acres of farmland were publicly marketed during the first nine months of this year compared with 35,600 acres in the same period of 2017, an increase of 16%. This compares with a corresponding increase of 32% across England for the same period. Scotland accounted for 24% of farmland marketed in Britain and the North East of Scotland represented almost a third of this at 13,500 acres, with the majority located in Aberdeenshire.

Values remain stable

Average farmland values in Scotland have been relatively stable for the past five years whereas those in England peaked in 2015. Although there has been some correction in England, average Scottish values are currently trading at a 15% discount to those south of the border.

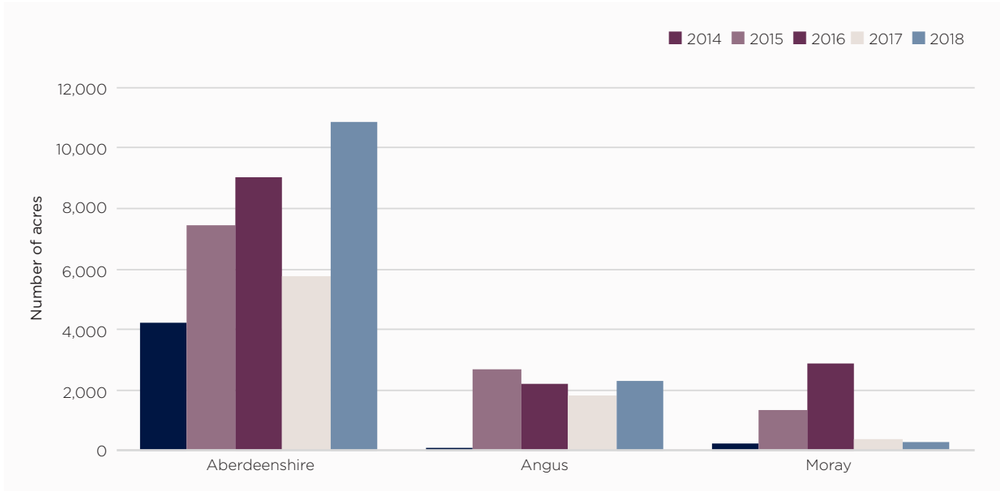
The Savills Farmland Value Survey records average prime arable land, excluding fixed equipment, in Scotland at £7,640 per acre. Average grassland is just under £3,000 per acre. However, there were a wide range of prices achieved with grassland farms exceeding £5,000 per acre and the best arable farms making more than £10,000 per acre. Indeed, value can vary by over £10,000 per acre within 40 miles, depending on quality, location and local demand.

Demand going forward

Looking ahead, amenity farms and those with a variety of income streams will continue to be in demand. In contrast, commercial units in need of investment, without the scope to diversify, are more likely to come under pressure, unless there are neighbouring farms looking to expand.

41,200
acres publicly marketed in 2018 compared with 35,600 acres in the same period of 2017, up 16%

Farmland market activity across North East Scotland (January to September)
Supply has caught-up, following a slow first half in 2018 affected by the weather



Source Savills Research

Savills Research
We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.

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