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REAL ESTATE ADVISORS

“Intelligence”

Scottish Investment Market

Quarterly Review
June 2020

“Intelligence”

WELCOME

Is there ever a perfect time to launch a new business?!

On the face of it, March 2020 might not seem like the ideal time but at Lismore Real Estate Advisors, we believe that in turbulent times it is even more important that investors receive the best possible market “*intelligence*” to help shape their thinking.

With this backdrop, we are pleased to launch our first Scottish investment market review, which we will be publishing quarterly. The review will aim to highlight emerging trends and headline statistics but also give a view on what we are seeing “at the coal face”.

Market overview.

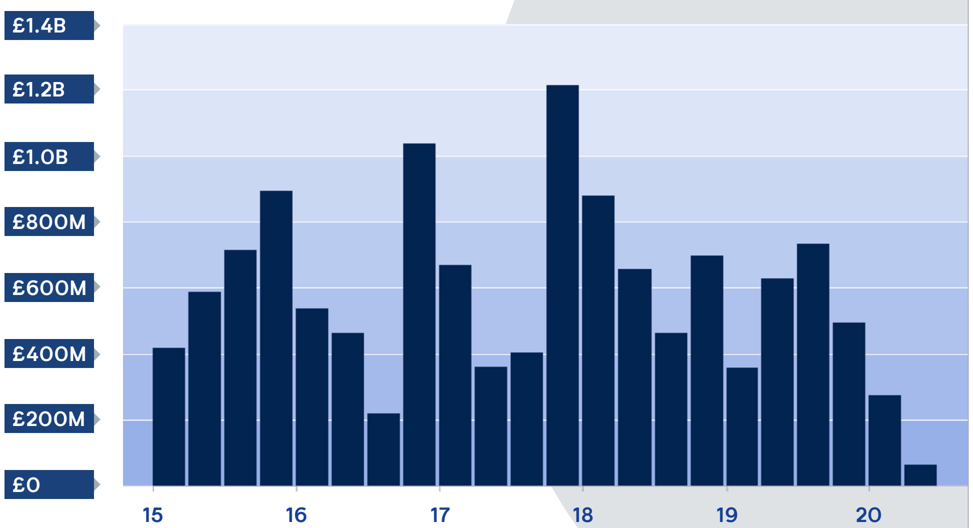
Key themes

- **Cash is king —** income preservation and rent collection remain the top priorities for the majority of investors.
- **The definition of prime is narrowing —** we are seeing polarisation in pricing against secondary stock.
- **COVID is accelerating occupational trends —** flexible office working, warehousing demand to support on-line retailing and increased residential letting appetite.
- **Debt financing —** reducing in availability and generally increasing in pricing.
- **Key development projects —** in Edinburgh and Glasgow potentially delayed by 6-12 months.

Transaction volumes

- After an encouraging first quarter, 2020 half-year volumes stood at c£350m, c70% down on the 5 year average over the same period.
- We are aware of c£300m in a small number of large transactions currently under offer in Edinburgh and Glasgow. This mainly reflects strong appetite from specific groups of international investors.

Sale volumes



Pricing

- Pricing for annuity grade stock, prime offices and logistics is holding firm.
- Limited evidence of transactional activity for mid/short-term income assets. Property fundamentals will be even more closely scrutinised.
- Value add — almost too early to call but we anticipate a softening in certain sectors as investors err on the side of caution with their appraisal assumptions.

Investor activity

- For prime stock the buyer pool continues to be dominated by overseas equity sources, specifically Asia, GCC and mainland Europe (particularly Germany).
- There is a growing pool of overseas private equity waiting in the wings for anticipated distress, which has yet to materialise.
- UK institutions remain focused on long income, sheds and beds (in all its forms i.e. BTR, senior living, care homes & student accommodation).

Sector Spotlight: Edinburgh offices.

Each quarter, we will be focusing on specific sectors and geographies. The Edinburgh office market remains active and is the focus of this edition.

Key investment transaction

4 North, St Andrew Square

- Vendor – Knight Property Group
- Purchaser – client of KanAm Grund Group
- Price/Yield – £31m/4.3%
- Date – May 2020

Key development project

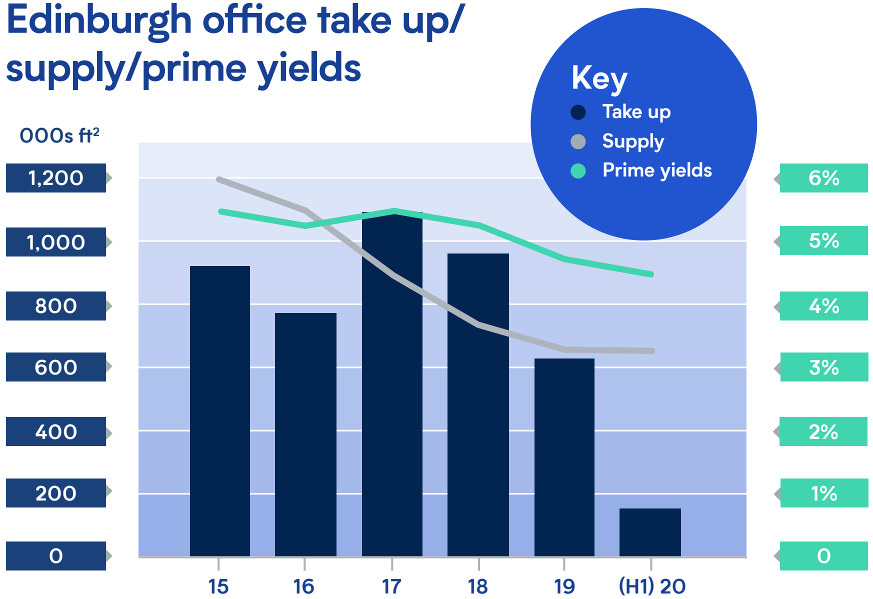
Haymarket, Edinburgh

- Developer – M&G Real Estate/Q Mile Group
- 380,000 ft² offices plus hotels, retail and leisure
- This will be a major catalyst for the natural extension to the CBD, further enhancing Haymarket as a vibrant business/leisure location

Headline statistics

- 5 year average take up is 870,000 ft². H1 2020 is 150,000 ft², representing an understandable decline. A further 350,00 ft² is currently under offer, however, where occupiers are making long term decisions and commitments.
- Vacancy rate across the city 2.8% with new build Grade A vacancy even lower at 0.13%
- Prime headline rents now £36 ft²

Edinburgh office take up/ supply/prime yields



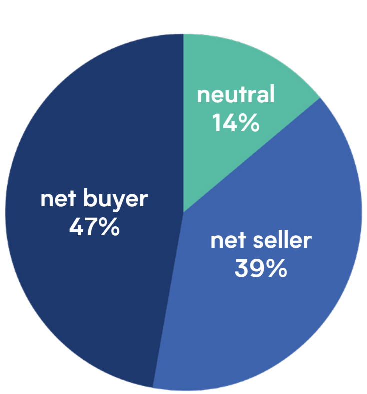
Why we believe Edinburgh will continue to succeed

- Future supply pipeline remains seriously constrained.
- It has a diverse and robust occupier base – Financial/Professional Services, Education, Technology and Fintech.
- A capital city with a strong track record for attracting UK and International Investors.
- A compact city – offering reduced commuting times.
- Widely acknowledged as a leading UK city for quality of life. A factor which will continue to increase in importance for employers to attract and retain talent.

The investor view — on offices.

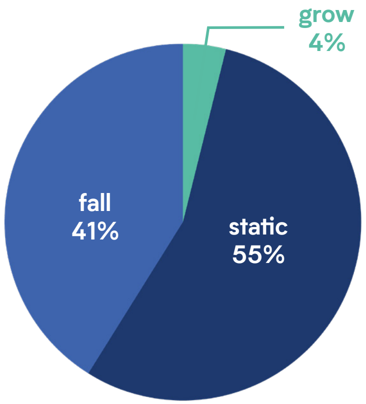
The future of the office is firmly in the spotlight. To assist in understanding investor thinking, we have engaged with a wide range of investors (funds, property companies and overseas/private equity) asking the following questions:

1) When considering the office sector over the next 12 months will you be a net seller, net buyer or remain neutral?



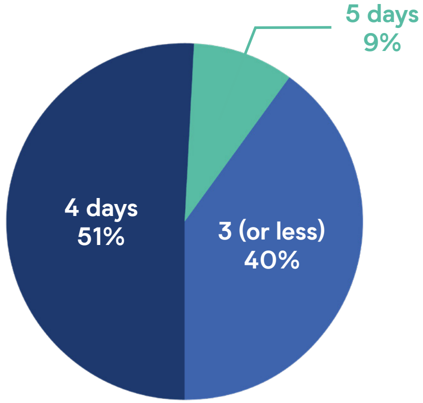
- The largest proportion of active buyers were overseas/private equity (42%) with funds (29%) and property companies (29%).
- The largest sellers were funds (50%), closely followed by property companies (40%) with overseas/private equity at 10%.
- Importantly there was a clear distinction between open ended retail funds, who were more likely to be net sellers and life funds who were more likely to be net buyers.

2) Over the next 12 months do you anticipate headline office rents will grow, fall or remain static?



- The majority (55%) anticipated static rents. The split was fairly even between funds (32%), property companies (34% and overseas/private equity (34%).
- Of the 41% predicting falls, 52% were funds, 24% property companies and 24% overseas/private equity. The majority differentiated between prime (which would hold up strongest) and secondary, which would be under more pressure.
- Only 4% anticipate growth, and all specified that this would only be in the very tightest of markets and relate to new build developments.

3) Post COVID, how many days a week will it be normal to work in the office 3 (or less), 4 or 5?



- The highest proportion, choosing 4 days, was fairly evenly split — funds (40%), property companies (32%) and overseas/private equity (28%). Most stated that there would be significant variance depending on sector and commuting time.
- The majority anticipating 3 or less were funds (46%), with property companies and overseas/private equity evenly split at 27% each.

To finish, some lis-morsels...

The office is dead, long live the office! Evolving yes, dying no. For the majority, average time in the office will reduce slightly but it remains hugely important for forging a business culture, enabling effective management, developing a team ethos and, just as importantly — providing human interaction.

The growing emphasis on staff wellbeing will become even more important with employers having to create an environment which staff are drawn to and feel safe.

Cash buyers will thrive but will want to see some sort of "value". We envisage a softening of pricing in certain sectors (high street/shopping centre retail, leisure and secondary offices) but not as severe an adjustment as that seen post GFC.

Bank "forbearance" will only last for so long and we anticipate some encouraged selling before the year end.

Gated funds will continue the process of strategic sales where possible. The initial focus will continue to be on retail as a sector but inevitably there will be a move to sell more liquid sectors, which will give a better understanding of pricing for core plus and value add stock.

Overseas capital will dominate the prime markets in Edinburgh and Glasgow. Virtual tours will prove popular in tandem with an easing of travel restrictions to allow more liquidity.

Private equity buyers waiting for distress will need to show patience. The fundraising in this sector has already been significant and continues to grow.

Whether it is a V, U, W, L or a Swoosh economic recovery, opportunity will come. The bravest will be in early but for those less brave they are likely to follow the Buffet mantra "never test the depth of the water with both feet..."

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