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Scottish Real Estate Market **Predictions 2020**

Time to act

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On 30 January 2020 Dentons held its Scottish Real Estate Predictions event in Glasgow at which a panel of industry experts gave their views on what is likely to happen in the Scottish real estate market in 2020. There were a variety of different perspectives on what is in store for different sectors, but general agreement that the key influencing forces would be:

- political uncertainty,
- our changing demographics, and
- global responsibility.



Political uncertainty

2020 is off to a positive start for the Scottish real estate market. The Conservative Party's general election victory at the end of last year and the UK leaving the EU on 31 January have provided some political stability, which the market has been craving. It looks hopeful that this buoyancy will continue for the first half of the year.

However, might it be a year of two halves? 31 January was only the beginning of the end of Brexit. We now face a year of tough negotiations, uncertainty and cliff hangers. Some resultant market volatility seems inevitable as the year goes on. In Scotland, there is heightened uncertainty in the form of a potential IndyRef2. If Brexit negotiations don't go well, this will lend more credence to the pro-independence movement. As long as another referendum is on the agenda, many investors (particularly UK funds) may remain cautious.

Having said that, Scotland continues to see a large amount of foreign investment, particularly from Asian and Pan-European investors. Scotland remains a strong

place to invest, offering good value and solid property fundamentals. Scottish retail warehousing in particular is one to watch in 2020.

Within Scotland, the city of Glasgow is in a particularly strong position in 2020. The supply and demand dynamics in Glasgow are currently at their optimum, and the city is providing both good yields and net effective rental growth.

Changing demographics and requirements

Changes in the size and age structure of the population are having implications for the real estate market. Scotland's population is continuing to age, with our working age population projected to fall, particularly if EU migration is reduced.

What people require from their living spaces is also changing. Increasingly, people want to be able to work, play, learn, shop and exercise from in or near their homes. There is a growing demand for mixed-use developments in Scotland, whether build to rent



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– which is becoming more established north of the border – or private renting. Particularly popular are developments with integrated social aspects. A city centre is of course by its very nature mixed use, and there is an increasing demand for residential offerings in city centres. The demand is coming not just from millennials but from older people looking to downsize. An increase in ‘downtown’ living could help stimulate the leisure and retail economy of city centres outside of working hours.

In a similar vein, office requirements continue to evolve. The co-working model, where companies deliver flexible office space as a service remains important to our economy. It is well established that people work better with other people around them and in an environment where they have all the modern commodities and services that a more established business would have. Co-working spaces and serviced offices with real flexibility of tenure remain in high demand. Developers and landlords are now having to respond by offering more facilities and services.

There is also a continuing and increasing demand by occupiers for flexibility in lease durations. Businesses, particularly small and/or start-up companies, need core spaces with flex options. Downsizing is no longer necessarily a negative thing, as agile working increases and technology provides more efficient business solutions. Of course while businesses are fluid, properties are fixed, so developers and

landlords are left with a challenge. Sometimes the provision of serviced elements can be a solution. For investors, a key challenge is how to value office blocks filled with tenants who on paper are short term, albeit they often end up staying longer than expected. Traditional methods of valuation will need to evolve.

Environmental, Social and Governance (ESG)

The prominence of ESG continues to grow within the industry. The climate crisis is, and has for some time been, the biggest trend currently affecting the real estate market. Everyone is talking about the importance of sustainability in buildings. But do we still need a little less conversation, a little more action? Some funds and investors are taking action, but others seem to be waiting, perhaps to take action only once mandatory regulations are imposed, or once occupiers make stronger demands. As occupiers increasingly require this, it will become more of a priority for investors, and therefore for developers. The pressure will be cumulative. Achieving sustainability in buildings should result in less depreciation of assets and protect against reputational risk. The increasing availability of advanced building technologies will also drive the ESG requirement.

A core challenge for real estate is how to refurbish old buildings to make them sustainable, whilst also fit for purpose and for modern working/living. This is not helped by rising construction costs, and a shortage of trade skills and construction professionals in Scotland. Another challenge arises from the pressure which local authority planning and building control departments are under. Public officers working in these areas need to be properly resourced, remunerated and trained.

In November 2020, Glasgow will be hosting Conference of the Parties 26 (COP26), a major United Nations climate change summit, with up to 30,000 delegates expected to attend. Not only will this shine a spotlight on Glasgow, but it will bring sustainability even more into the collective consciousness of Scotland in 2020.

A key social aspect of real estate is creating communities. We observed earlier the growing demand for mixed-use developments, with integrated social aspects. At the heart of this is place-making, and encouraging community engagement. These are two principles which are at the forefront of Scottish Government policy. In 2019 the Scottish Government adopted a Place Principle, committing to take a collaborative, place-based approach and to encourage community involvement and local flexibility. A report produced by the Infrastructure Commission for Scotland in January 2020 highlights the importance of putting “place” at the heart of infrastructure prioritisation and planning, in order to achieve an inclusive net zero carbon economy.

Glasgow has recognised the fundamental importance of place for social, economic and inclusive growth. A Place Commission for Glasgow was launched in September 2019 and will be looking this year at how the city can design its places to put people first and make the city a better place for all to live in.

Balancing short term gain against long term responsibilities

These three forces of political uncertainty, changing demographics and global responsibility are longer-term pressures that will persist beyond 2020 and beyond our immediate shores.

However, investors, occupiers and developers will still have to navigate more immediate pressures on their businesses such as fluctuations in currency, rising construction costs, and changing consumer demand for goods and services to ensure that they are well positioned to navigate these global forces.

Businesses will therefore need to balance their need for short term gains against longer term sustainability and social responsibility goals. The best advised will realise that with consumers’ increasing demand for products, services and buildings from businesses that have ESG high on their agenda, governmental regulation will also increase. The Scottish Government already has ambitious climate change targets and it seems likely that they will also incentivise businesses to develop innovative solutions to the social and environmental problems that we currently face.

One thing we can be sure of is that the balance is shifting. Sustainability and responsibility should therefore no longer be seen as a box ticking exercise, and one that is detrimental to profits or returns. There is now a real opportunity for the most flexible and innovative businesses to capitalise on this change in demand and turn that into competitive advantage in 2020 and beyond.

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