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Spotlight
Edinburgh Offices

February 2013

SUMMARY

■ Take-up in the second half of 2012 was weaker than in the first, but overall the year was 21% up on 2011.

■ Availability continues to fall, and we estimate that by the end of 2012 only 15% of the vacant office space was of Grade A quality.

■ Rents remain flat in the core, but continue to fall in the fringe. However, we expect to see upward pressure on prime CBD rents beginning this year.

■ The investment market remained fairly quiet in the second half of 2012. However, Edinburgh remains a credible location for domestic and international investors, and we expect to see steady demand for prime assets in 2013.

"In the short term we believe that headline rents in Edinburgh will hit £30/sq ft."
Kate Graham, Savills Edinburgh

Occupational market

■ Take-up in the second half of 2012 was not as strong as in the first six months of the year (at just over 300,000 sq ft). However, this was enough to bring the total for 2012 to 711,769 sq ft.

■ This means that 2012's level of leasing activity was a healthy 21% above 2011's total, driven by a rise in activity both from inward investors to the City, as well as moves by existing occupiers.

■ As Graph 1 shows, this makes 2012 the best year since 2010, with take-up that was only 3% below the 10 year average.

■ The Insurance & Financial Services sector remained the most active acquirer of space in the City in 2012, with its continued dominance being assured by Blackrock's 80,000 sq ft letting in the first half of last year. This strength is relatively unique in a national context, with most regional cities having seen a fall in financial services leasing activity in recent years.

■ One area where demand in Edinburgh has mirrored the national trend is in the rising importance of the Telecoms, Media and Technology sector (TMT) in its office market. We estimate that this sector accounted for 15% of all the leasing activity in Edinburgh in 2012, and while none of these lettings were particularly large, it is clearly a sector of rising importance to Edinburgh and most other major cities.

■ The supply side continued to tighten in the second half of the year, with the City's total availability falling to 2.39m sq ft (Graph 2). This means that office availability has fallen by nearly 10% over the last 12 months, though the currently level of vacancy represents three and quarter years of supply at average annual take-up levels.

■ However, behind these figures a tale of two cities is emerging, with virtually no new or newly refurbished space of any size available in the CBD, yet significant levels of Grade B and Grade C vacancy across the City (particularly in West Edinburgh).

■ We estimate that as at the end of 2012, only 15% of the available space in the City was of Grade A quality, with only a handful of buildings offering the very best quality space (e.g. 1 Tanfield and Westport 102).

■ This lack of Grade A supply is a function both of the almost complete cessation of the development pipeline over the last five years, and the pick-up in new Financial Services lettings in late 2011 and early 2012.

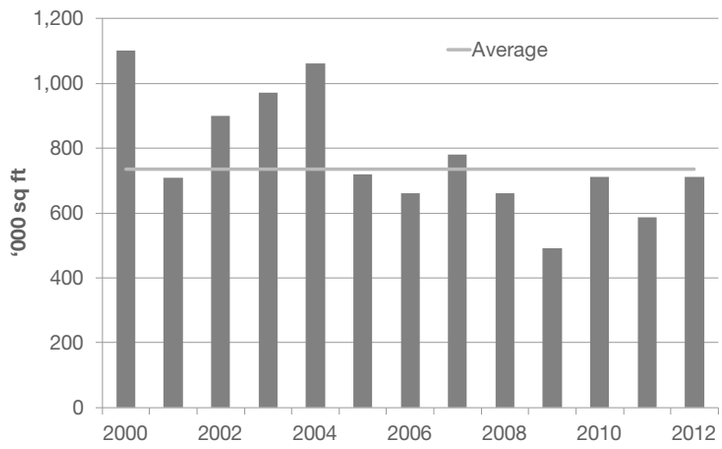
Rents

■ The second half of 2012 saw little new rental evidence of top rents moving in the core CBD market, however the tone of "average prime" rents definitely improved from around £25/sq ft to £27-£28/sq ft. We expect to see some new evidence emerging in early 2013 when the full details of the Green Investment Bank's letting at Atria emerge.

■ The tale of two cities story continues in the tone of rents across the City, and we believe that the gap between core and fringe rents continued to widen

GRAPH 1

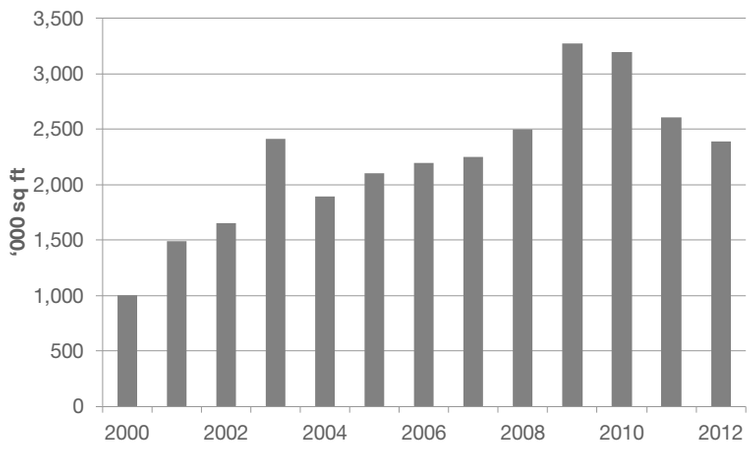
Take-up rose in 2012, but remained below average



Graph source: Savills

GRAPH 2

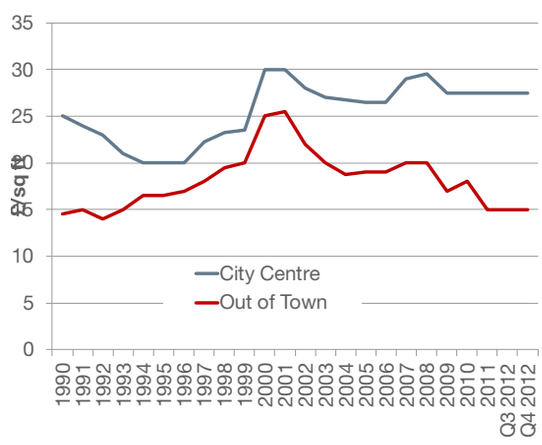
Office availability in Edinburgh continues to fall



Graph source: Savills

GRAPH 3

Top rents have remained flat in 2012



Graph source: Savills

in the second half of 2012. Indeed, as Graph 3 shows, the gap between prime rents on the core and out-of-town markets is now at its widest level for more than 20 years.

■ A similar story is true in terms of the gap between Grade A and Grade B rents, with Grade A rents remaining stable, and Grade B rents continuing to fall in the second half of 2012.

Investment

■ While the second half of 2012 was relatively quiet in terms of deals that completed, there was a sharp pick-up in activity with both Waverlygate and Calton Square going under offer.

■ We understand that the yields on both these assets are in the 7-7.25% range, giving around a 100bps difference between core and fringe. In our opinion this gap is too wide and 2013/14 will see a closing of the gap.

Outlook

■ While we estimate that Edinburgh's economy continued to contract in 2012 in output terms, the recovery has begun in terms of employment. According to data from Oxford Economics (OE), overall employment in the City grew by 1.0% in 2012, while office-based employment has been rising gently since the downturn of 2010.

■ The key driver for the take-up of office space will be rising office-based employment and pick-up in lease events, and we believe that these factors will combine this year to lead to a pick-up in demand. OE are forecasting the office-based employment will grow at an average rate of 0.9% per annum over the next five years, equivalent to a net growth of 5,500 jobs.

■ Rising employment levels will combine with a bulge in lease events, particularly in the CBD-biased professional services sector, and this will lead to a rise in take-up in 2013-2015.

■ Few of these professional services companies are likely to consider a move outside the CBD, as that tends to be where their client base is. This will intensify pressure on an already undersupplied market, particularly since none of the requirements are likely to be large enough to unlock a stalled development on its own.

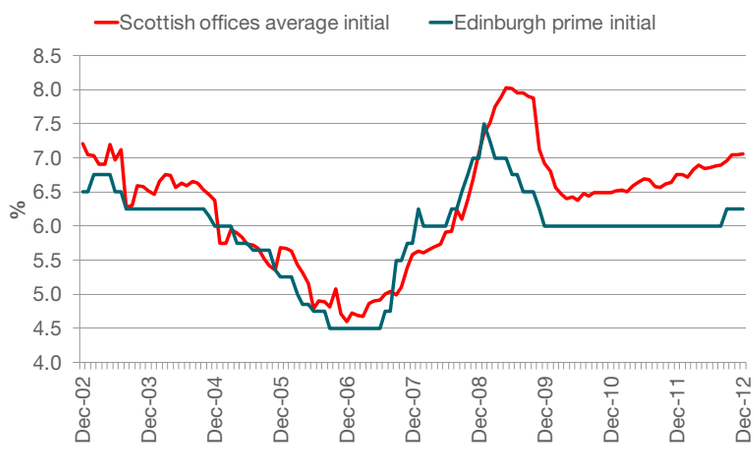
■ This trend makes the prospects for Edinburgh's handful of immediately deliverable schemes look increasing attractive, and we expect schemes such as St Andrew's Square and The Haymarket to set new rental highs as and when they come to the market.

■ While we are by no means forecasting a boom in demand, the imbalance between Grade A supply and demand should be enough to deliver rental growth of 1.5% per annum over the next five years.

■ The story is less positive away from the prime market, and we expect to see the split between core and non-core, and prime and secondary continuing to widen in 2013.

GRAPH 4

Yields softened in 2H 2012



Graph source: Savills, Investment Property Databank

Expert view

Kate Graham picks her key themes for the Edinburgh market in 2013

■ Take up figures in 2012 showed a 21% increase on 2011's figures and with an expected glut of lease expiries in 2014 to 2017 this will continue into 2013.

■ We expect that the Telecoms, Media and Technology sectors will continue to be active in Edinburgh, mirroring the wider global growth of these industries. This should favour both new build and high quality refurbished buildings.

■ Take up levels coupled with limited development activity has resulted in continued concerns over the supply pipeline. As a result, in the short term, we believe that headline rents in Edinburgh will reach in excess of £30/sq ft.

■ Despite this, developers continue to find it challenging to raise finance without a significant pre-let in place. Therefore, we forecast that funding will increasingly have to come from different sources such as private equity or contractor balance sheets. There are only three developments under construction at present, none of which are funded by traditional funding sources.

■ We also envisage seeing a steady rise in refurbishment activity in Edinburgh as landlords take advantage of the lack of Grade A stock, lender caution, and an increasing trend amongst some tenants to look for austerity-friendly properties.

Recent significant deals and key contacts

Address	Area Sq ft	Price	Yield	Vendor	Purchaser
Waverleygate	205,000	£43m	7.3%	Highcross	Prupim

Address	Area Sq ft	Rent £/sq ft	Landlord	Tenant
Haston House	13,545	Confidential	Schroders	Sainsburys Bank
Saltire Court	11,325	Confidential	ACH Shoosmith	Goodwill Nominees

Definitions:

Top rent: the highest rent achieved in one or more transactions.

Property criteria: Leasing transactions and supply recorded for units of 1,000 sq ft or over.

Grade A space: All newly developed space (available now or due for completion in the next six months), plus major refurbishments.

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