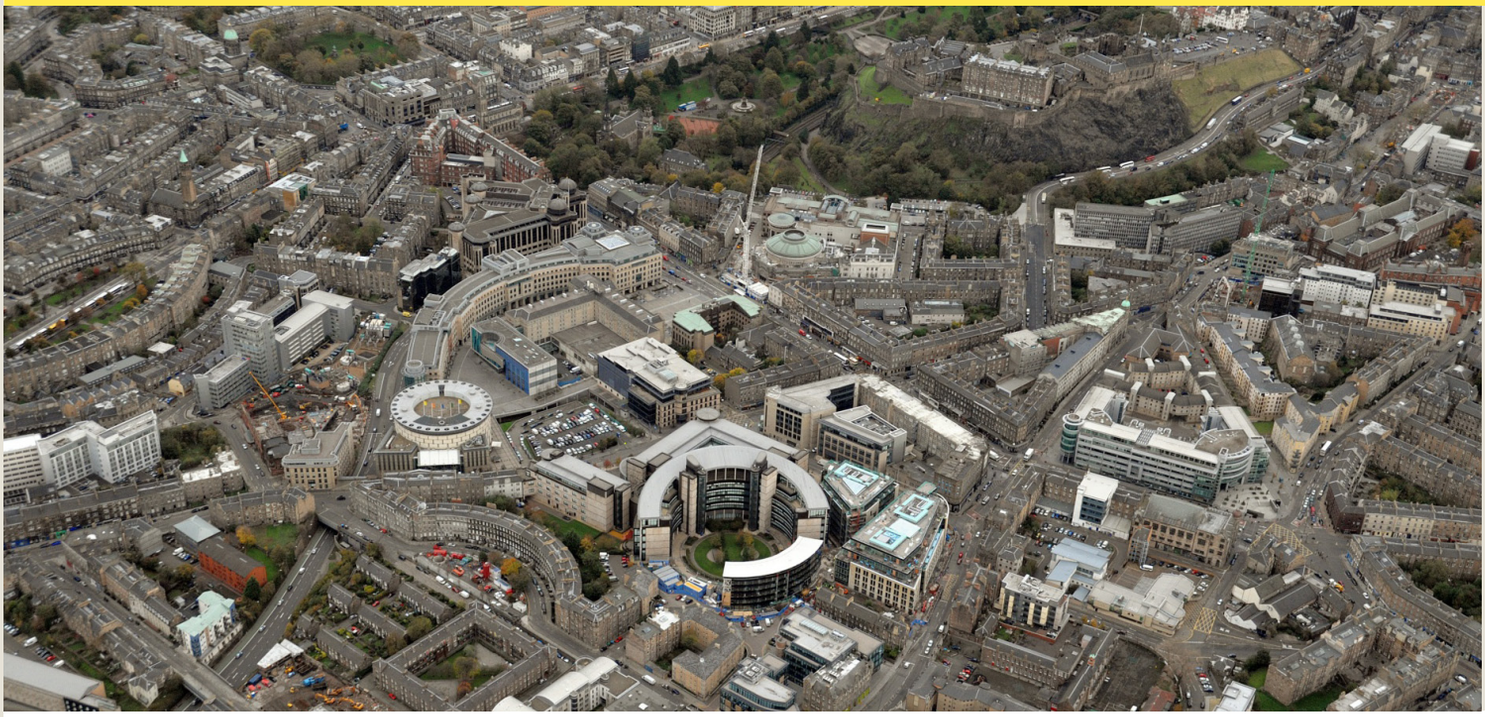
savills

Spotlight
Edinburgh Offices

September 2013



SUMMARY

■ We expect that take-up this year will be in line with the long-run average of 700,000 sq ft.

■ Supply stabilised in the first six months of the year, but there is now less than 150,000 sq ft of newly built office space across the City.

■ Prime headline rents are now around £30/sq ft. We expect the rest of the market to start to see upward pressure on rents in 2014.

"We have real concerns now that the existing Grade A stock is not sufficient to match demand in 2014-2016."

Keith Dobson, Savills Edinburgh

Occupational market

■ Take-up in the first half of 2013 was broadly in line with the same period last year, at 351,998 sq ft. This puts the market on track for a full year total of just over 700,000 sq ft, exactly in line with the long term average for the City.

■ The second quarter of this year saw a slight pick-up in activity in comparison to the first quarter, with a particular uptick in tenant demand for the best quality Grade A space. Clearly tenants are not only feeling more confident about the future, but beginning to realise that there is an impending shortage of Grade A space in the City due to the very restrained development pipeline.

■ Typical of this trend is the recent letting by PWC of 32,000 sq ft at Atria One. While this July letting does not fall into our first half data, it is indicative of a trend where CBD tenants with lease events in 2014 and 2015 are facing a shortage of suitable space. PWC have acted relatively early and secured a very attractive rent free period on a long lease, with a headline rent of circa £30/sq ft. This leaves only 100,000 sq ft in Atria One, one of the few remaining options for tenants looking for large floorplates in prime buildings in the City.

■ The structure of tenant demand in the first half of this year has been more balance that in 2012, with no business sector accounting for more that 20% of the leasing activity. The dominant sectors remain Public Services, Financial Services and Business & Consumer Services, with both of the latter sectors showing a marked bias towards Grade A space in and around the CBD.

■ The overall availability in Edinburgh has remained stubbornly stable throughout the first six months of 2013, at 2.4m sq ft (Graph 2). Based on an average annual take-up of 750,000 sq ft this represents three years of supply - a level which we would consider as over-supplied.

■ However, the level of availability of Grade A space has continued to fall since the beginning of the year. At the end of 2012 we estimated that only 15% of the available office space in Edinburgh was of Grade A quality, and this has now fallen to 14% (334,694 sq ft), even with the addition of 26,000 sq ft due to the completion of 145 Morrison Street.

■ The shortage of Grade A space is even more apparent if we just look at newly built "Grade A1" properties, of which there is now less than 150,000 sq ft available across the City.

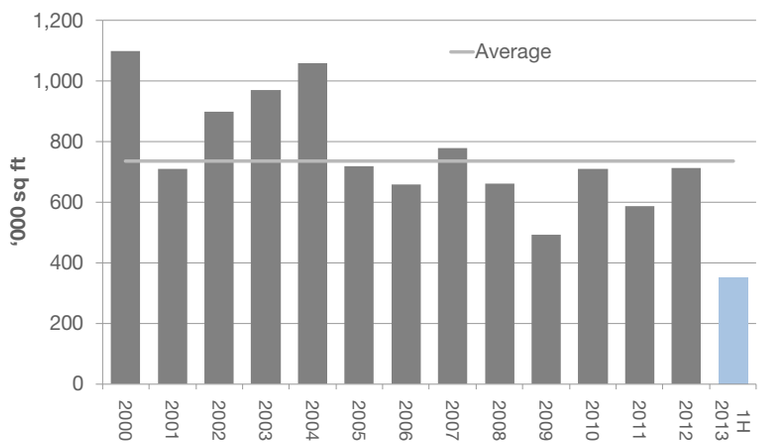
■ We do expect the supply-side to react to this shortage, but there is unlikely to be a rush of speculative development in the City. Once Atria One and Quartermile One and Two are mostly let we would expect to see either of St Andrews Square or The Haymarket proceeding speculatively.

Rents

■ We predicted in our last report that prime headline rents in the City would reach £30/sq ft in the short term, and this prediction has already come true. While the full details of the lettings to the Green Investment Bank and PWC

GRAPH 1

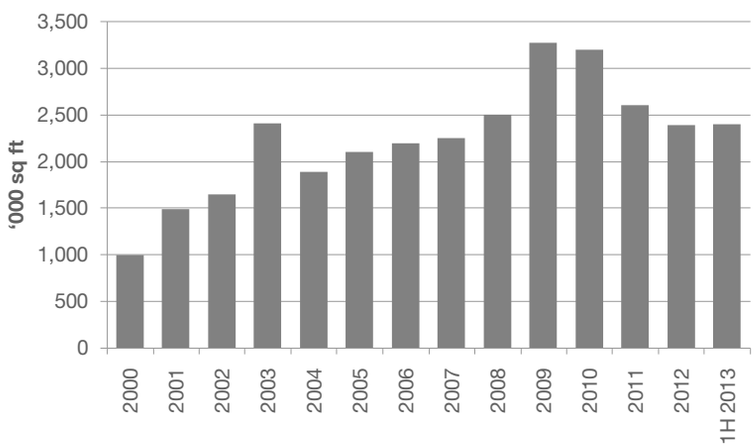
Take-up is broadly in line with the 2012



Graph source: Savills

GRAPH 2

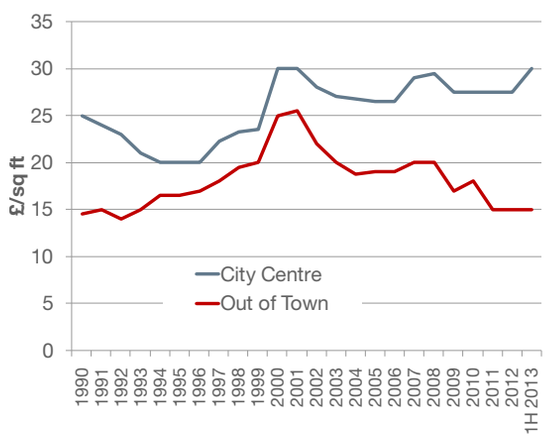
Overall availability in Edinburgh remains stable



Graph source: Savills

GRAPH 3

Top rents are back to their peak



Graph source: Savills

at Atria One have not been revealed, we are confident that both with have been at £30/sq ft or above.

■ This bring top rents in the City back to their previous peak, and sets Edinburgh apart from the majority of other regional cities in the UK where rents remain below their previous peaks.

■ Of course headline rents don't tell the whole story, and landlords continue to offer very attractive rent free periods to good covenants on reasonable sized lettings. We estimate that the typical rent free period on offer for a ten year lease remains 24-30 months, though the next six months will see this begin to shorten.

■ Away from the undersupplied prime core of the Edinburgh office market the rental story is very different. Rents on Grade B and out-of-town space remain around £5/sq ft below their 2007 peak, with significant rent free periods on offer.

Investment

■ The first half of 2013 saw little new prime investment evidence in Edinburgh, with the most significant transaction being Blackrock's acquisition of Caledonian Exchange for £17.5m at 8%.

■ We believe that the tone of prime yields in the City remains stable at 6.5%, but with the potential for downward pressure rising.

■ The rationale behind this view is twofold. The first is that there is recent evidence in other regional cities that a prime yield of 6% or below is supportable. The second reason is illustrated in Graph 4, with the gap between London and Edinburgh office yields now at its widest level since the mid 1990's.

■ While some ultra risk-averse non-domestic investors might be cautious about investing in Scotland due to the unpredictability of the political situation, the 300 basis point gap to London is too wide for most domestic funds and property companies to ignore.

■ Finding a willing vendor of a prime investment in Edinburgh over the next six months will be challenging. But if such a property does come to the market then we would expect to see the yield at around 6.0% i.e. in line with the pricing in the UK's other strong regional cities.

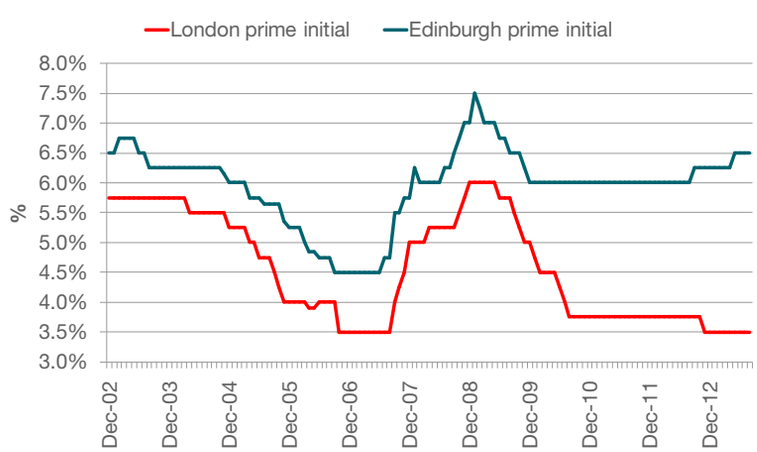
Outlook

■ The prospects for both the leasing and investment markets in Edinburgh are framed by the word "undersupply".

■ The shortage of Grade A and A1 office space to lease in the CBD will shorten rent free periods over the next six months, and put further upward pressure on prime rents in 2014. It will take some time for the rest of the market to catch up, but we expect to see a rise in refurbishment and redevelopment activity next year as landlords move to capitalise on the burgeoning undersupply.

GRAPH 4

The gap between London and Edinburgh yields is wider than it has been since the mid 1990s



Graph source: Savills, Investment Property Databank

Expert view

Keith Dobson picks his key themes for the Edinburgh market in 2014

■ We have real concerns now that the existing Grade A stock is not sufficient to match the perceived demand around lease events in 2014 through to 2016, the earliest point we feel that any significant new speculative office schemes will be completed.

■ This is to the benefit of the developers of recently completed schemes being City of Edinburgh Council on Atria One & Two, Ediston Properties on 145 Morrison Street and soon to be completed Wemyss House forming the south side of Charlotte Square developed by Fordell and Corran Properties.

■ With this supply /demand imbalance we perceive swiftly reducing incentive packages and upward pressure on rents during 2014.

■ This under supply of Grade A will benefit landlords of newly refurbished Grade B accommodation or potentially peripheral office schemes.

■ Speculative office development we perceive will only progress through institutional financing on a speculative basis.

■ The potential under supply over the upcoming two to three years may force tenants to extend existing lease commitments rather than relocate limiting wider property market activity.

Recent significant deals and key contacts

Address	Price	Yield	Vendor	Purchaser
Carlton Square	£52m	7.2%	Jaguar Capital	GLL
Holyrood Park House	£8.7m	9.2%	Henderson	Orchard Street
Caledonian Park Exchange	£17.68m	8.0%	London & Oriental	Blackstone
QM1	c£40m	6.5%	Aviva	Epic

Address	Area Sq ft	Rent £/sq ft	Landlord	Tenant
Quartermile 1	9,763		Gladedale, Aviva	Skyscanner
Atria One	32,000	c£30/sq ft	Edinburgh Council	PwC

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.

Edinburgh offices

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