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Spotlight | 2017

Edinburgh: a global city in demand

Summary Expansion across residential and commercial sectors, with associated infrastructure, is essential if this high-demand European capital is to meet its full potential.

- **Edinburgh retains 42%** of its graduates, creating an attractive talent pool to draw in global occupiers. **Page 2**
- **Population and household** growth have outpaced development within the City. This has increased pressure on the city's housing market, **page 3**, and created opportunities for the region. **Page 4**
- **As Edinburgh's boundaries** become looser, strategic infrastructure will be imperative in planning for Edinburgh's future growth. **Page 5**
- **Edinburgh St James** will relieve the pent up demand for larger retail units to the east of the city and intensify competition among office occupiers for prime space. **Page 6**
- **An additional 2,400 hotel rooms** will support Edinburgh airport's five year investment plan to increase passenger numbers to 16.5 million by 2021. **Page 7**

A global city

Developing the appropriate commercial and residential space in Edinburgh is key to unlocking growth

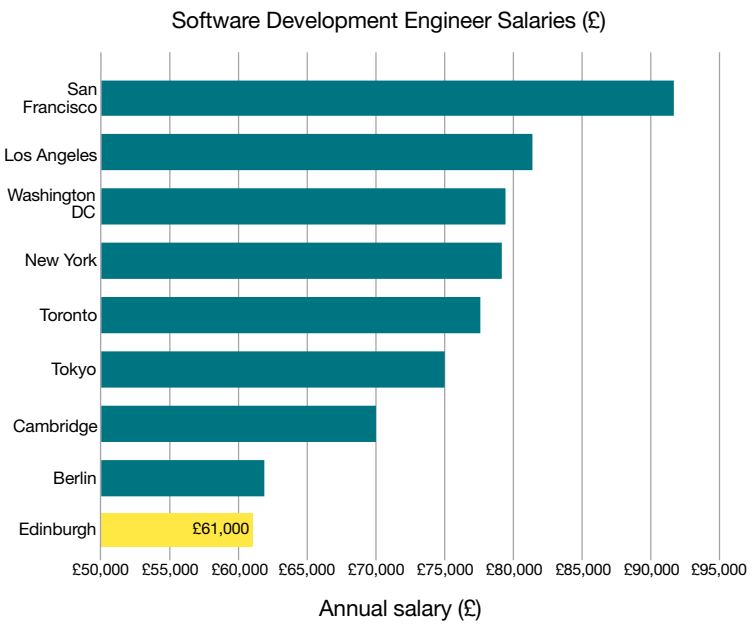
Edinburgh is home to more FTSE 100 companies than any other UK city outside London, with a large banking, insurance and financial services occupier base. But, it is not just large corporates which are driving growth in the city. Edinburgh has a higher proportion of start-ups per 10,000 population than the UK average, which cluster within incubators such as those operated by Codebase, before expanding into conventional office space on their maturity. Skyscanner, Fanduel and Rockstar North are key examples of home-grown tech companies who now employ over 500 workers in the city collectively.

However, Edinburgh has also drawn global occupiers including Microsoft and Amazon, which have been attracted by the relative affordability of talent, compared with competing global innovation centres. Multinationals are generally most concerned with securing the best talent at competitive wages, as wage costs account for around 55% of total business costs, whereas property costs only account for around 15%.

Accounting for exchange rates, the annual salary of a software development engineer in Edinburgh is 33% lower than that of the equivalent role in San Francisco, so global occupiers will continue to favour Edinburgh for affordable talent.

Edinburgh's large talent pool is partly down to the University of Edinburgh, one of the leading centres for computer science. The city is able to retain 42% of its graduates upon graduation and with 3,200 additional professional, science and tech jobs forecast in the city over the next five years, a number of these roles will be filled by graduates of the university.

FIGURE 1 **Affordable talent keeps Edinburgh attractive**

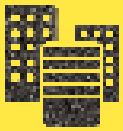


Source: Glassdoor

Edinburgh in focus

The numbers reveal an attractive city for people to live and work

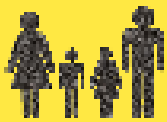
42% of Edinburgh's graduates remain in the city upon graduation



259,000 sq ft of Grade A office space remains in the city centre

Edinburgh's prime office yields remain attractive at 5.25%

1.7 million international overnight visitors in 2016



Projected population growth of 5,000 people per year

Investing for the future

As part of the recent £1.1 billion City Deal, UK and Scottish Governments are each investing £300m into Edinburgh, which will be used to support growth through innovation, infrastructure, housing, tourism and culture, including a new concert hall. Investments at Heriot-Watt, Queen Margaret and Edinburgh University will also contribute to the deal which is expected to create an additional 21,000 jobs for the city.

Commercial property investment activity has accelerated in Edinburgh following June's General Election. Edinburgh attracted £1.2 billion of commercial investment during 2016, the highest level for 10 years, which was driven by a record year from overseas investors. The risk premium has contracted, relative to the rest of UK offices given the likelihood of a second independence referendum now lower, coupled with the potential for a softer "Brexit".

During 2017, Edinburgh's prime office yields have moved in 25 basis points to 5.25%, and the 25-50 basis points yield gap which previously existed between Scottish office yields and the rest of the UK's regional office markets is showing signs of closing.

Office market pressures

The office market remains structurally undersupplied. Average take up volumes across the past five years have reached 623,000 sq ft, and Savills forecast 2017 take up volumes to exceed this by at least 20%.

Grade A availability currently stands at only 259,000 sq ft, enough to cater for around one year's worth of Grade A demand. With only 100,000 sq ft of speculative office developments under construction, Grade A office supply will remain scarce. This has the potential to push on new build rents to £34 per sq ft for a top floor suite in the city centre by the end of this year.

Tourist hotspot

Edinburgh is the UK's second city for international tourism, with data indicating the city welcomed 1.7m international overnight visitors in 2016, up 7.6% on the previous year, spending a total of $1.1bn and placing it above other European cities such as Copenhagen (1.6m overnight visitors) and Hamburg (1.5m overnight visits).

While ranking second to London in terms of number of international arrivals, the relative 'impact' generated from overseas arrivals is more pronounced in Edinburgh. For example, relative to the city's urban population there are 3.36 international arrivals per capita exceeding the 1.93 recorded for London (see Figure 2). In fact, Edinburgh ranks 8th globally for international arrival 'penetration', exceeding larger visitor markets such as Bangkok, Singapore and Kuala Lumpur.

Edinburgh's hospitality and retail markets have been benefiting from the weak Sterling post the EU Referendum, due to its appeal to overseas visitors. This boost from currency fluctuations is apparent in hotel performance data and retail sales. Year to date, RevPAR for Edinburgh hotels is up 14.6% on the previous year according to STR (as of August 2017), some of the strongest growth seen in the market over the last five years.

Likewise retail sales in Edinburgh's city centre are up 3.1% year on year as of June 2017, according to data from Essential Edinburgh, and have been tracking upwards in line with the softening in Sterling. The relatively high penetration rate of international arrivals highlights the bearing they have on Edinburgh's retail market.

Undersupplied residential market

Between 2001 and 2011 the population of Edinburgh grew by 28,000 or 6.2%, reaching 476,626. During this time the number of households grew by 18,398, reaching 223,081.

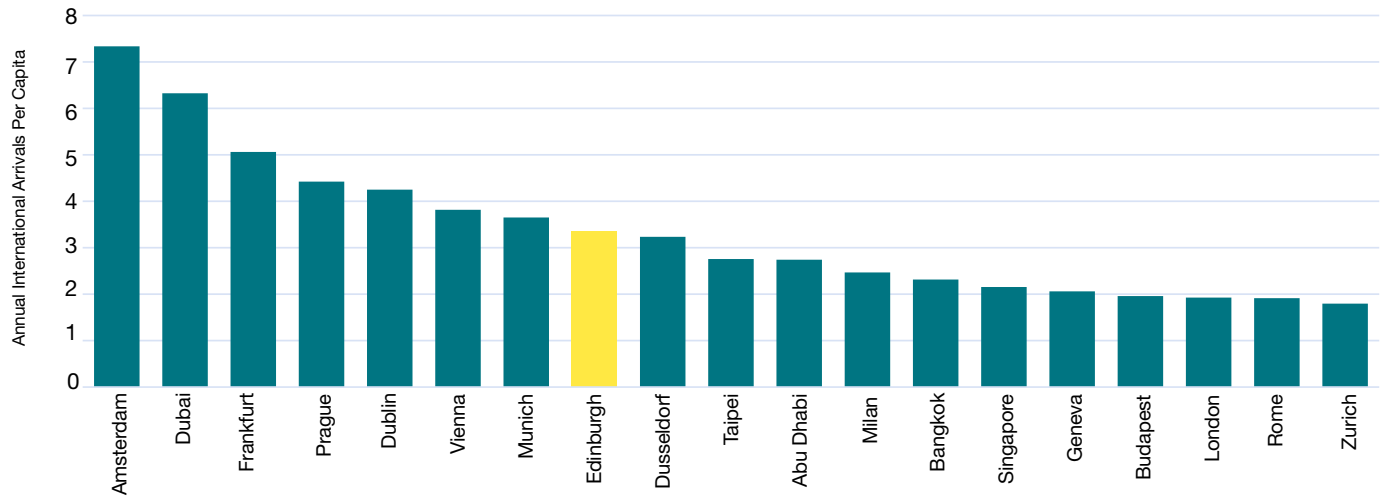
Between 2011 and 2017 growth has continued and the population exceeded 500,000 for the first time in 2016. The population is forecast to grow by in excess of 5,000 people per year and the number of households by in excess of 3,000 per year over the next 20 years. This will add further pressure on an already tight housing market which is lacking stock.

New build development has not kept pace with population and household growth, delivering on average 1,080 new homes per year (2008- 2017 Q1). Whilst there has been a recent pick up reaching 1,832 units in the year to March 2017, this is not enough to mitigate historic undersupply.

This has had two main implications. There is a lack of supply which is constraining transactions. This is both a second hand and new build market challenge because without appropriate supply the market will intensify.

With less stock, transaction values will increase. Annually the average transaction value has increased by 5% from £230,261 to £240,942 but there are individual areas where growth has been considerably quicker. This raises affordability challenges for the city.

FIGURE 2 **International Arrivals Per Capita**



Source: Mastercard, UN Urban Areas

Connecting the city

An expanding city creates challenges and opportunities for the city region

The City of Edinburgh is often awarded many accolades. Internationally the city scores highly for its quality of life (2nd), beauty (4th) and dynamism (9th). Within the United Kingdom, Edinburgh is rated for its walkability (1st), green space (1st) and friendliness (1st) (Convention Edinburgh Statistics).
As many other cities are experiencing a resurgence in demand for of city centre living, the popularity of Edinburgh's centre, a key component of its success, is pushing businesses and households out.

What does this mean for areas beyond the Bypass? Undoubtedly, an increasing role in the city's future but this comes with challenges, not least how to cater for demand whilst maintaining the quality of life and dynamism which are the city's attractive attributes.

The migration bonus

Edinburgh benefits from a migration bonus, gaining more people than it loses. Over the past five years (2012-2016) the population has grown by 24,540, exceeding the half a million mark for the first time, and households have increased by 8,010.

Despite this, and recent pick up in development, there have only been 6,200 new homes built which is intensifying historic undersupply. Therefore, it is unsurprising that the surrounding local authority areas are attractive for those seeking a new home. Almost 6,800 people moved out of Edinburgh to the immediate four surrounding local authority areas in 2016 alone, 3,000 more than the number that moved into Edinburgh from the same areas.

So what makes these areas attractive?

Developing suburbia

New residential development beyond the Bypass has given impetus for this migration primarily through the provision of family housing.

Over the past five years there have been 6,500 new homes completed across East Lothian (1,463), Midlothian (2,873) and West Lothian (2,259). Figure 3 shows the scale and location of these additional dwellings. Clearly, the most significant additions have been in areas immediately beyond the Bypass and along key road routes.

Over the past five years the population has grown by 24,540, exceeding the half a million mark for the first time, and households have increased by 8,010 over this period.

Bypass commuting

The Savills *What Workers Want* survey indicates that 'good public transport connections' was the most important factor for Edinburgh's workers.

Whilst those living in Edinburgh report higher levels of commuting to work by foot than average, the same cannot be said for those living in the commuter belt. Here road, bus and rail dominate.

As Figure 3 shows, there have been key clusters of development along transport links and whilst bus usage has increased on some routes, so too has traditional congestion.

As the number of residents increases, infrastructure needs further consideration. Edinburgh is ranked the fifth most congested small city (populations less than 800,000 in Europe) according to TomTom Data. Journeys typically take 40% longer than they should due to traffic and take 70% longer during peak times. This places it ahead of London for delays and on par with Rome and Shanghai.

Furthermore, all bar two of the city's delay hotspots (2016 Q2, latest available) were along the Bypass with particular clustering around the routes connecting to Queensferry Road, Hermiston Gait and the Midlothian area.

Office rentals

Rental pressure and shortage of space in town has consequently seen the number of office leasing deals in the out of town markets more than double from 20 to 53 between 2009 and 2016.

Standard Life has taken a lease of 31,000 sq ft at South Gyle Broadway during the first half of 2017 and we expect to see continued growth in office take up around Edinburgh Park as the airport expands. Rents have consequently risen from £17 per sq ft to £22 per sq ft over the past five years, but still remain at a discount to 2007 levels.

Moving In: Residential v Office

Sites in proximity to the Bypass, and as a result Edinburgh itself, continue to be in high demand, both from a residential and commercial perspective.

A number of large land releases are planned for the West, including Cammo, Edinburgh Park, West Craigs and the Edinburgh Garden District. Supply across these areas will deliver almost 10,000 new residential units over the next 10 to 15 years, but more supply across a variety of tenures will be needed to satisfy growth.

Out of town office space continues to look attractive here too, due to its connectivity to the city centre, Bypass and airport. This will create competition for the most connected opportunities.

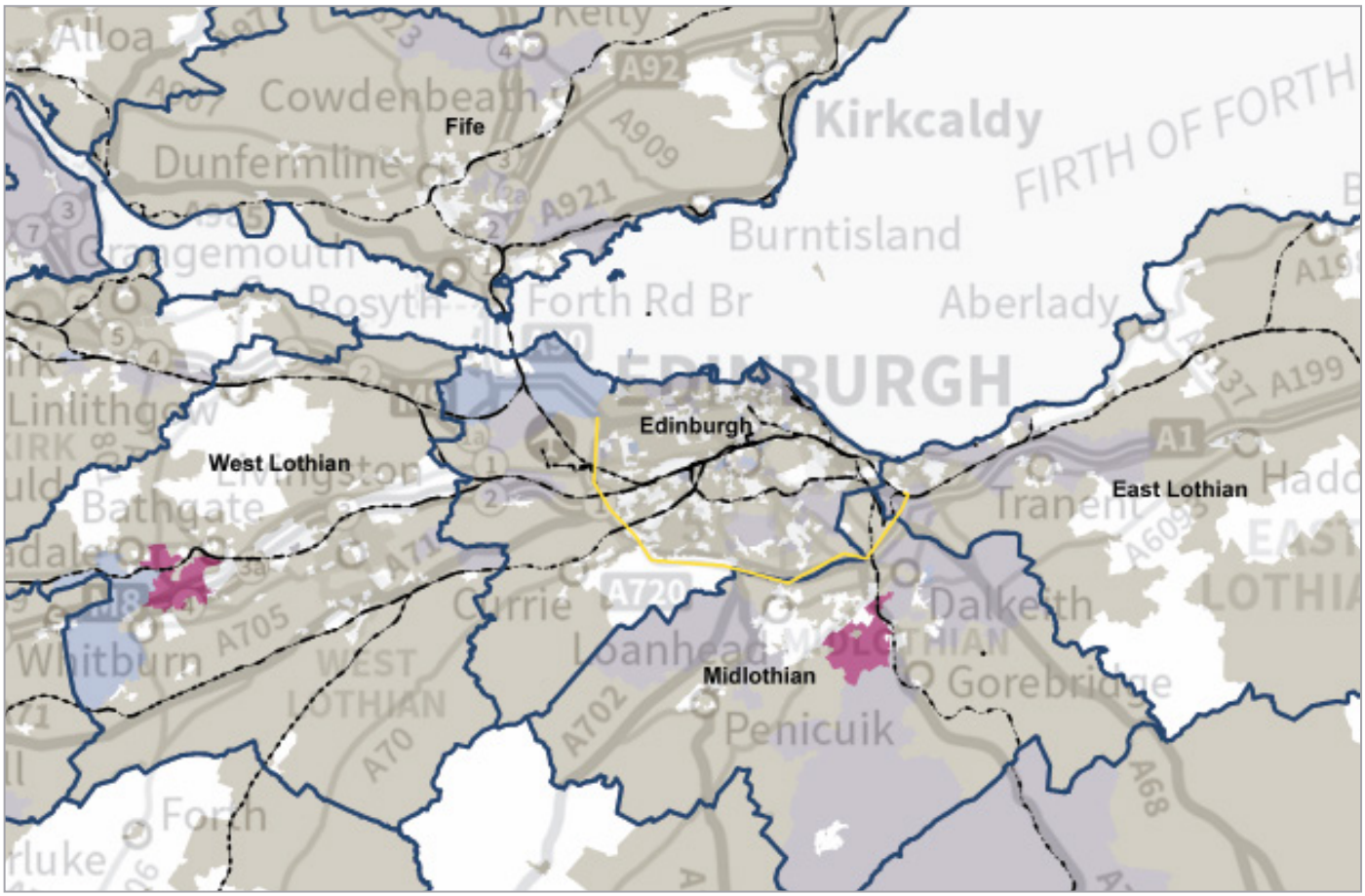
PUSHING THE BOUNDARIES

Edinburgh needs to think of itself as a city with looser boundaries pushing beyond the Bypass which has historically constrained it

Short term Existing and proposed development will consolidate the western section and the new Queensferry Crossing will strengthen demand in this direction. Easily connected locations in Midlothian and East Lothian will continue to attract both developers, occupiers and tenants.

Long term. Sites will be picked off along the boundary but these need to be supported by infrastructure. Therefore, a strategic approach will be key. Entry to the city needs to be moved away from the existing bypass with infrastructure investment in transport.

FIGURE 3 **The location of residential development in the Edinburgh City Region in relation to the Bypass**



Increase dwellings (2011 - 2016)

500 to 750 | 250 to 500 | 100 to 250 | 0 to 100 | Railway Line | Bypass

Source: Scottish Government, Savills Research

Edinburgh's eastern expansion

New development is unlocking commercial and residential opportunities to the east of the city

Scheduled to complete in 2020, 850,000 sq ft of new retail and leisure space delivered by Edinburgh St James will further enhance Edinburgh's position as an international destination. This redevelopment, amongst others, is encouraging a gravitation towards the east of the city centre.

Retailers are beginning to favour the best space towards the east end of Princes Street in anticipation of increased footfall following the redevelopment of Edinburgh St James. Savills anticipates that this will spur future rental growth. Apple, for example, took space on 10 Princes Street in 2014 in anticipation of the redevelopment.

Established rental growth over the past five years on George Street has seen rents reach around Zone A £200 per sq ft, which are now beginning to level off. Certain retailers located on George Street are withholding from agreeing longer lease commitments at their existing premises as they wish to ascertain how the area around Edinburgh St James evolves.

Edinburgh St James will relieve the pent up demand for larger stores, offering international mid-market retailers unit sizes which they have been unable to obtain in Princes Street and George Street. The 17,000 sq ft Everyman Cinema, 30 food and beverage units, the W Hotel's 214 rooms, alongside high quality residential units, will provide a truly mixed use environment.

Office market boost

The redevelopment of the St James Centre will act as a further magnet to office occupiers to the east of the city centre due to the quality of its amenity provision, which is becoming an increasingly important factor in attracting and retaining staff.

During the first half of 2017, the Government Property Unit (GPU) pre-let 190,000 sq ft of space at New Waverley, which is located only a 10 minute walk away, whilst Baillie Gifford signed for additional space at The Cube. Aberdeen Standard Investments are owner occupying 6 St Andrew Square, which also offers a strong rent for leisure accommodation in the city.

With 1 St Andrew Square the only Grade A space currently available in the traditional city core, the delivery of 60,000 sq ft of speculative office space at The Mint in Q2 2019 will ease pent up occupier demand.

New hotel development

The strength of Edinburgh's tourist market is supporting further hotel development, with an additional 2,400 rooms in the development pipeline by 2020, reflecting a 17.5% increase in stock. In percentage terms, this exceeds other major regional cities including London, which is expected to see a 10.3% increase in stock, and Glasgow, which is expected to see stock levels rise by 12.3%.

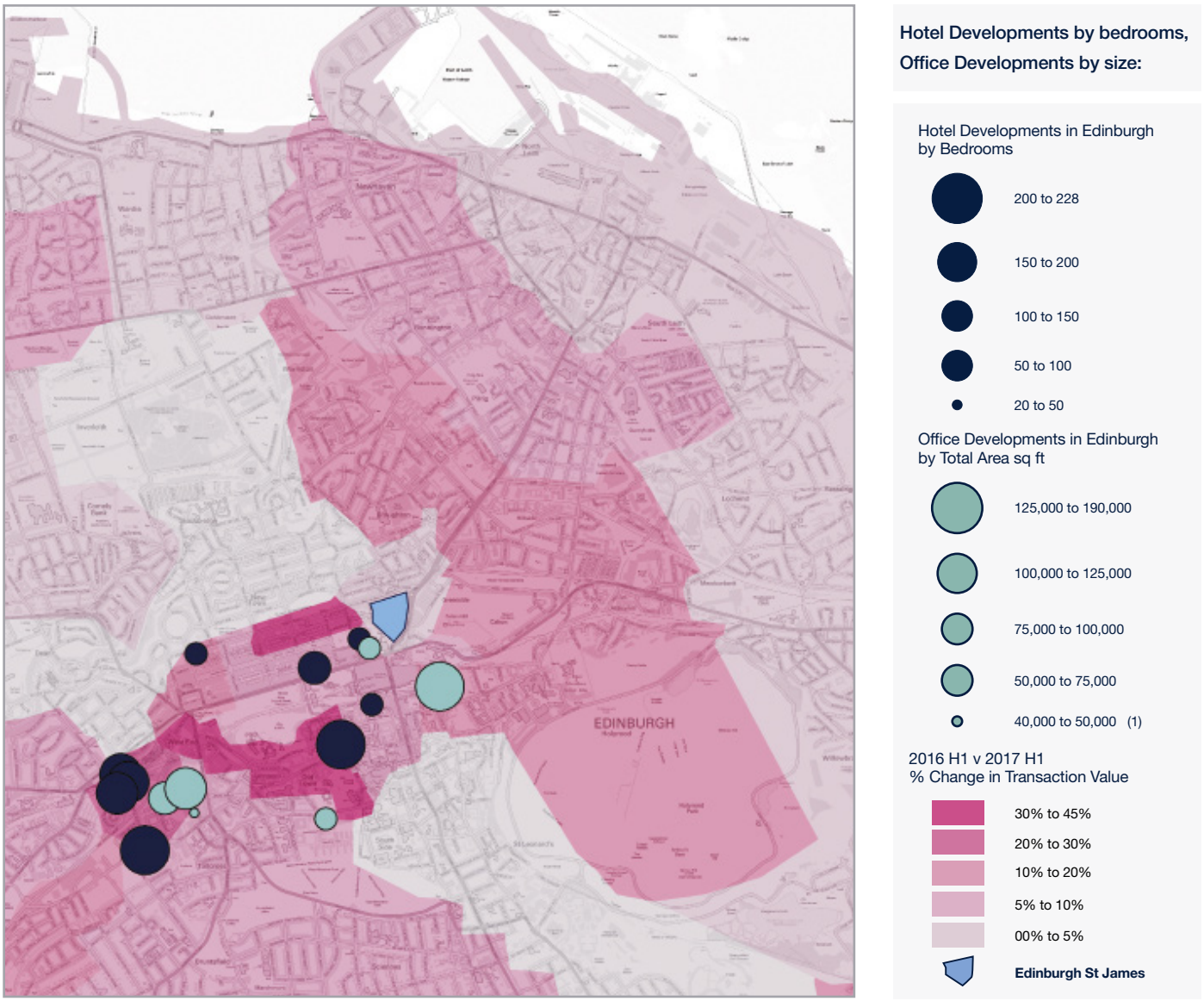
Increasing hotel stock plays an important role in supporting further growth in overseas arrivals, together with the knock on benefits this has for retail sales in the city and in turn retailer demand. Further infrastructure improvements will no doubt play a more vital role.

Edinburgh airport's five year £220m investment plan, which is envisaged to increase passenger numbers to 16.5m by 2021, will play a key part in driving overseas visitor growth, and in turn, hotel and retail sales performance in the city. The airport's goal is to double the number of passengers to 25.8 million by 2040.

While a significant investment, it does lag behind other similar sized European cities. For example, Copenhagen is also planning to double capacity, taking passengers to 40m over the next 25 years, an 11m increase on current passenger numbers, largely through increasing capacity for intercontinental routes.

In order for Edinburgh to remain attractive as a visitor destination, with increasing competition internationally from within Europe, delivering new hospitality and retail space as part of wider attractive mixed use environments will be imperative.

FIGURE 4 **City centre developments are expanding the city eastwards, where we are seeing some of the strongest residential growth**



Source: AMPM, Savills, Registers of Scotland

Residential markets: city centre pushes out

There are three main residential themes in the city centre. Firstly, potential for strong value growth in the traditional core. This is the result of the city's geography, historic nature and currently a lack of stock, particularly at the upper end. For example, the number of transactions in EH3 are 11% lower than the previous year. This is a result of Land and Building Transaction Tax (LBTT) and a lack of stock.

Secondly, residential conversions are achieving strong values. These properties have often been townhouses converted back to residential from office space. This type of development will continue, alongside upper floors of commercial space. This cluster of properties have provided much needed stock, around George Street, and we would anticipate further conversions to provide for this market as and when opportunities become available.

Finally, residential demand is pushing east. The strongest growth is taking place along Leith Walk, particularly in the areas closest to town, with values up 15% year on year in EH7. Value growth is reflecting the impact of recent and proposed regeneration projects both for sale and rent. The growth is slightly lower further east at 6% year on year, still above the city average.

Mid-market rent development at Western Harbour combined with CALA's waterfront scheme will consolidate development around Ocean Terminal and Newhaven. Making sure the infrastructure is in place to serve these new neighbourhoods will be essential to creating a sense of place and connecting them to the city centre.

The Tram extension (decision not expected until autumn 2018), amongst other strategic investment, could facilitate the redevelopment of brownfield sites in this part of the city in a connected and strategic way.

Edinburgh in numbers

7,100 additional office based jobs forecast over the next five years in Edinburgh, indicating a need for over **700,000 sq ft** of space.

Only **12 months** of Grade A office supply remaining in the market at average Grade A take up levels.

Historic undersupply of new residential units combined with projected growth of **3,000** households per year is creating strong demand for development across all tenures.

Strategic infrastructure will facilitate much needed residential development within the city.

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