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Savills World Research
Edinburgh Offices

Spotlight
Edinburgh Offices

Summer 2012

SUMMARY

■ Take-up in Edinburgh in the first half of 2012 was more than double the level seen in the first half of 2011.

■ The amount of available Grade A space in the City has continued to fall during 2012, and this combined with an exceptionally restrained development pipeline will be the driver of prime headline rental growth over the next five years.

"We expect to see a steady rise in refurbishment activity in Edinburgh as landlords move to capitalise on the increasing shortage of Grade A and good quality Grade B properties."
Keith Dobson, Savills Edinburgh

Occupational market

■ We commented in our end 2011 Edinburgh market report that there were a number of high profile requirements in the market that should boost take-up in the short to medium term. The first half of 2012 has seen two of these come to fruition.

■ Firstly, Brewin Dolphin acquired 47,816 sq ft at Atria on Morrison Street (the largest pre-let in five years), and then in Q2 there was Blackrock's pre-let of 79,500 sq ft at Exchange Place One, which is one of the largest office lettings that has been seen in the City for 10 years. Other notable deals this quarter include 27,122 sq ft to Skyscanner and 10,667 sq ft to Investec, both at Quartermile One.

■ As a result of all this activity the Q2 2012 take-up figure was a strong 217,125 sq ft.

■ This brings the total office take-up in Edinburgh in the first half of 2012 to 404,941 sq ft, more than double the take-up in the same period last year. Indeed, as Graph 1 shows, the take-up in the first six months of this year represents around 80% of 2011's total take-up.

■ The prospects for the second half of 2012 look good, with 37,000 sq ft already having been let to NHS Education for Scotland at Westport 102.

■ The amount of available office space in Edinburgh continues to fall, reaching 2.5m sq ft at the end of June 2012. This takes the market back to where it was at the end of 2008, and is more in line with the long term average level of availability in the City.

■ As we have commented in previous reports, the proportion of the available space that is Grade A and in the CBD continues to fall. We estimate that overall across the City only 40% of the available office space is new or recently refurbished (our defintion of Grade A). However, only 28% of the office space that is available to occupy in the next six months in the CBD is of Grade A quality, and given the current state of Edinburgh's development pipeline this is unlikely to increase in the short to medium term.

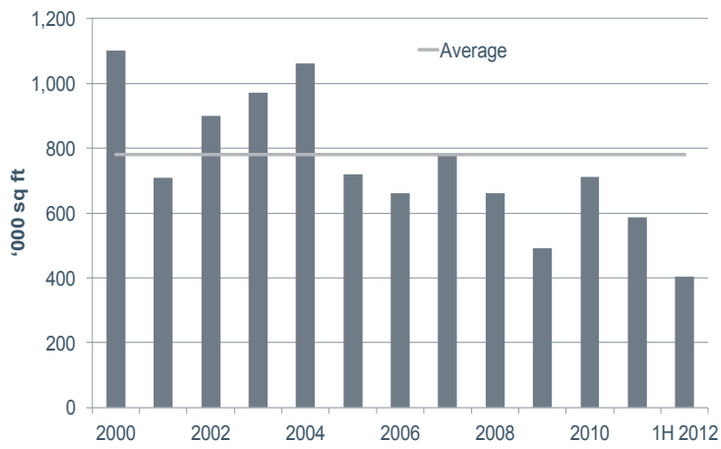
■ The one major speculative office development in the pipeline is the 200,000 sq ft Atria development on Morrison Street, which is due for completion in Spring 2013.

■ All that having been said, the City remains slightly oversupplied with vacant office space. Our normal metric for such things is to divide the total availability by the average annual take-up, and this points to Edinburgh having three years worth of supply at "normal" levels of take-up.

■ The question of what will be done with the steadily increasing amount of secondary office space in the City is yet to be resolved. We remain of the view that as the leasing market starts to recover we will see more and more of this non-prime office space being refurbished to compensate for the lack of development activity in the City.

GRAPH 1

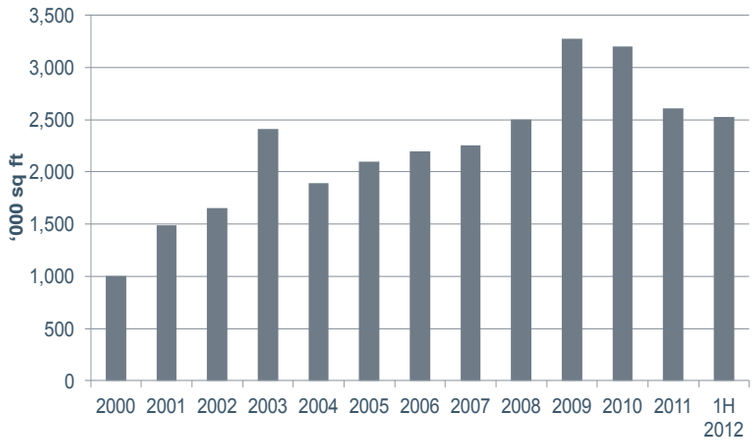
1H 2012 sees take-up double the 1H 2011 total



Graph source: Savills

GRAPH 2

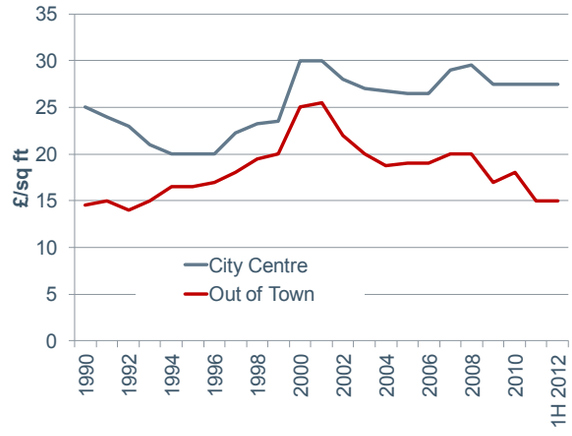
Office availability in Edinburgh continues to fall



Graph source: Savills

GRAPH 3

Top rents have remained flat in 2012



Graph source: Savills

■ This is certainly a trend that is very prevalent in London at present, and we expect it to trickle out to all of the regional cities as tenant demand starts to recover and Grade A availability starts to fall.

Rents

■ After three years of stability in prime rents we believe that 2013 will see some upward pressure on prime net-effective rents in Edinburgh. While the rent paid by Blackrock at Exchange Place has not been released, we expect it to have been circa £26/sq ft for the best space, and £27.50/sq ft remains our view of best achievable rent in the CBD at present.

■ Headline rents in the out-of-town market have stabilised this year at a headline rent of £15/sq ft, which is 41% below their early 2000's peak. Incentive packages remain heavily tenant-biased.

■ Rent free periods have remained stable during 2012, with 30 months per 10 years term certain being typical for smaller lettings at the prime end of the market.

■ Looking to the future we expect to see a pick up in prime CBD headlne rents as the level of Grade A supply in the CBD continues to fall in 2013.

Investment

■ 2012 has generally seen a continuation of the air of caution that has driven the investment market throughout the last five years. This has been expressed by rising investor interest in locations that are perceived as secure, as well as a strong investor bias towards longer term, secure income streams.

■ The second quarter of 2012 has seen an intensification of this risk-aversion, primarily due to worries about the future of the Eurozone, and this has led to a rise in investor interest in London at the expense of regional cities like Edinburgh.

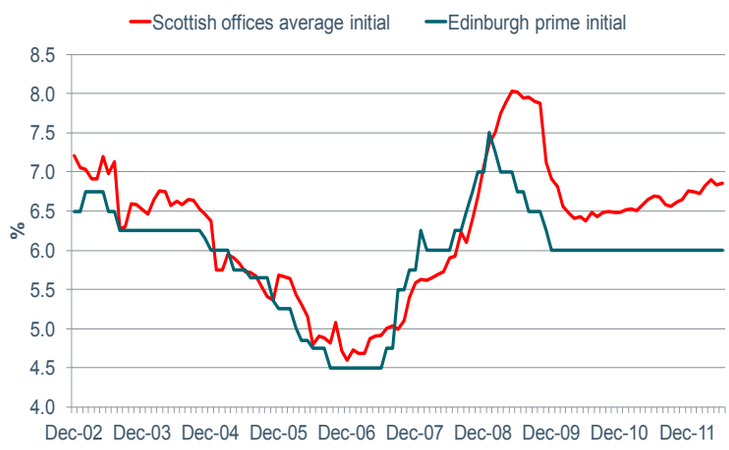
■ The largest investment deal in the wider Edinburgh market this year was LaSalle Investment Management's purchase of Edinburgh Technopole for £7.25m.

■ The reduced buyer interest in the City has been compensated for by a very limited pool of assets for sale, particularly at the prime end of the market. As a result of this we continue to suggest that prime rack-rented assets with income security of 15 years or more would achieve an initial yield of 6.00% - 6.25%. Shorter income deals of the same quality would be likely to achieve a net initial yield of 6.25% to 6.50%.

■ Average yields, as measured by the IPD Scottish offices index (Graph 4) have started to rise, reaching 6.85% at the end of June 2012.

GRAPH 4

Average yields soften as prime stay stable



Graph source: Savills, Investment Property Databank

Outlook

Keith Dobson, head of business space agency in Scotland, examines the outlook for the Edinburgh office leasing and investment markets.

■ 2012 has seen a rise in leasing activity in Edinburgh, which has predominantly been driven by lease events rather than inward investment. We expect this to remain the tone for the next 12 to 24 months, with requirements from resident professional businesses focusing on an increasingly short supply of prime CBD office space.

■ Larger occupiers who are able to plan further in advance will continue to look to leverage their requirement to achieve a pre-let at an attractive rent. However, it is the smaller local businesses who will be most challenged to find suitable good quality space in which to expand.

■ Shortage of Grade A space to let will deliver steady upward rental growth over the next five years, and we expect the top headline rent achieved in Edinburgh to exceed £30/sq ft in the short term, as average prime rents grow at 2-3% per annum from 2013.

■ Developers will continue to find it challenging to raise finance to commence speculative development in the City without a pre-let. However, we do expect 2013 to 2015 to see a steady rise in refurbishment activity in Edinburgh as landlords move to capitalise on the increasing shortage of Grade A and good quality Grade B properties.

■ In the investment market we expect that prime yields will remain stable at 6.50% for all of the next 12 months. However, as belief in the impending recovery in the leasing market gathers pace, then we expect to see more interest in "value add" type investments that are not only higher yielding, but offer better prospects of stronger returns.

■ The one area where we might see some yield hardening over the next 12 months is in very long leased assets. Annuity funds are reporting increasing problems with deploying their equity as the supply of long-leased assets in the UK has dried up. The pool of assets with 20+ years of income security in the UK is tiny, but the appetite for such assets is strong enough to support further yield hardening in regional markets such as Edinburgh.

Recent significant deals and key contacts

Address	Area Sq ft	Price	Yield	Vendor	Purchaser
Edinburgh Technopole	90,921 sq ft plus development potential for a further 410,000sq ft	£7.25m	13.9%	Grosvenor	LaSalle Investment Management

Address	Area Sq ft	Rent £/sq ft	Landlord	Tenant
Exchange Place One, Semple Street	79,500	Confidential	Scottish Widows	Blackrock
Quartermile One, Level 2	27,122	£26.00	Aviva	Skyscanner
Quartermile One, Part Level 3	10.667	£26.00	Aviva	Investec

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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