RESEARCH

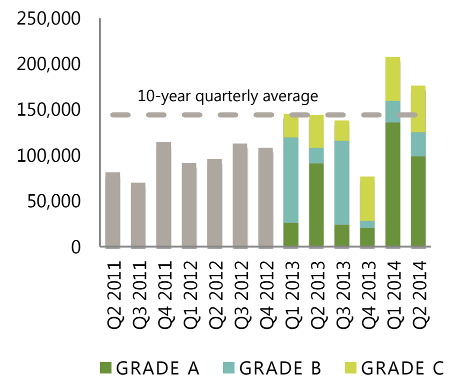
EDINBURGH OFFICES

MARKET UPDATE **H1 2014**

Occupier market

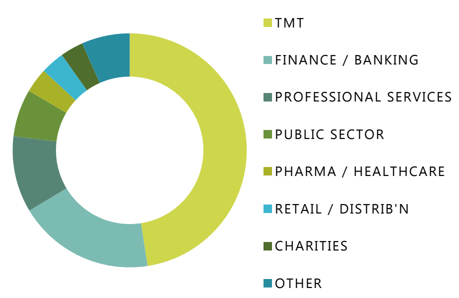
- Improved occupier sentiment translated into strong activity during the first half of 2014. Take-up amounted to around 385,000 sq ft in H1, a significant increase on the 260,000 sq ft taken up during H2 2013. While Q2 take-up was slightly below Q1's level, it was nevertheless comfortably above the 10-year quarterly average.
- Meanwhile, the level of active requirements in the market reached almost 310,000 sq ft in Q2, its highest level since Q2 2011.
- One of the largest transactions involving Grade A space saw Scotsman lease 25,555 sq ft at Orchard Brae House while, elsewhere, Aberdeen Asset Management leased 14,815 sq ft of Grade A space at 140 Princes Street and Brechin Tindal Oatts (BTO) took 11,094 sq ft at Edinburgh Quay.
- Despite the shortage of available modern office space, over 60% of take-up in H1 was made up of Grade A accommodation, with the remaining 40% made up of Grade B and C accommodation. Technology, Media, Telecommunications (TMT) and Financial Services continued to dominate activity, together accounting for over two thirds of H1 take-up.
- Availability of good quality modern space continued to decline throughout H1. Grade A supply currently stands at around 283,000 sq ft, down from 450,000 sq ft at the end of last year.
- Q2 saw 100,000 sq ft of new speculative development commence construction. The scheme is situated on the South side of St Andrew Square, and is funded by Standard Life. Completion is expected in early 2017.
- Additional speculative construction is also likely to start in the near term, as we expect to see funding of Quartermile Phase 4 (200,000 sq ft of office space) approved.
- The continued erosion of new Grade A supply is expected to lead to rising rental levels over the next 12 months. Prime headline rents, currently at £28.00 per sq ft, are projected to increase to around £29.00 per sq ft.
- We have also witnessed a reduction in rent-free periods to six months per typical five-year term for sub 5,000 sq ft units within the core City Centre.

FIGURE 1
City centre take-up by grade (sq ft)



Source: Knight Frank LLP

FIGURE 2
H1 2014 take-up by sector



Source: Knight Frank LLP

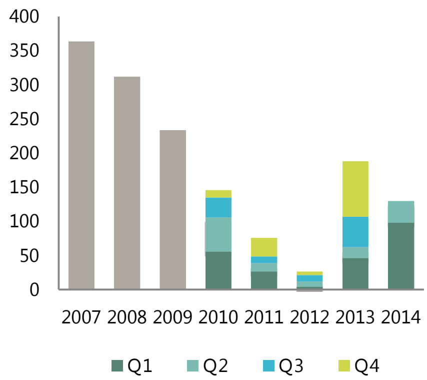
Agent's view

The diminishing supply of Grade A offices in the central core together with a dearth of new speculative schemes will have a positive impact on rental growth and is also likely to encourage larger prospective occupiers to consider pre-lets. Driven by the lack of prime office space, there is now a need to refurbish second-hand space to meet rising occupier demand.

Reflecting the revival of occupier confidence, we expect take-up for the full year 2014 to surpass 600,000 sq ft, and perhaps even to reach its highest annual level since 2007.

In Q2, Henderson Global Investors leased 4,000 sq ft at Atria One.

FIGURE 3
Edinburgh offices investment turnover (£m)



Source: Knight Frank LLP, Property Data

Investment market

- Edinburgh's city centre investment market saw significant amounts of activity at the start of 2014. Q1 investment volumes reached £98m – the highest quarterly volume since Q2 2009, before falling to £32m in Q2 (Figure 3).
- One of the largest transactions in a strong first quarter saw SWIP (advised by Knight Frank) purchase Hobart House, a mixed use retail and office development situated in a prime city centre location, for c. £20m. Another significant deal was Aerium's purchase of Princes Exchange and New Uberior House in Edinburgh's Exchange District for around £62m, which are let to Lloyds Banking Group for a further twelve years.
- However, uncertainty over the Independence Referendum has seemingly impacted on the investment market since April, primarily because vendors are holding back sales until after the Referendum's result is released.
- Evidence from recent transactional activity and general sentiment in the market suggests that prime, long-income yields in Edinburgh stand at c. 5.75%, unchanged during Q2, following a 25bps inward shift in Q1.
- Despite the uncertainty over the Referendum, a number of institutions continue to seek investment opportunities in Edinburgh. Consequently, there is potential for yields to compress post-referendum because of the pent-up demand being generated by a lack of available investment product.

Hobart House – Knight Frank advised on the purchase.

TABLE 1
Selected investment transactions in H1 2014

Date	Address	Purchaser / Vendor	Price	NIY(%)
Feb 14	New Uberior House	Aerium Finance Ltd / iii-BVK Europa Immobilien	£61.75m	6.29
Jan 14	Morrison Street, 3-5	AXA REIM (Caesar Fund) / Climate Change Capital	£28.65m	6.00
Apr 14	Hobart House, Hanover Street, 80	Scottish Widows / West Coldstream	Conf.	Conf.
Jun 14	George Street, 111-115	DTZ Investment / Hampton Investment	£6.96m	6.70
Mar 14	Nova House, Ponton Street, 3	Private investor / Thistle Property Co Ltd	£5.50m	6.77

Source: Knight Frank LLP

Knight Frank

Newmark Knight Frank Global

COMMERCIAL RESEARCH
Nejc Jus, Senior Analyst
+44 20 7861 1547
nejc.jus@knightfrank.com

CAPITAL MARKETS
Alasdair Steele, Partner
+44 131 222 9622
alasdair.steele@knightfrank.com

LEASING
Toby Withall, Partner
+44 131 222 9616
toby.withall@knightfrank.com

Simon Capaldi, Associate
+44 131 222 9621
simon.capaldi@knightfrank.com