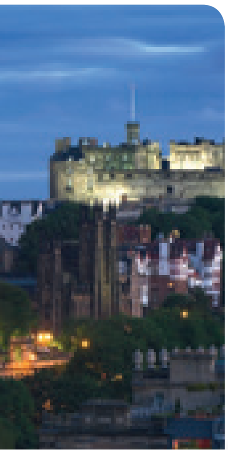
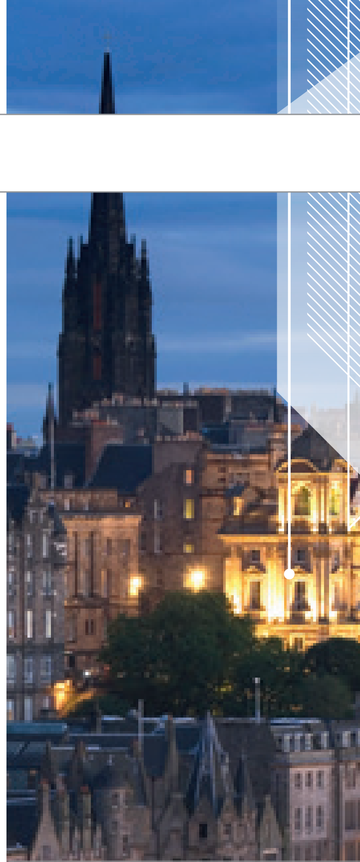




Edinburgh

DIVIDED SCOTLAND

As Scotland prepares to go to the polls this September, Cityscape asks 'What would independence mean for the Scottish real estate market?'

Scotland's real estate market is currently in limbo – as politicians, business leaders and the wider public await the outcome of a vote on independence, set to take place on 18 September 2014.

The ramifications of the vote will reverberate throughout the country, and none more so than in its real estate sector.

WHAT WILL THE REFERENDUM MEAN?

Recent polls show that Scotland is still divided on whether or not it will vote in favour of independence. According to a YouGov poll carried out on 28 April 2014, 37% would vote Yes, 51% would vote No, and 12% were undecided. This has left the real estate market in a state of hiatus. "There are buyers putting off until after the referendum," admitted Faisal Choudhry, Associate Director Residential Research, Savills Scotland.

"We expect a slow down in sales in the lead up to the referendum. If there is a Yes majority vote that will lead to further uncertainty of 18 months and we expect values to slightly drop before independence in March 2016."

A poll conducted at a recent Savills seminar of 400 delegates showed that the industry does expect prices to decline if Scotland votes in favour of independence. This is due to uncertainty on many big issues, not least what base currency Scotland will take, as well as issues on stamp duty and other taxes.

For commercial building owners, questions arise on how an independent Scotland would regulate increases in rents. At present these are referenced to a UK-wide public price index, the Retail Price Index (RPI) or in some instances the Consumer Price Index (CPI). How indexation of rents would work in the event of independence is not clear. "If there is a No vote we expect the market to really take off and improve compared to what it is now," Choudhry countered.

PRICE RISES

The Royal Institution of Chartered Surveyors (RICS) predicts that house prices in Scotland will see an increase of 7% over the course of 2014, while the cost of renting a home should rise by a further 2%.

"This growth is being driven by the acute imbalance between rising buyer demand and inactive supply. The rise in activity is partly due to the introduction of Help to Buy in Scotland in late 2013," said Sarah Speirs, Director, RICS Scotland.

While a shortage of homes may be driving up prices, a jump in new starts in Scotland over the coming year could rebalance the market.

"In 2014 house starts are predicted to rise to 16,400, compared to 14,730 this year and around 13,343 in 2012. While this is an encouraging trend, it is still insufficient to meet the projections for more rapid population growth," Spiers pointed out.

In the office segment, the main driver of total returns compared to previous periods is going to be yield compression with rental growth beginning to be seen in the principal office markets for best quality stock.

"Aberdeen has been the stand out for a couple of years with office rents there now the highest in the UK outside London. The transformation of Aberdeen from a North Sea oil city to a global energy city has been remarkable and looks to be sustainable in the medium term and beyond," said Douglas Smith, Chairman Scotland, CBRE Ltd.

WHO IS INVESTING?

While Scotland tries to work out the finer details of its future governance, international investors seem undeterred and are still buying in.

"Sensibly priced, quality stock will attract international interest and we have seen recent activity by investors from Spain, Germany, Israel, Turkey and the U.S. to name a few," said CBRE's Smith.

> *"If there is a No vote we expect the market to really take off and improve compared to what it is now."*

According to Bruce Patrick, Director of UK Investment, Savills, American investors are active in Scotland predominantly through private equity funds buying up the loan portfolios of UK banks.

"While those portfolios have included quite a bit of secondary properties they have also included prime properties," he explained.

"We've also seen a tranche of Middle East buyers and that includes oil wealth and Sharia-compliant funds, like Gatehouse Bank. These have been big buyers of sheds let to the right people.

"The biggest buyers are the European funds. Predominantly Germany funds – Union, Dechert – are up here buying prime office buildings and again attracted by the fact that the yield is so favourable," Patrick added.

"Regarding the independence question, international investors are more relaxed about this than the UK investors. This is because these are global investors and they look at our market in a global way rather than a finite way," he said.

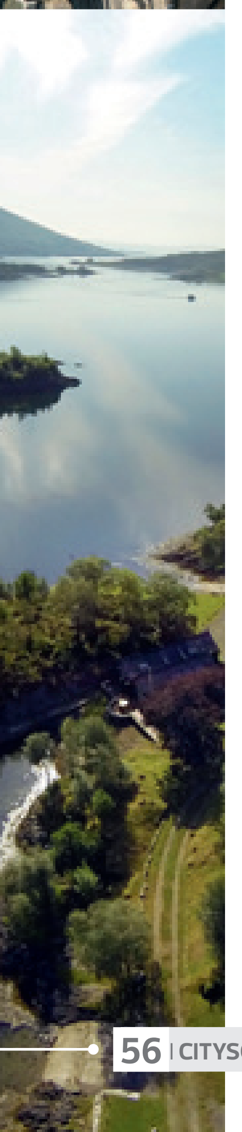
WHAT ARE THEY BUYING?

Commercial property has seen a real upturn in fortune in Scotland since the third quarter of 2014.

According to Savills, prime offices are very much in demand from a wide range of investors, mainly institutional funds predominantly from the UK and Europe.

Edinburgh and Glasgow lead the office market. "Those markets are highly desirable with their strong CBDs, good quality tenants and prospects for rental growth. If buying at the right price, where rents are reasonable, yield should pick up in 2015," said Patrick.

In terms of retail, Glasgow is the strongest location in Scotland and seen as the second strongest in the UK outside of Oxford St in London.



However, for big returns, investors need to look at logistics.

"Logistics is the darling of the market at the moment," admitted Patrick. "There's been a lot of sheds come to the market. At the start of the year we sold one of the biggest sheds in Scotland, 550,000 sq ft, for £55 million (US$ 92 million). Premium pricing is being paid for size and uniqueness of property."

The shopping centre market has also seen lots of activity, with Eastgate Shopping Centre in Inverness sold for £250 million (US$ 420 million) to F&C REIT in 2013, while early 2014 saw Land Securities divest its Overgate Centre in Dundee to Legal & General Property for £125.3 million (US$ 210 million).

According to Patrick, the East Kilbride Shopping Centre is coming to market soon and will be fought after.

WHERE TO BUY

Aberdeen continues to drive the market with increased activity in North Sea oil and its recent evolution into a global energy hub.

"Aberdeen is not just about oil but people exporting energy knowledge all around the globe. It is a market where the tenants are committing to 15–20 year leases. And where there is inherent growth in the rent. UK institutions cannot buy that type of stock anywhere else in the UK and are filling their boots," said Savills' Patrick.

CBRE's Smith agreed: "The dynamics of the Aberdeen market have been truly amazing. Occupational demand continues to exceed supply and, provided the historic infrastructure deficit can be made up, there seems to be substantial further economic growth to come."

However, Smith also touts Edinburgh as one market to watch.

"Edinburgh has been much more stable through the recession than many commentators predicted. What has attracted new office occupiers into the city has been the availability of a highly skilled financial services workforce and this has allowed new entrants to expand at a much faster rate than otherwise would have been possible."

For now, all eyes are on 18 September 2014, when Scotland's future will be decided.

> *"The transformation of Aberdeen from a North Sea oil city to a global energy city has been remarkable and looks to be sustainable in the medium term and beyond."*

Glasgow

KEY DATES

- 26 NOVEMBER 2013: Publication of White Paper
- 18 SEPTEMBER 2014: Referendum Day
- 24 MARCH 2016: Independence Day
- 5 MAY 2016: Scottish Parliament Election