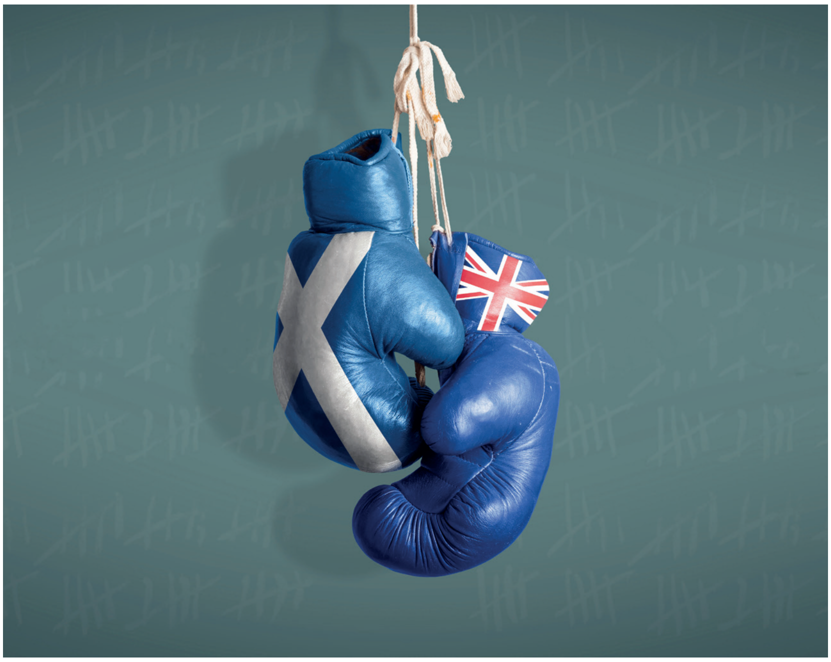
SCOTTISH RESIDENTIAL
MARKET QUARTERLY

WINTER 2014

In this issue...



A POST REFERENDUM PERSPECTIVE

The first half of 2014 saw a budding market recovery amid the chill of limited supply, tightened finance and constitutional uncertainty.

In this issue, we examine how different parts of the Scottish housing market are performing and how confident we can be of the recovery in a post referendum Scotland.

As Scotland's leading independent property company, we work across the whole market, from Sales to Lettings, Property Management, New Homes, Farms & Estates, Land, Development, Valuation, Residential Investment, Structured Development Finance and Research & Consultancy. This joined-up, comprehensive service means that we have unrivalled access to market knowledge and information that provides Scottish-based research for the Scottish market. We also endeavour to tell people what they need to know rather than what they want to hear, with an honest and direct assessment of where the markets are at and likely to be heading.

MESSAGE FROM SIMON RETTIE

Simon Rettie FRICS
Managing Director
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There has been much to reflect upon for the Scottish residential property market in 2014. There was the no small matter of an Independence Referendum, the drying up of Help to Buy, and the announcement of a new proportional tax to replace Stamp Duty come April next year.

"These political uncertainties, interacting with a fledgling economic recovery, has produced mixed results for the property market. We have seen that, on the whole, residential sales are rising, but not uniformly across markets. In some areas, the build-up of political noise has brought the market to a near standstill, while, in other places, it has been more the case of business as usual.

For markets that have been negatively impacted by constitutional uncertainty, e.g. the prime market, we have seen some ground being made in the shadow of the Referendum. For a sustained recovery, we need the return of market confidence, boosting sales and prices to follow suit. Land values are only just now creeping back up to pre-crash levels and there is renewed but cautious optimism. In rural markets, activity is slow but improving. The upper end of the market appeared to be struggling in the first half of 2014, but we will likely see the impact of the new Land and Building Transaction Tax cause the prime market to burn bright over the coming months before the tax changes hit. The lettings market, however, has gathered momentum. Rentals are strong because of undersupply but also because a sizable portion that cannot or will not commit to buying. Going forward, investment in the private rented sector is looking particularly promising."

Simon Rettie FRICS
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KEY FINDINGS FROM THIS QUARTERLY

- The key message that can be taken from this year is that it appears to be a milestone for durable recovery in the Scottish residential property market. For the whole of Scotland, residential sales are up 9% on the previous year. The recent churn of sales has nudged average prices upwards, increasing by 5% in the past year to over £170,000.
- The strength of recovery, however, is not equally felt and some markets are burning brighter than others. Sales volume levels are only now climbing back to where the market was pre recession. The economic recession has put the clock back ten years on the housing market and in Scotland today market turnover stands at 2004 levels. Locally, the same can be said for Edinburgh, but Aberdeen stands at 170% and Glasgow is 70% of the value of market turnover from a decade ago, demonstrating the unevenness of the recovery and, in Scotland today, market turnover stands at 2004 levels.
- The policy landscape in 2014 has added a level of uncertainty to the residential property market in Scotland. Notably, the Independence Referendum in September has seemed to have stalled the market and changes to Stamp Duty (to come into effect in April 2015) will likely influence sales and investment in prime property in the run up. The new Land and Buildings Transaction Tax (LBTT) will stoke the first-time buyer market and there might well be a race to conclude sales at the top end of the market before the new tax levels bite.
- Government stimulus packages such as Help to Buy and improved economic conditions and have helped to give the residential property market a boost despite limited supply and constitutional uncertainty. Considering these factors, Rettie & Co forecast that prices will rise by just under 30% in the next 5 years, with transaction numbers up by around 60%.
- The news from our rural offices is mixed - sales have been slow, but prices stable. LBTT is likely to impair sales of homes selling for more than £325,000 but there will potentially be a churn of higher value properties in the run up to April 2015.
- The Scottish new build market appears to have hit its bottom last year and, in 2014, is finally on the rise, with increases in both private and social sector starts. 2014 marks the first time since the recession that new build starts have outpaced completions. Sustained recovery going forward seems promising as both starts and completions are up from the previous year by 16 and 5%, respectively.
- The land and development market has returned strongly post referendum, but with a hint of caution. Land values for standard housing surrounding economically active cities are strong, but land values in other areas are potentially showing signs of levelling off.
- Rents are rising above inflation as demand continues to outstrip supply in key rental markets. Demand for property has remained high throughout 2014 and shows no sign of easing up as we enter the final quarter of the year. However, over the medium- to long-term, rent rises are still below inflation and below rises in social rents.
- There have been a limited number of quality farms and estates on the market in the last year. The east is continuing to outperform the west in farmland. There are significant market uncertainties here around Land Reform and Right to Buy.

THE SALES MARKET
IMPROVING DESPITE UNCERTAINTY

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The key message that can be taken from the latest official Registers of Scotland data is that 2014 is a milestone for durable recovery in the Scottish residential property market. The strength of recovery, however, is not equally felt and some markets are burning brighter than others.

The first half of 2014 showed promising signs of a market revival after a sustained downturn. The latest official data show that, in Q3 2014, most local authorities saw double digit growth in residential property sales from the previous year. For the whole of Scotland, transactions were up 9%.

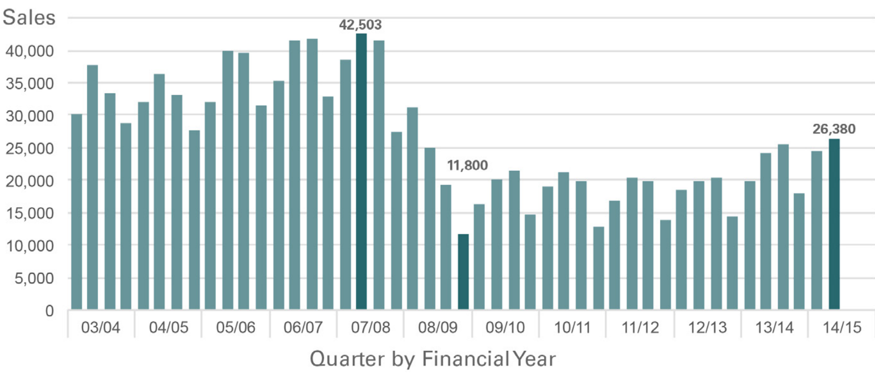
Official figures suggest that the new market normal in a post recession Scotland is reaching around 90,000 home sales per year compared to when the market bottomed out in 2009 at 70,000 transactions. This recent uptake in sales, however, is nearly half the volume of transactions registered prior to the recession, which hit a peak of more than 40,000 sales per quarter, a level that proved to be unsustainable. See Figure 1 After a protracted slump in sales, the number of homebuyers entering the market has grown in the past few years. However, renewed market activity was not equally enjoyed throughout Scotland. Most local authorities in the Central Belt boasted sales increases of over 10% from the previous year, but, notably, sales were down in Dumfries & Galloway (-12%), Aberdeen City (-9%), East Renfrewshire (-8%), Dundee City (-3%), and Inverclyde (-1%). See Figure 2.

The recent churn of sales has nudged average prices upwards, increasing by 5% from £160,000 in Q3 2013 to over £170,000 in Q3 2014. For the first time since the recovery, the rate of year-on-year average price increase is on par with that in England and Wales. Despite having higher year-on-year percentage increases than England and Wales in the run up to the crash, houses in Scotland have, generally, retained value and have not suffered price drops to the same degree elsewhere in the UK (outside hotspots such as London).

For most of Scotland, averages prices have risen above inflation, but there are some areas that experienced dropping average property prices, such as Shetland (-9%), Scottish Borders (-6%), South Ayrshire (-4%) and Dundee (-1%). Renfrewshire and Falkirk saw the highest price increases, growing by 17% and 12% respectively. See Figure 3.

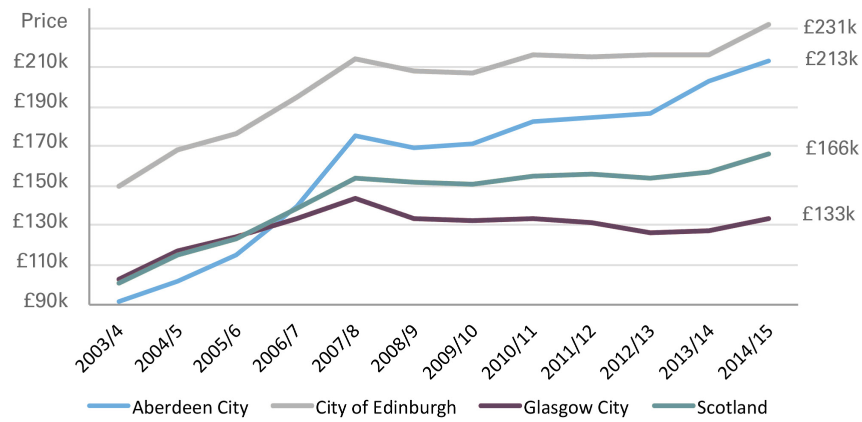
The economic downturn has had a mixed impact on local markets. Nationally, the trend shows prices to be hovering at a stagnant £150,000 post recession with only an uplift in the past year. Yet, national averages mask interesting local variations in major markets. For example, the Glasgow market has taken a sharp drop and has yet to climb back to pre-recession levels. Prices in Edinburgh, however, have risen post 2009 but not without some fluctuation. In Aberdeen, average prices took a short dip immediately following the downturn but have increased well above inflation and by nearly £42,000 in the last five years. See Figure 2.

Figure 1 *Quarterly transaction levels in Scotland from Q3 2004 to Q3 2014*



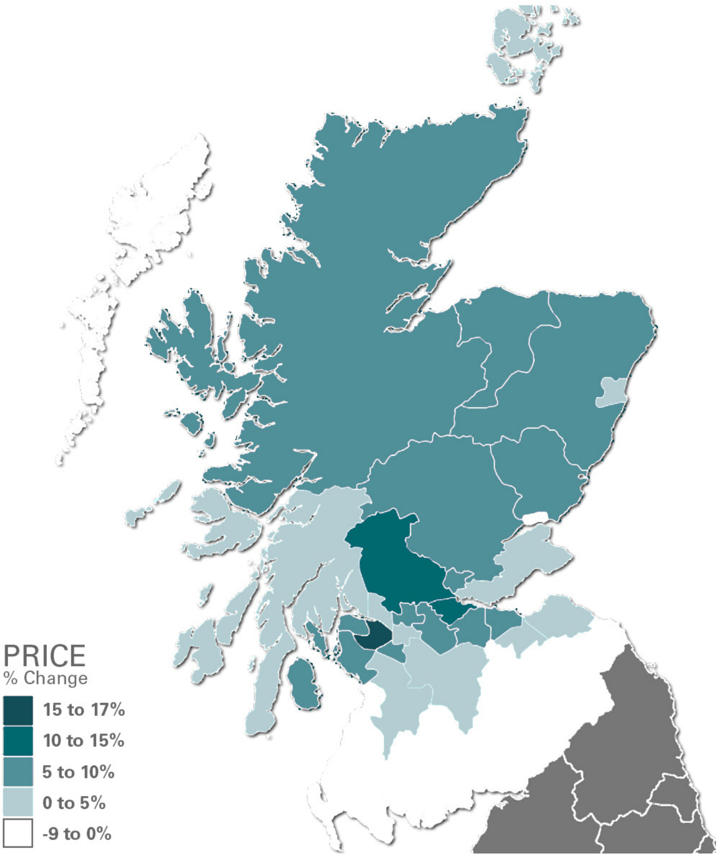
Source: Registers of Scotland

Figure 2 *Nominal average prices for Scotland, Aberdeen, Edinburgh and Glasgow from 2004 to 2014*



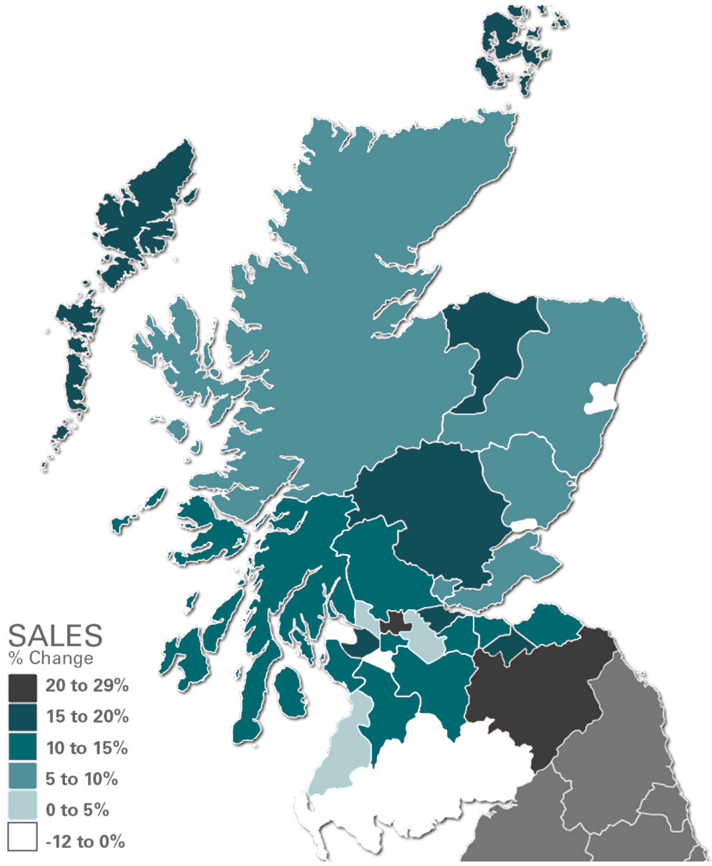
Source: Registers of Scotland

Figure 3 *Map of average price change in Scotland from Q3 2013 to Q3 2014*



Source: Registers of Scotland

Figure 4 *Map of change in residential sales in Scotland from Q3 2013 to Q3 2014*



Source: Registers of Scotland

The best barometer of the housing market performance, however, is the value of property sold (or market turnover) which combines transaction levels and prices. In the third quarter of 2014, the residential property market was worth over £4 billion in Scotland.

Despite downturns in average prices in some places and decreased sales activity in others, nearly all local authorities registered positive growth in market turnover from 2013 to 2014. Generally, places where prices are down, sales are on the up, and vice versa. This is particularly the case in Aberdeen which saw some of the largest price increases over the year (5%) coupled with one of the largest reductions in the volume of sales (-9%). Here a lack of supply is fuelling price increases.

Although 2014 is showing positive signs for a sustained market recovery, it should be put in the perspective that levels are only now slowly climbing back to where the market was pre-recession. Effectively, the economic recession has put the clock back ten years and, in Scotland today, market turnover stands at 2004 levels. Locally, the same can be said for Edinburgh, but Aberdeen stands at 170% while Glasgow is 70% of the value of market turnover from a decade ago.

RETTIE & CO. CORE MARKETS

Edinburgh is proving to be one of the more resilient markets in Scotland. Like elsewhere, transactions are well off market peak from 2007 but are on the up and rising faster than the national average over the past year. Recovery in EH2 (city centre) appears particularly strong, where sales have returned to pre-recession levels. Areas that had been sluggish such as EH12 (including Murrayfield and Corstorphine) have now also picked up. Average house prices remain broadly stable, up in most areas but not markedly. EH1 (city centre) is an exception as prices here have grown at pace recently.

In East Lothian, average prices are consistently well above the national average by nearly £50,000 and are increasing at a faster pace than the Scotland average, increasing 6% in a year to £223,429 in Q3 2014. Transactions in East Lothian are up by 50% since the start of the recovery in 2009, which is largely at the same pace as national trends.

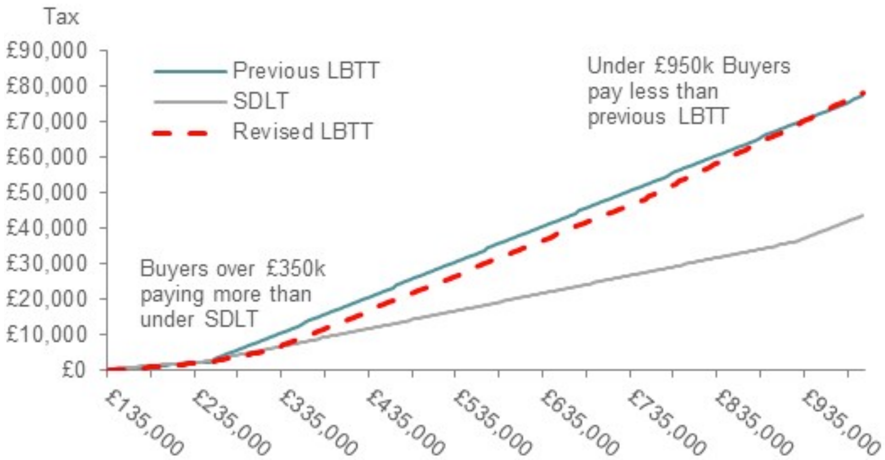
In Perth & Kinross, average prices are about £20,000 higher than the national

Table 1 *SDLT vs LBTT Tax Rates*

SDLT		Previous LBTT		Revised LBTT	
£125,000	2%	£135,000	2%	£145,000	2%
£250,000	5%	£250,000	10%	£250,000	5%
£925,000	10%	£1,000,000	12%	£325,000	10%
£1,500,000	12%			£750,000	12%

Source: Rettie & Co.

Figure 5 *Impacts of new Stamp Duty changes*



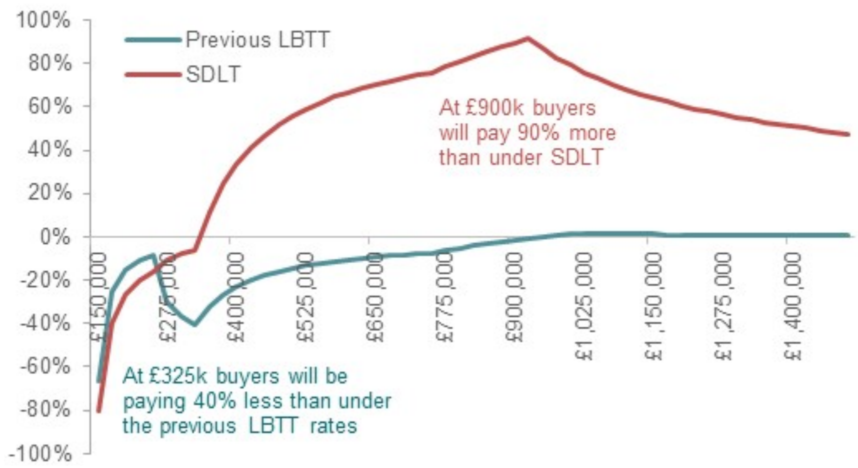
Source: CML

Table 2 *Comparison of Tax Rates at various property prices*

House Price	SDLT	Previous LBTT	Revised LBTT
£200,000	£1,500	£1,300	£1,100
£250,000	£2,500	£2,300	£2,100
£325,000	£6,250	£9,800	£5,850
£500,000	£15,000	£27,300	£23,350
£750,000	£27,500	£52,300	£48,350
£1,000,000	£43,750	£77,300	£78,350

Source: Rettie & Co.

Figure 6 *Stamp Duty and LBTT at various property values*



Source: CML

average. Prices have largely been unchanged from 2010 and remain at just over £180,000. Sales are up by a third in Perth & Kinross from the previous year and transactions have increased by 70% since the start of the recovery.

Recovery in Glasgow has lagged behind the rest of the country but there are some bright spots in the city. Sales in G3 (Westend) rebounded with a 48% rise in transactions in the last year, while sales in G11 (including Broomhill and Partick) and G13 (including Anniesland and Knightswood) have increased by a quarter for this year. Across the West End market, Rettie & Co.'s share of value of property sold totalled just over £56 million, 12% of the total market turnover.

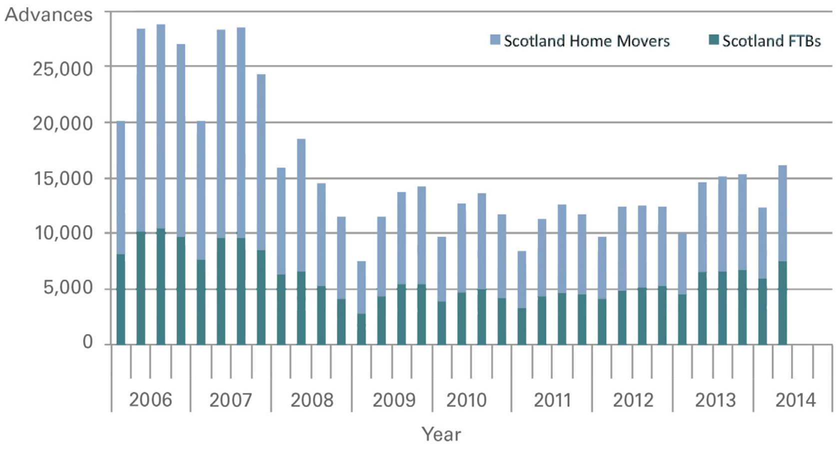
Sales in Bearsden are up by 7% in Q2 2014 and market turnover in G61 & G62 has increased by half from three years ago. Despite an uptick in transactions, average prices have been broadly flat, remaining at just over £250,000 since 2011. However, prices in Bearsden are still well above those in the wider East Dunbartonshire and Stirling regions.

The Berwickshire and Northumberland property market saw a significant upturn in activity that has continued into 2014. The summer has been a challenging time for the Scottish Borders and North Northumberland market due largely in part to constitutional uncertainty. However, since the Independence Referendum, viewing numbers on both sides of the border have reached their highest levels since early May. What we are not seeing are new properties coming to the market, which is encouraging for those already on the market, but also offers an opportunity for those who are unsure if now is the time to come to the market.

In the Scottish Borders, average prices took a slight tumble in 2011 bringing them closer to the national average by the end of 2013. But prices have increased slightly in the past year to more than £166,000. Sales in the Scottish Borders have been slower to pick up since the start of the recovery compared to national trends. Nevertheless, transactions have increased by 30% from lowest levels registered in 2009.

Limited supply and increasing demand are sending already high property prices upwards in Aberdeen. Most local authorities saw double digit sales increases from the previous year, yet Aberdeen City was one of two local authorities to have negative growth,

Figure 7 *Mortgage advances in Scotland, 2006 to 2014*



Source: CML

Table 4 *Rettie & Co house price forecasts for Scotland, 2013-18*

Scotland Annual House Price Growth			
	Central	Downside	Upside
2013 (actual)	1.4%	1.4%	1.4%
2014	3.9%	3.0%	4.8%
2015	4.0%	3.0%	6.3%
2016	5.0%	3.8%	6.5%
2017	6.0%	4.5%	7.5%
2018	6.0%	4.5%	7.5%
Total Growth			
2013-18	27.5%	20.2%	35.8%

Source: Rettiue & Co.

Table 5 *Rettie & Co house transactions (sales volume) forecasts for Scotland, 2013-18*

Scotland Annual Transactions Growth			
	Central	Downside	Upside
2013 (actual)	84,200	84,200	84,200
2014	99,200	97,900	104,900
2015	106,700	103,800	114,300
2016	113,800	109,200	123,700
2017	121,300	115,200	134,200
2018	130,300	121,500	145,600
Total Growth			
2013-18	54.80%	44.30%	72.90%

Source: Rettiue & Co.

highlighting the problems of lack of supply and (probably) affordability. In Aberdeen, average prices took a short dip immediately following the downturn but have increased well above inflation and by nearly £42,000 in the last five years. Despite shrinking sales in recent years, market turnover is 170% higher than a decade ago.

POLICY LANDSCAPE

In October 2014, the rates for the new Land and Building Transaction Tax (LBTT) were announced that will replace Stamp Duty Land Tax (SDLT) in April 2015 for all residential and non-residential purchases in Scotland. This was quickly followed by The Chancellor of the Exchequer announcing changes to take effect immediately for Stamp Duty across the UK, which meant that almost all property sales in Scotland from 4 December 2014 to 5 April 2015 would pay less than under the old Stamp Duty system. On 21st January 2015, John Swinney announced amendments to the original LBTT rates, raising the initial taxable threshold to £145,000, introducing an intermediate 5% rate from £250,000 to £350,000 and reducing the upper 12% threshold from £1m to £750,000. Having had to wait over 300 years to regain property tax powers in Scotland, there were effectively 3 changes in 3 months. The new rates, compared with the old rates, are shown in Table 1.

The introduction of an intermediate rate between 2% and 10% was something Rettie & Co. had lobbied for after the first announcement of LBTT to make the tax less punitive for those buying a family home in strong employment areas such as Edinburgh and Aberdeen. The revision to include a 5% bracket means that a family buying a £325,000 home who would currently be paying £6,250 under SDLT but was facing an increased tax bill of £9,800 in April under the old LLBT rates, will now be expecting to pay £5,850.

The change of the LBTT rates will also mean that buyers up to £950,000 will be paying less than they would have expected to pay under the old LBTT rates. The main savers in percentage terms will be those buying between £275,000 to £350,000 where the new rates are 30% to 40% lower than the previous LBTT rates. Transactions from £325,000 to £750,000 will have the highest cash savings paying £3,950 less than under the previous rates.

However, when the new Scottish LBTT rates are compared to the current UK SDLT rates - the rates that buyers in other parts of the UK will continue to pay after April 2015 - buyers in Scotland paying over £325,000 will still be facing a significant increase on their tax bill. For example, a £450,000 transaction will see buyers paying 50% more tax when LBTT is introduced, while buyers at £900,000 will be facing a 90% high tax bill - £66,350 under LBTT compared to £35,000 under SDLT.

For those in the middle to upper ends of the housing market in Scotland, LBTT could still be seen as fairly punitive compared to UK taxation, whereas those at the lower rungs of the market are unlikely to save much. This has implications regarding whether LBTT can be revenue neutral in Scotland, as the Scottish Government intends, if it stalls the higher rungs of the market while doing little to stimulate the lower rungs.

These multiple changes in tax policy has meant that the market over £325,000, where buyers will be paying more come April, has burnt brightly since the original announcement in October. In December 2014, there were 3 times as many properties listed over £325,000 in Edinburgh than there had been in the same month a year earlier. There could then be a considerable lag in trading at the upper end as the market waits to digest pre April 2015 trading activity.

THE MORTGAGE MARKET

Two in three properties sold in the second quarter of 2014 required mortgage finance. Half of these mortgage advances were made to first-time buyers as the number of home movers requiring financing declined in relative and absolute terms since the economic downturn. First-time buyers are fuelling the recent uptick in sales, with 15% more households entering the property market for the first time than in the previous year. In the second quarter of 2014, more than 16,000 mortgages were advanced, the largest volume of lending in six years. See Figure 7.

Although mortgage lending has become less restrictive, it is still around half the volume of market peak in 2006. This drop is almost entirely made up of advances to home movers. Interestingly, the number of mortgage advances made to home movers has declined by 53% compared to only 28% for first-time buyers since market peak. The value of mortgage lending made to first-time buyers in the second quarter of 2014 was £790 million.

RETTIE & CO FORECASTS

Our previous market forecasts have been relatively accurate in recent years. We correctly identified back in 2008 that the correction in an overheated market would be based on falling sales rather than prices and we also accurately predicted the largely flat market in prices and transaction levels we had from 2010-13. We expected 2013 to witness a stronger market recovery, which occurred, although the scale of the recovery in transactions was greater than anticipated. To date, our forecasts for 2014 (both prices and transactions) seem accurate. Our forecasts for price and transaction rises up to 2018 are included above. We believe that prices will rise by around 28% in the next 5 years, with transaction numbers up by around 60% on 2013 figures.

Improved economic performance is a major reason underpinning our growth projections. Government stimulus packages have helped to improve transaction levels and have fed into prices, but these will weaken from next year. Lending is still expected to be restrictive given bank attitudes to risk and regulatory requirements. Therefore, we anticipate that the rise in prices will not be approaching the double digit growth seen in the last boom.

As well as a 'most likely' (central scenario), we also produce more optimistic and pessimistic forecasts, which, sensibly, gives a range of possible movement in the overall market, dependent largely on future economic conditions. It is important to bear in mind that even with these levels of growth in transactions, the market would still have over 20,000 less transactions in 2018 than it had in 2007.

Due to the relatively high levels of inflation, it should be noted that the growth that we predict in nominal prices will be eroded by the rate of inflation. Based on the above forecasts, it will be 2017 or 2018 before house prices are back to what they were in real terms in mid-2008.

"We have witnessed unprecedented levels of enquiries in November and have agreed more sales in the first week of December than we had in the whole of September. The supply of properties about to hit the market will be at levels not seen since before the recession."

James Whitson
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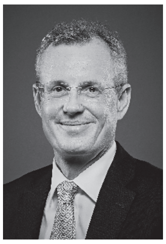
RURAL MARKETS
CATCHING UP, BUT BEHIND THE CITIES



Andrew Smith
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The news from our rural offices is mixed- sales have been relatively slow overall, but prices remain stable.

The Independence Referendum had a quieting effect in more rural markets in terms of sales volumes, but has not negatively impacted on price. Property values today are largely unchanged from this time last year. The high end of the market in East Lothian seems to be an exception, with more properties valued at £1 million or higher coming onto the market.

On the whole, house sales in rural markets are achieving Home Report valuations and there is a greater number of applicants, suggesting increasing demand. However, there appears to be less demand for rural property beyond 25 miles of urban centres. A greater number of people are moving out of cities into rural locations that are within commuting distance with good transit links. North Berwick in East Lothian is proving to be particularly popular for this reason.

Refurbished property is proving hard to attract a premium as fewer buyers are willing to organise improvements or are unable to secure the financing required to do so. Buyers are also willing to pay more for energy efficient homes and properties with energy efficient amenities, as potential purchasers are increasingly deterred by the cost of running larger properties.

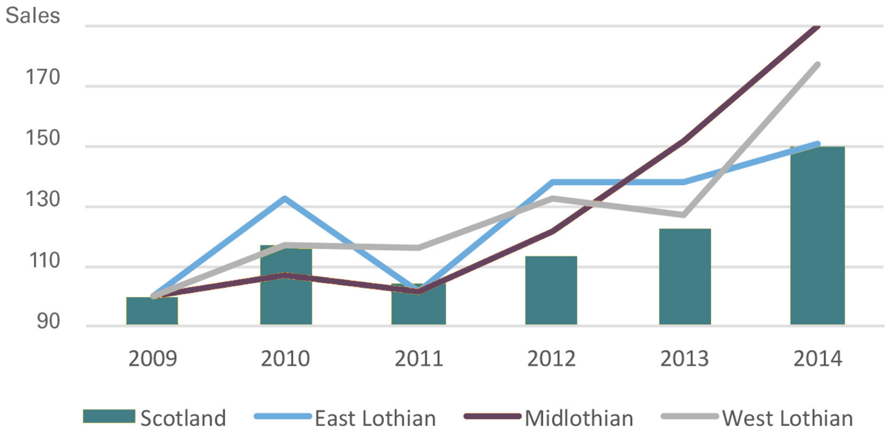
LBTT is likely to impair sales of homes selling for more than £300,000, but there will potentially be a churn of higher value properties in the run up to April 2015.

THE LOTHIANS

Recovery in the Lothians has proven to be more robust, with sales increasing at a greater pace than the national average. Transactions in East Lothian are up by 50% since the start of the recovery in 2009, which is largely in line with national trends. Sales in Midlothian have nearly doubled in the last five years, with around 450 transactions in Q3 2014. Transactions in West Lothian have increased by 40% over the past year and sales are 80% higher than at the start of the recovery in 2009. See Figure 8.

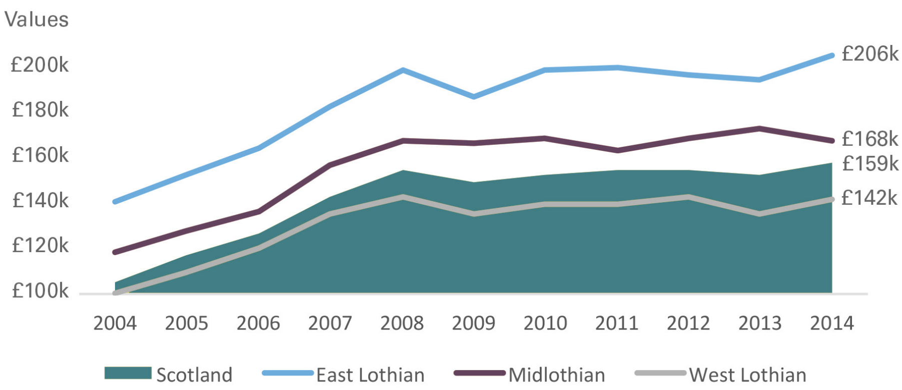
Average prices are higher than the national average in East Lothian and Midlothian. In East Lothian, prices are increasing at a rate of 6% per year with an average price of more than £223,000 in Q3 2014. Price increases in Midlothian have been largely flat coming out of the recession and have increased by 3% over the year to just under £178,000. Since the recession, average prices in West Lothian have been about £20,000

Figure 8 *Index of transactions in Scotland, East Lothian, Midlothian and West Lothian from 2009 to 2014 (2009 = 100)*



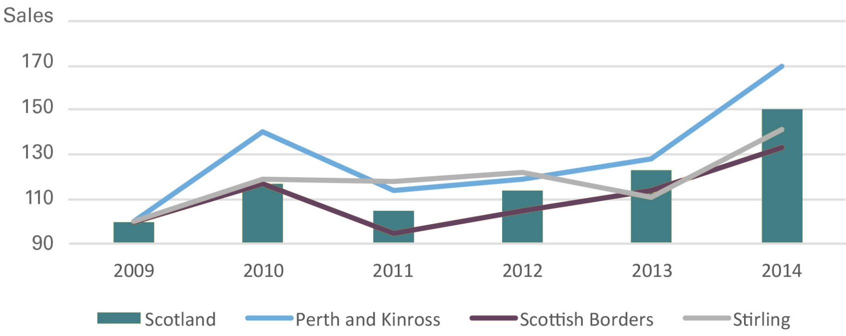
Source: Source: Registers of Scotland

Figure 9 *Average prices in Scotland, East Lothian, Midlothian and West Lothian from 2004 to 2014*



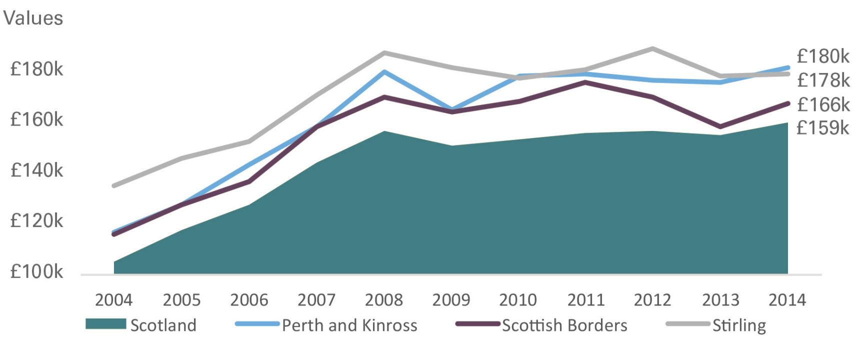
Source: Source: Registers of Scotland

Figure 10 *Index of transactions in Scotland, Perth & Kinross, Scottish Borders and Stirling from 2009 to 2014*



Source: Registers of Scotland

Figure 11 *Average prices in Scotland, Perth & Kinross, Scottish Borders and Stirling from 2004 to 2014*



Source: Registers of Scotland

less than the national average and have been flat since 2008, although in the past year prices appear to be increasing again (up 6%). See Figure 9.

CENTRAL SCOTLAND AND THE SCOTTISH BORDERS

The market in Central Scotland and the Scottish Borders is showing mixed results.

Sales are up by 17% in Perth & Kinross from the previous year and transactions have increased by 70% since the start of the recovery. This is compared to sales increasing by 50% for the whole of Scotland over the same time period. Sales in the Scottish Borders and Stirling have been slow to pick up since the start of the recovery compared to national trends, increasing by 30% and 40% respectively from lowest levels registered in 2009. See Figure 10.

Average prices in Perth & Kinross are about £20,000 higher than the national average and in the last four years have largely remained unchanged at around £190,000. Average prices in the Scottish Borders took a slight tumble in 2011, bringing prices closer to the national average by the end of 2013, where they have largely remained. In Stirling, prices have fluctuated in the years following the recession and, counter to national trends, had been declining over 2012-13, but have now recovered. Average prices here are about £30,000 more than the national average. See Figure 11.

"Like elsewhere in the country, the Independence Referendum has had a quieting effect in more rural markets in terms of sales volumes but has not negatively impacted on prices. Current property values today are largely unchanged from this time last year. The high end of the market in East Lothian seems to be an exception, with more properties valued at £1million or higher coming onto the market."

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THE NEW HOMES MARKET
GROWING AGAIN AT LAST

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The Scottish new build market appears to have hit its trough last year and, in 2014, is finally on the rise, with increases in both private and social sector starts. Aside from a slight resumption in new build starts in 2011-12, when councils started building more homes again, there has been a reversal of the downward trend in new build activity can be seen in 2013-14. See Figure 12.

This year also marks the first time since 2007-08 that new build starts outpace completions. Sustained recovery going forward seems promising as both starts and completions are up from the previous year by 16% and 5%, respectively.

However, even with this improvement, the new build rate in Scotland is well short of the ten-year average and only around 40% of the Scottish Government's target level. See Figure 12.

More than 1,500 new homes were started over the past year in Edinburgh, with 1,404 completed by Q2 2014. One in ten new builds across all sectors in Scotland were started and completed in the capital in 2013-14. A similar volume of new build activity has centred in Aberdeenshire, evidence of new supply persistently falling short of demand in Aberdeen City. A further 8% of starts and 7% of all completions in Scotland for 2013/14 were centred in Glasgow.

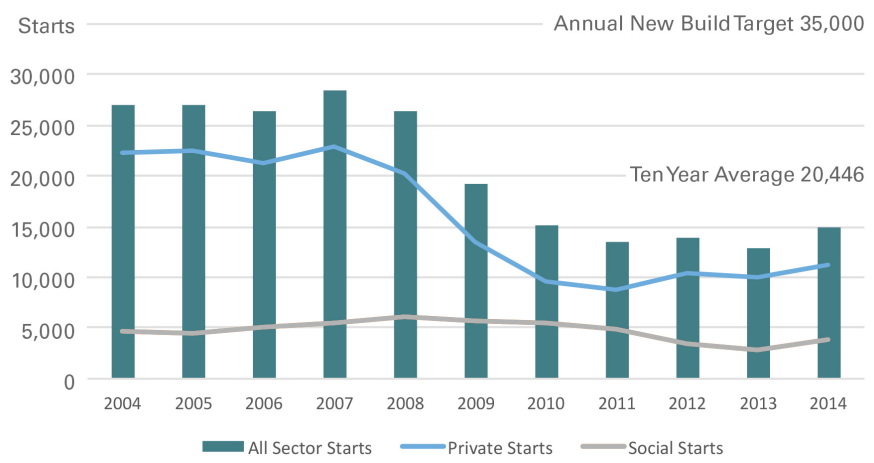
Outside of the Central Belt, few new homes are being built or coming on the market, particularly in the Scottish Borders and Dumfries & Galloway.

On average less than seven new homes are built per 1,000 households in Scotland. There is, however, variation across markets. When viewed in terms of population, the most new homes are being built in Angus, at 17.5 units per 1,000 households per year, with the fewest number in Dundee at just one home per 1,000 households. See Figure 13.

In line with the more promising outlook presented in official figures, our own more up-to-date data shows that the sales of new homes are continuing to perform well in key sites that we are selling. There remains a shortage of new home stock and this is likely to be the case for some time yet, as the new build market tends to lag trends in the wider economy. As a result, we anticipate this demand for new build outstripping supply over the next year at least, which will likely bring rises in new build prices.

Good quality stock in strong prime areas is still selling well, particularly developments in strong residential areas such as the Grange and Murrayfield in Edinburgh. Woodcroft, a development of 81 luxury properties in the Grange by

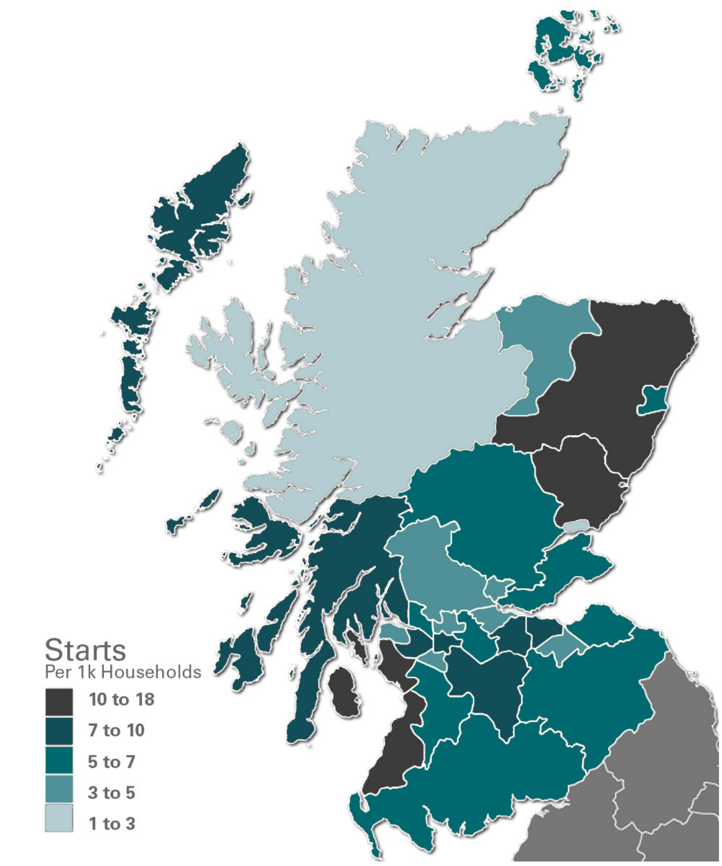
Figure 12 ***New build private and social sector starts, 2004-2014***



Source: Scottish Government

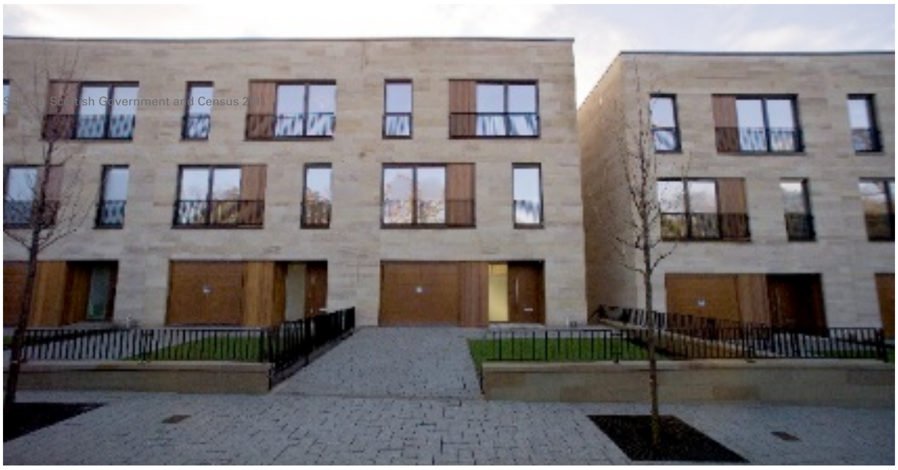
Woodcroft

Figure 13 *Map of all sector new build starts from 2012/13 to 2013/14*



Source: Scottish Government and Census 2011

Ellersly



Abbey Park

Queensberry and Telereal Trillium, has had strong uptake, with 10 released and 6 reserved in the first week.

Ellersly, a luxury 3.4 acre development in Murrayfield by Northern Trust and S1 Developments, has enjoyed a rate of sale of 2.5 per month, 2.5 per month and is now sold out. Abbey Park in St Andrews (Robertson Homes) has also sold well with 20% sold off plan entering Winter 2014.

"After the peak Summer season enquiry levels have increased although sales have slowed. Good quality stock in strong prime areas is still shifting, particularly developments in strong residential areas such as the Grange and Murrayfield in Edinburgh. People are committing to purchase in circumstances where they did not before and, on most of the major sites where we have been involved, we are seeing an increasing number of reservations and people purchasing off-plan."

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LAND, DEVELOPMENT & RESIDENTIAL INVESTMENT

IMPROVING BUT MANY CHALLENGES REMAIN

Will Scarlett
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The Land & Development market has improved post Referendum. Clients who had postponed investment pending constitutional uncertainties are now moving ahead - this is particularly true of larger mixed-use developments.

It is not all plain sailing from this point onward. There remains an air of caution from non-Scottish investors caused by the combined effect of LBTT and the prospect of Tenancy Reform. LBTT does not help land value on high value sites and the prospect of Tenancy Reform (see later section on Lettings) could have unintended consequences. However, there still appears to be a strong appetite from a number of funds for Private Rented Sector (PRS) opportunities in the major Scottish cities.

LAND MARKET

The market for Greenfield residential land among PLC house builders has, up to now, continued to firm up this year. Secondary sites on the edge of Edinburgh (just outside the bypass) have recently transacted at a headline price of around £800,000 to £900,000 per gross developable acre. This compares with the better Greenfield land sites inside the bypass, which have repeatedly transacted between £1 million and £1.5 million (headline price) over the last two years. This reflects not only house price growth and lack of supply, but also demand from certain house builders trying to break into the Edinburgh market. The tapering off of Help to Buy will have a dampening effect on demand for land, particularly at the entry level market, and we are now seeing indications that land values are perhaps levelling out.

Prime residential development sites in the best Edinburgh and Glasgow locations remain scarce and in strong demand. Land values of £3 million per acre are not uncommon and reflects the strength of the market. In November, Rettie & Co held a closing date for a prime residential site in Murrayfield, Edinburgh and received 14 offers.

Demand from the major house builders is creeping into secondary markets such as Fife, where land is now transacting at a headline price approaching £500,000 per gross developable acre. The market for significant land releases remains limited to a small number of density house builders. Competition will be limited in secondary areas.

RESIDENTIAL INVESTMENT

The PRS continues to be a hot talking point and a number of large schemes are now beginning to look more deliverable for PRS. In Edinburgh, these include Fountainbridge, New Waverley and Edinburgh St James. It has become clear that PRS works best in secondary locations where land and build costs are lower than primary locations but rents are similar.

Increasingly, we are witnessing a shift in the funding landscape in the Scottish residential market (as in the commercial market). International real estate fund managers and US private equity firms are emerging as the backers of a number of well-known Scottish 'propcos', as well as investing directly through their own UK vehicles. Those now backing developers active in the Scottish residential market, or active in their own right, include Moorfield, Patron, Oaktree, Proprium Capital, TIAA-CREF, Aberdeen Asset Management, Standard Life, and the Blackstone Group among others. These funds appear to have replaced traditional development funding from the main UK clearing banks.

It will take time for the PRS market to become commoditised in the same way that the student housing market has now become a regular and accepted means of institutional investment. However, this looks likely to happen given the demand and supply imbalances in the market and the opportunity for good and regular returns.

There remains a gap to be bridged between the funds and the development market. There is a role here for agents with the right skill set. Rettie & Co have put together a strong mixed discipline team to address this gap including financial modelling, asset management, land, development, investment, sales, research and affordable housing expertise.

"The post Referendum land & development market has returned strongly but with a hint of caution. Land values for standard housing surrounding economically active cities are strong, but land values in other areas are potentially showing signs of levelling off. The weight of money trying to get into the PRS significantly outweighs the number of opportunities available. Funds are perhaps frustrated by the lack of opportunity and the inability to find a mechanism to enter the market."

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STRUCTURED FINANCE
ALTERNATIVE FUNDING SOLUTIONS PROVING EFFECTIVE

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Rettie & Co's Structured Finance and Consultancy team have been focussed on the Affordable Housing sector over the last year, creating value added outcomes on behalf of a range of clients across Scotland, as well as delivering much needed housing across a range of tenures. For example, over the last three years, funding has now been lined up for 380 mid-rent units that are either completed or under construction, with a pipeline of over 700 units in advanced negotiations.

Figure 14 provides a summary of the number of approvals under the Scottish Governments Affordable Housing Supply Programme. To date, more than 7,000 units of affordable housing have been approved for 2014, of which 1,800 were for Mid Market Rent. This is the highest figure in four years.

There remain both challenges and considerable opportunities in the affordable sector and we continue to work with clients and public sector bodies, in particular covering Edinburgh, Fife, Highland, West of Scotland and Borders to deliver solutions. The demand for affordable housing opportunities has never been higher, particularly on the back of an economic recession and an increasingly limited supply of social housing.

Notable recent successes include completion of final contracts for 96 units on the Western Harbour. This has not only enabled new activity on one of Edinburgh's most significant masterplans, but is also delivering much needed affordable housing for the City. Using the National Housing Trust (NHT) initiative to provide the re-financing package, Hart Builders, with construction funding provided by Cruden and RBS, have now started on site on the £16.8 million project with completions expected over the course of 2016.

Rettie & Co. also acted on behalf of Places For People to acquire the prominent Shrubhill development site in Edinburgh, which could deliver up to 350 residential properties. We continue to work closely with Places For People on the delivery program.

The final handover also took place in August at the 145 apartment Salamandar Place development in Edinburgh. The properties were constructed to include a full underground car park and are now let at affordable rents. The same construction delivery team of Hart Builders, with funding by Cruden and RBS, completed the development on-time and within budget. The £21.7 million deal, arranged by Rettie & Co.'s Structured Finance Team, achieves some key features that could provide the basis for future affordable housing programmes. The long-term interest in the properties was pre-placed with an Institutional Investor, in this case Hillcrest Housing Association, to create a direct 'pass through' of the interest in land to an end investor. The deal creates an attractive medium-term yield to Hillcrest, allowing them to offer much needed affordable rental accommodation while avoiding construction risk.

This and similar structures offer an attractive template for future institutional investment in the Mid-Rent and PRS in Scotland and a potential way to address the critical issues around the aggregation of a number of sites to create a sufficient scale to offer efficient investment opportunities for pension funds and other long-term funding providers.

"Alternative Development Funding methods have been instrumental in delivering both private and affordable housing throughout the downturn. We anticipate continued demand for some of the methods and models designed and rolled-out, even in an improving market, as a method of maximising development return."

Nick Watson MRICS
Director, New Homes and Consultancy
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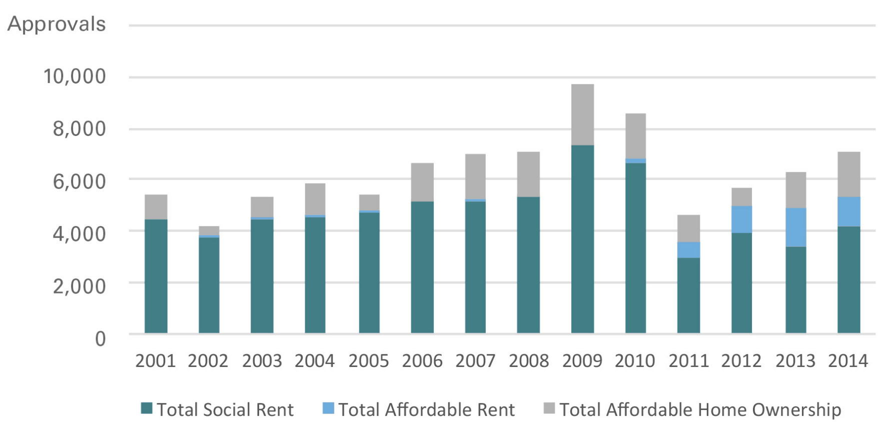
Figure 14 ***Approved affordable housing by tenure and year of approval***



Source: Scottish Government

LETTINGS
GOING STRONG IN ALL CONDITIONS

Stuart Montgomery
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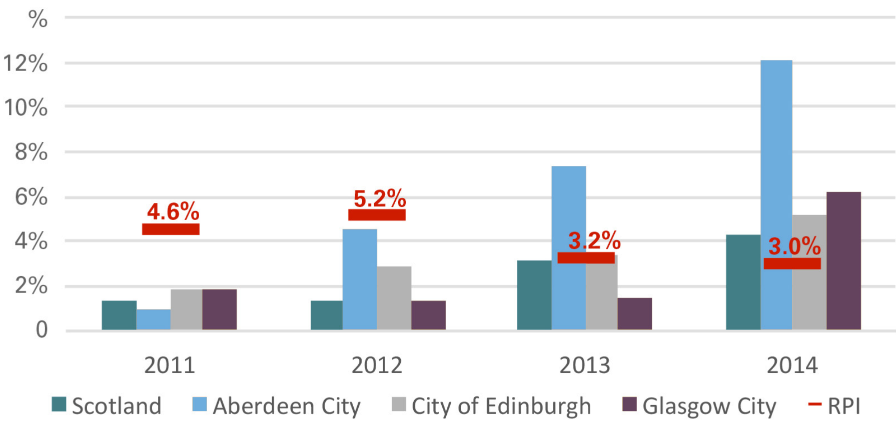
In the lettings sector, advertised rents are rising above inflation as demand continues to outstrip supply in Scotland's key rental sector.

However, Figure 15, below, shows that, for both 2011 and 2012, rent increases failed to keep up with inflation nationally and in the major cities. In 2013, only Aberdeen saw above inflation rent increases. Notably, advertised rents in Glasgow increased by more than 6% in 2014, after to failing to keep up with inflation levels in previous years. Advertised rents in Aberdeen increased by 12% from 2013 to 2014.

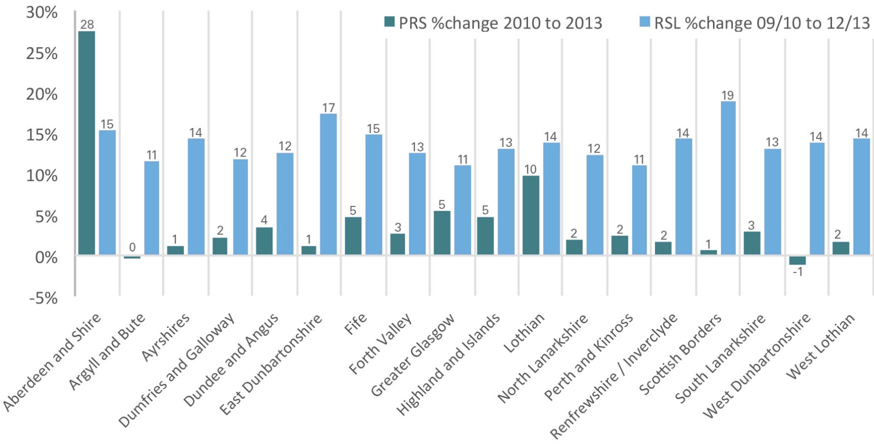
PRS rent increases should also be understood in the context of other forms of renting. Although rents in major markets have only recently rose above inflation, social rents have increased higher than inflation in many areas over the last four years and are well in excess of PRS rent rises in this time in all locations apart from Aberdeen City & Shire. This is demonstrated for 2-bed properties in Figure 16. The same is also true for 3-bed properties.

Figure 15 *Percent rent increase from the previous year compared to RPI for Scotland and major cities from 2011 to 2014 (Q2)*



Source: Rettie & Co analysis of data from Registers of Scotland and Citylets

Figure 16 *Rent increases by Broad Rental Market Areas by tenure for 2 bedroom properties between 2010 and 2013 (superscript 1)*



Source: Scottish Government and the Scottish Housing regulator

(superscript 1) Comparison is up to 2013 because RSL rents only available to this period

For the past three years, Time to Let (TtL) a property in Edinburgh and Aberdeen has been consistently below the national average, with properties in Aberdeen usually taking half the time, or less, to let than rentals elsewhere in the country. Up until the end of 2013, it had taken longer to let properties in Glasgow than the national average, but from the start of 2014 onwards, the time to let a property here has come down in Glasgow and is on par with rentals in Edinburgh. In the three major markets, it takes between 23 and 26 days to let a property and, on average, 29 days nationally in the third quarter of 2014. See Figure 17.

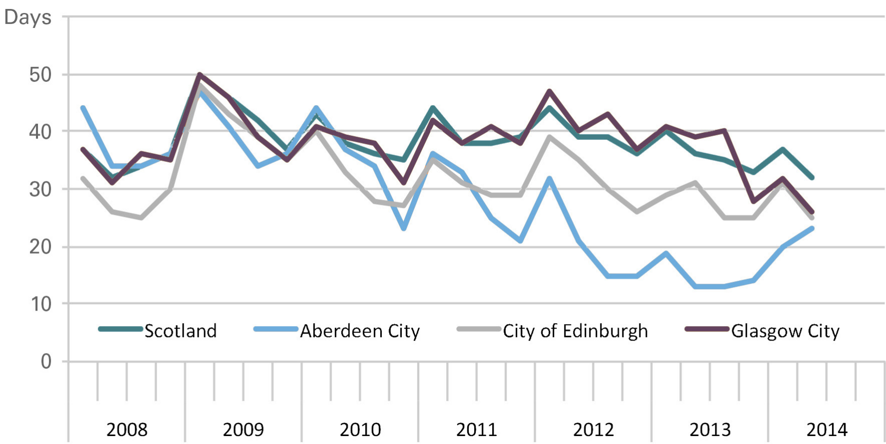
OUTLOOK

Despite political and economic uncertainty, demand for rental property has remained high throughout 2014 and shows no sign of easing up. Renting is flexible and the tenant's commitment can be as little as 6 months, therefore it has a clear attraction to those in an uncertain job market.

Such is the shortage of housing, the only market factor capable of seriously affecting the continued demand for rental property would be another strong housing boom, which seems unlikely.

However, another factor that could impact on the market is legislative change. The Scottish Government have produced a set of consultation proposals on a new tenancy in the PRS. Rettie & Co are supportive of much of what is suggested, e.g. on length of tenancy and notice to quit periods, but we have concerns about the removal of no-fault grounds for repossessions and we have particular concerns about any move towards rent controls. The latter is particularly likely to be highly damaging to the PRS and possibly kill off hopes for institutional investment into the PRS

Figure 17 *Average Time to Let a 2-bedroom property for Scotland and major cities from 2011 to 2014*



Source: Rettie & Co analysis of data from Registers of Scotland and Citylets

to create much needed new supply. As we highlight above, the PRS is not experiencing rapidly rising rent levels in the overall context and, in virtually all areas, rent rises and below those in the social rented sector.

Rents have continued to rise both following an annual review in a continuing lease, but more particularly at a higher rate when a tenant changes and there is an opportunity to readjust the rent on the open market. Occupancy levels are understandably crucial to landlords, meaning they are hesitant to be too aggressive with rent rises at the risk of losing a tenant. However, there has clearly been some adjustment upwards as a result of strong demand and relatively weak new supply over the last year or so.

"With in excess of £650m of assets now under management our lettings team have had a particularly busy 2014. We have refocused our team structure in Edinburgh in such a way that each landlord client is assigned to a dedicated Portfolio Manager who can develop an in-depth understanding of their clients assets. This represents a substantial change for the business and displays our commitment to delivering a service that goes beyond traditional property management.

With the uncertainty brought about by the Referendum now behind us confidence is returning to the buy to let sector, buoyed on by strengthening returns. While income yields are being driven by high demand in the face of constrained supply the market is subject to substantial local variations. It remains crucial therefore that investors take specialist advice and consider a blended yield of both income and capital appreciation when looking to invest in residential."

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FARMS & ESTATES
STRONG DEMAND BUT LITTLE TO BUY

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The offering of good quality farms for sale has remained limited in Scotland this year and the number of estates new to the market has been even more scarce.

ESTATES MARKET

The uncertainty created by the Referendum vote in September held back many estates from the market and the ongoing issue of future Land Reform remains a consideration for many estate owners.

Transactional volumes in the estate market in 2014 to date have been severely constrained. Very few new estates have been offered for sale in the open market and a number of estates have remained unsold, despite having first come to the market in 2013. Uncertainties created by the Referendum and the Land Reform Debate and the ongoing debate about the Absolute Right to Buy for 1991 Act tenants continues to impact upon confidence and, as with all forms of property, be it residential, commercial, agricultural or sporting, confidence is required for transactions to take place, market values to grow and investment to occur.

FARMLAND MARKET

In the farmland sector, it is still largely a tale of east versus west and livestock versus arable. Good quality arable land in the eastern counties of Scotland remains sought after. Complete arable farms with farmhouse, farm steading, cottages and the farmland, as originally constituted in the property title, are rarely marketed these days. Whenever this complete opportunity emerges in the eastern counties of Scotland, it attracts keen interest and, dependent on scale, can attract buyers from throughout the United Kingdom. Smaller arable offerings are typically reliant on neighbours within five miles or so. In our opinion, arable land values have largely stalled, with one or two exceptions, over the past 12 months and this could only be expected after several years of sustained capital growth. Dependent on location and soil type, values can range from circa £5,000 per acre upwards to typically £8,000 per acre. But better quality, flexible cropping lands suited to vegetables, potatoes and soft fruit, notably in Angus and some of the other eastern coastal counties, can fetch sale prices in the £12,000 to £15,000 per acre range. Demand from outwith the farming sector is largely driven by tax incentives and investors speculating on future development gains, which has returned following a long period of dormancy through the recession from the autumn of 2008 onwards.
House-builders are actively seeking land via promotional option agreements for residential development and their demand is augmented by further demand from property companies with established track records in gaining development consent.

To date, there have been 128 agricultural properties offered for sale on the open market in Scotland this year. Total acreage advertised for sale is about 29,250, with three hill units totalling 5,632 acres accounting for nearly 20% of the total landward offering. The three largest arable farm offerings, all over 600 acres, have been in the north-east of Scotland (Aberdeenshire) and, generally, there remains a strong weighting in favour of units in the western half of Scotland and stock farms rather than arable farms. As in recent years, a number of smaller blocks of arable accommodation land have been offered for sale. See Figure 18.

In recognition of ongoing demand from neighbours looking to expand, the private sales market has continued to be active, particularly for sales between parties known to each other.

"Closing dates for offers remain the norm for arable farms located in the eastern counties close to principal conurbations. However, there is thinner demand for stock/dairy units, particularly those located in the western half of Scotland. At the time of writing, there remains considerable uncertainty about the detail of the Common Agricultural Policy Reform and, with depressed product prices, the prospect for continued capital growth in farmland remains muted."

Chris Hall MRICS
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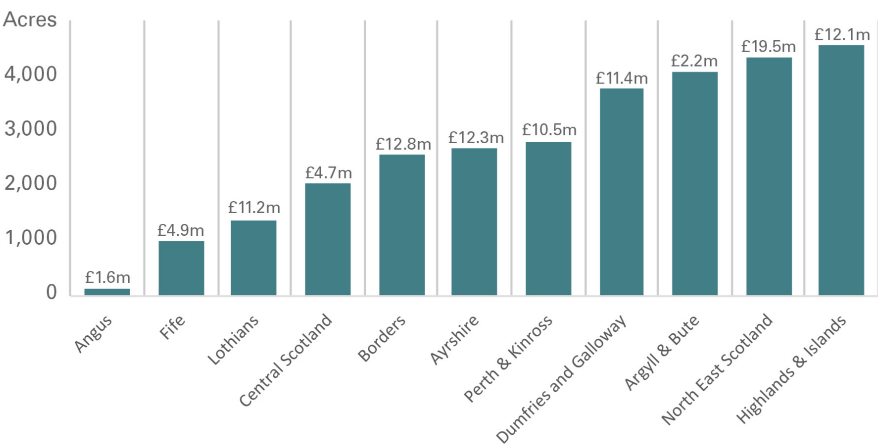
Figure 18 ***Farmland sold in 2014 by acres, location and total value of sales***



Source: Rettie & Co

ABOUT RETTIE & CO RESEARCH

This Market Quarterly has been prepared by our Research Team, the largest dedicated residential research team in Scotland. The Team can help you to understand and make the right decisions on what is happening and likely to happen in housing markets. We offer advice that is robust, objective and based on not just analysis of these markets, but through engagement with our other teams who work in these markets on a daily basis.

WE OFFER:

- Information and advice on national, regional and local housing markets including prices and sales by property types, and rent levels
- Analysis of key market drivers, including economic conditions, and demand and supply indicators
- Benchmarking (including by price, sales, rates, product mix, incentives and specifications) through our custom designed in-house Property Tracking System (PTS)
- Assessing current availability, take-up, occupancy, stock and pipeline developments
- Housing market forecasting on national, regional and local markets, including prices, sales, values, rents (housing and land) by property types and locations
- Forecasting key market drivers, including economic conditions, demography and other demand and supply indicators, and assessing the impacts of these
- Advising on future housing strategies and targets, based on our assessments of likely future market and economic conditions
- Inputting into new housing developments and masterplans, with advice on how these should be market led, as well as on product type, mix, pricing and phasing
- Devising affordable housing solutions for future UK housing provision - Our Resonance® model involves close private/public sector co-operation to advance the delivery of affordable housing through a flexible and relatively straightforward structure

As well as housing, we can also offer similar analysis and advice on other property types, including office, industrial and retail.

Combined, these services can provide you with a clear understanding of the housing market in which you are interested and the overarching economic situation to enable you to make robust, evidence-based decisions.

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