Think Tank

# A better future
## Edinburgh

September 2020

SHOOSMITHS
National expertise, local insight

**The real estate industry has a once in a lifetime opportunity to bring about real change. The Covid-19 pandemic has forced us into a new way of working and living that will change how we use our built environment forever. There is a growing realisation that we don't need to go back to the way we were – lengthy commutes, long working hours, less time with friends and family – so what does the future look like for our towns and cities?**

As part of our 'Future Cities' campaign, Shoosmiths is holding a series of virtual 'think tank' discussions with prominent local stakeholders in different locations across the UK to share insights and ideas around what the future holds for these locations. Here we discuss Edinburgh, and the view appears to be that the city continues to be a fantastic place to live and invest in with real optimism and positivity for the green agenda, despite ongoing challenges around affordability and infrastructure.

We set out below a summary of the discussion, which was chaired by the head of Shoosmiths' Edinburgh office and real estate partner, Janette Speed.

## Panelists

- Paul Lawrence – Executive Director for Place, City of Edinburgh Council
- Richard Lockhart – Associate Director, Scottish Futures Trust
- Stuart Heslop – Managing Director, Real Estate Finance, Scotland & North England and UK Housing Finance, The Royal Bank of Scotland plc
- Jonathan Guthrie – Director for Strategic Partnerships, Robertson Group
- Heather Kiteley – Group Chief Executive, Port of Leith Housing Association
- William Kyle – Fund Director, PfP Capital
- James Godfrey – Partner, Culverwell
- Dr John Boyle – Director, Research & Strategy, Rettie & Co

## What are the key strengths and industries that will enable Edinburgh to bounce back faster, better, stronger than before?

**Paul Lawrence** – We are delighted to see the ongoing confidence that investors have in the city. Despite everything that we have faced over the last few months, the investment market appears to have retained strong confidence in the city, whether that's through ongoing planning activity, resumption of construction or pipeline projects. In times of crisis, as in 2008, the places with the most challenges are those with margins that work in boom times but don't in more demanding times. What people want is a degree of 'safe haven' and I think there is strong evidence that Edinburgh provides that and is in a very good position.

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Before Covid, our problems were primarily twofold: one was supply and the other was affordability. Edinburgh has a great deal of demand but not a lot of supply, for both geographic reasons and demographic reasons. The question now is whether the previous problem of supply will become one of demand. The key thing we need in Edinburgh is a pipeline of economically-viable development sites across asset classes that have a strong relationship with company growth cycles, so enough affordable start-up space, enough affordable scale-up space and enough corporate space, so that the affordability cycle is in sync with company growth models. That's not worked in the city previously, particularly with scale-up space. We're lucky to have CodeBase, one of the largest technology incubators in the UK, and a fair amount of affordable work space, but scale-up space has been challenging and that has been impacted by alternative uses and short term lets. Getting that alignment between the city's property offer and the demands of a growing economy is extremely important, and now we need to build flexibility into that. And what was important before but even more important now, is placemaking. Edinburgh is lucky, we have a lot of world-class environments, but they are fragile and compromised, and where that needs to find expression is in reforms to the transport system and the city's road infrastructure. Driving forward world class placemaking is of critical importance.

**Heather Kiteley** – On affordable housing, it is clear that there will be huge demand created by our current situation, and we have all seen news reports over recent days about the number of people who are out of work having been previously employed back in March. And this is the unfortunate cycle which may reflect to some extent what happened in 2008, where housing associations saw demand for their services go up, as with demand for services around placemaking. However, the current downturn is unusual in that there is a change in the overall demand in terms of what people expect from Edinburgh, with perhaps a trend towards less travelling and more people working from home, as well as increased demand for green space. People who were before looking to live near where they work may now be looking elsewhere and out to the suburbs, and therefore the impact that will have on the price of land is something that the housing associations will be looking at as it may mean we can purchase more land and develop more housing. So, there is more to it than just a financial downturn, there is also the changing demands of residents living and working in Edinburgh.

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**William Kyle** – A study by Arcadis in 2018 put Edinburgh at the top of the UK cities as an inward investment destination. So, to begin with, it makes sense to look at where Edinburgh was perceived to fall short. Affordable housing provision is vital in that context, in order to attract employees. Investing in business start-up and incubation is also essential so that the great work being done in research is nurtured and benefits the city. The city already has Microsoft, Apple, IBM, Amazon and a strong contingent from the fintech sector, so already offers a variety of employment opportunities. Residential development (for sale and BTR) will also continue to thrive, so long as there is a huge imbalance between supply and demand, and developers will need to look at what impact Covid has had on peoples' expectations of their home layouts. Live/work units have been in and out of fashion for many years – their day may finally have come!

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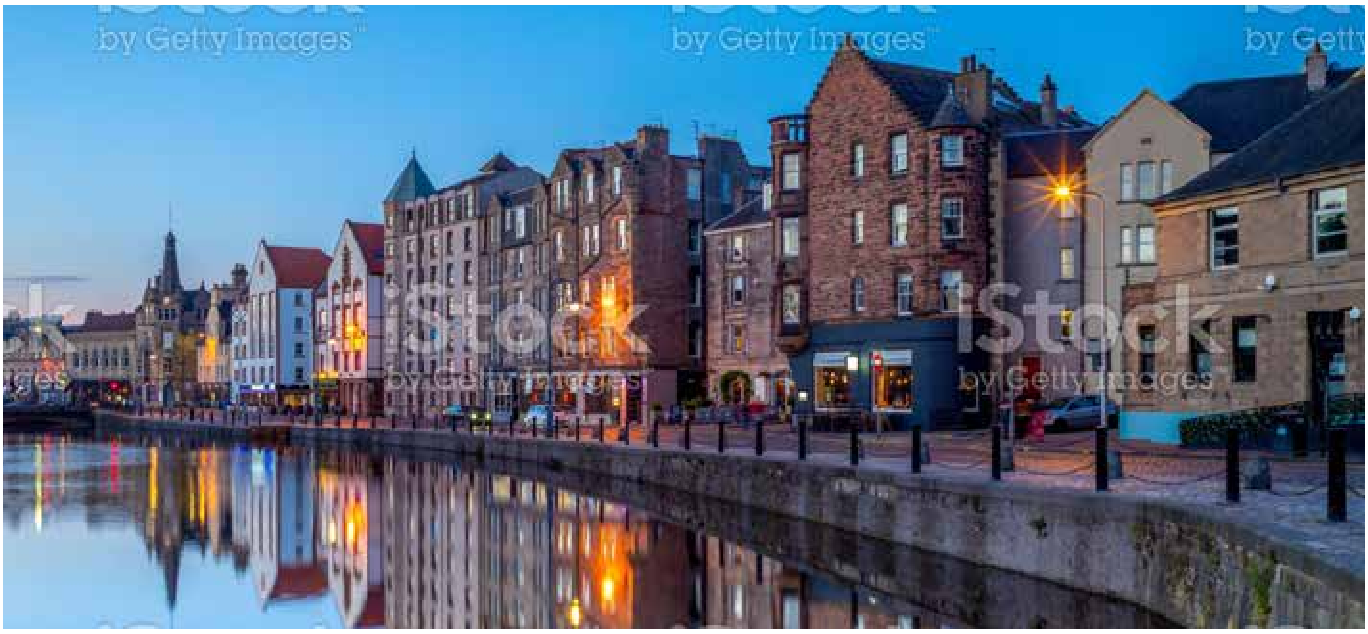
More broadly, Edinburgh's key strength is that it remains one of the most attractive places to live and work in the UK, which attracts both businesses and employees and ensures good graduate retention. It's a small city so easy to commute on foot or bike, has great open spaces and vibrant local areas such as Marchmont, Stockbridge and Leith. More localised economies have a big part to play and perhaps lockdown has helped us work that out.

**John Boyle** – One of Edinburgh's big assets is that it has a very strong mixed economy. The migration levels into the city before the Covid hit were pretty exceptional. The city has been experiencing significant population and household growth for the past fifteen years. The tech sector has emerged and is now strong in the city. The financial and business services sector has been there for several decades and is now employing more people than it did before the 2008 crash. Higher education is very strong, with three universities with international reputations. The city has a wow factor which is appealing to an international investor. That is something the city has been able to play on in terms of marketing itself over the years. Another big advantage is, because of the variety of jobs, it is able to retain its graduates. If you look at cities such as Newcastle, for example, they struggle to retain their graduates to the same extent. Edinburgh can retain its young people and grow and nurture them as they go through their careers. So Covid will have an impact but it is important not to overstate it. There will be a drift to home working, but people will still want to work in offices and gravitate towards city centres. And while there may be a move towards suburbanisation for a while, people will still want to live in flats, and flats in city centres will continue to be important for certain demographic groups. One of the mistakes the government made last time was that it slashed its infrastructure expenditure, and that was one of the prime reasons why we were still in recessionary conditions really until 2014. But we won't be doing that this time. We will continue to invest in infrastructure and that will accelerate the recovery far faster than the one we had after 2008.



**Stuart Heslop** – In terms of sentiment, we're seeing fairly muted appetite towards a number of asset classes: retail and leisure for obvious reasons are off the list for the time being with investors and lenders. With offices, people are pausing until we begin to understand what the long-term impact will be of home working. Student accommodation is another interesting one and I think you'll find that investors and lenders are cautious and will continue to be until we get through the September/October period and understand who has turned up and who is paying their rent. The fear is that those high-quality student accommodation platforms that attract overseas students may not be filled. That will take a bit of time to wash through but what is clear is that residential will probably lead us out of this crisis, and we saw this in 2008. We see really strong demand; house prices are remaining robust and that will continue. The danger is that at the end of the furlough period in the autumn, people will begin to lose their jobs, which may dampen demand and lead to a further correction in the market come the end of the year. However, the residential sector will likely be the first sector we lend into post-lockdown. With affordable housing, we've not paused at all and have been open all the way through the last few months, so that is a very defensive sector and we've got £12bn committed to it. There have been some operational difficulties with the sector but not major financial difficulties so far, and although there has been a drop-off in some rents being paid, we see that catching itself up over time. We're also seeing investors drawn to the sector and pricing has tightened in that space as a result. Generally, we see Edinburgh as a very investable market. We will see our support for those other sectors come back quite quickly, however residential will be the first, and Edinburgh is perfectly placed to benefit from that.

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## Edinburgh city centre was already experiencing a dramatic change, with many retailers abandoning the traditional retail pitches on Princes Street and George Street to take up space in the refurbished St James centre.  How does the pandemic affect this?

**Jonathan Guthrie** – In the past we may have looked at opportunities in Princes Street as being retail-led mixed-use regeneration projects, but they will no longer be retail-led because, with St James coming on stream and acknowledging the post-Covid impact, the emergence of retail in Princes Street is unlikely. Investors are looking at bringing back some of the long-held opportunities that we've all yearned after, such as residential above shops, but at a bigger scale than we would normally see in a town centre, as well as bringing in smaller footprint retail. That is exactly the type of thing we need, and certainly the support we've had from the planning department at Edinburgh Council has been fantastic to help us understand that there is an opportunity here to begin looking at post-retail led development in Princes Street. There will still be retail there but it may be a different format, and alongside there has to be a joined-up long-term approach so that the areas of the city are connected, and we can create opportunities that allow for long-term planning, long-term development and long-term growth. The council's priorities will be to keep an eye on the long-term opportunities and the increasing flexibility of planning. However, we do have to resist the temptation to panic and take the first thing that comes along, as has happened in other cities in which developments have been prioritised that have not been in the long-term interests of the city. But within the city of Edinburgh, there is that opportunity to flex some of the existing policy and planning restraints and start with something of really high quality, which will maintain Edinburgh's place as somewhere investors are attracted to.

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**James Godfrey** – Retailers and investors still want to focus on Edinburgh and still see it as a huge opportunity. Edinburgh's relatively small size and heritage is something that has really helped it through difficult times, unlike other cities that have been able to expand off the back of office or retail demand. Edinburgh, because of its limitations for development, hasn't been able to do that, so we're not now in a situation where we've got a plethora of vacant offices or retail stores for which we need to find occupiers. The city centre is actually very well let, although underlying that there are certainly cracks appearing which are symptomatic of the wider retail market. Turning to Princes Street, the stock there is just not fit for purpose to satisfy modern day retail requirements, both from a brand and configuration perspective, and with so many of the buildings being in fragmented ownership, that makes it extremely difficult to change through development. The council has worked hard to put together a framework to facilitate joined-up thinking between property owners, although unfortunately this can quite often be at odds with investors' own self-interests. This situation, together with changes in retail generally, will be compounded by Covid as it accelerates this change, meaning that we are going to see values fall in the short to medium term. That in itself is going to create opportunities which may help unlock some of these buildings on Princes Street and make development viable.

From a retailer perspective, the new Edinburgh St James will become the prime pitch in the city. It will be able to drive the highest footfall in the best environment and bring the best occupiers together under one roof. We have to embrace this as being extremely positive as it will attract new retailers to the city and allow existing retailers to right-size, which will help put Edinburgh on the retail map in a way that would be impossible if we just live with the current buildings on Princes Street and George Street. By leaving some of that space behind on Princes Street, there is a great opportunity to look at alternative uses and to develop the upper floors for uses such as offices, hotels or residential, and by putting the upper floors into use we are able to make the most of the fabulous views of the castle. On the ground floor there will still be retail demand as it is the place which tourists gravitate to, and where there is footfall, retailers will want to trade. I'm less sure we will see the much talked about café society develop in the short term, mainly because the rental and rateable values are too high presently. It may happen eventually, but it will take time especially when we've got so many other established leisure pitches in the city already. I believe the future for Edinburgh is extremely bright, certainly compared with other cities that have a massive over-supply of similar type retail. In Edinburgh, we are very fortunate to have different levels of retail, from discount to luxury, which makes Edinburgh stand out as a great destination for shoppers and visitors.

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**Paul Lawrence** – Tech disruption across all asset classes is a significant issue and we've seen some of that in the Covid period, but the changes we are seeing in retail and financial services, as well as the government investment in the Global Open Finance Centre of Excellence, for example, are all leading to new forms of service and business models. Another key challenge is the quality of place and its ability to create an experiential environment, which has a direct relationship with values and covenant strength. For example, street food start-ups would be perfect for Edinburgh, but that type of business isn't going to be able to pay the rents and overheads that a conventional food retailer is able to pay. So how can we accommodate alternative business models so that they are investable? The tech disruption we are seeing will encourage new business models to emerge, and supporting that as an ongoing investment will be a key challenge. If we can get all of that right, then we will be in a sweet spot.

## How will funders/investors look to support a green recovery and how will the affordable/private housing targets be met?

**William Kyle** - Part of the affordable housing target is intrinsically linked to the delivery of open market housing, and there are proposals to see the mix raised from 25% to 35% going forward. So, from the private housing side there is a question as to what that will do to the viability of open market developments. The argument from the industry is that it may actually reduce the amount of affordable housing availability as it means developments may slow down and be made unviable. I don't entirely buy that as I think we have to deliver our affordable housing in a number of ways, and there is absolutely a role for everyone to deliver more affordable housing, from the housing associations through to JVs and public/private partnerships. The lockdown has inevitably slowed down the development pipeline but, as we come out of lockdown, there is a desire to get on with things and get on with life. We've funded eight development sites that have all been paused, but our developers are keen to get moving. We need continuity of delivery and a supply chain that keeps rolling on because we can't step out of the market for twelve months and then come back in and get up to speed immediately. We all need to be delivering affordable housing in as many different ways as we possibly can.

In addition, pension funds have traditionally invested in Infrastructure because it provides access to low risk, stable, long-term income and I would argue that the provision of high-quality affordable housing veers into the territory of infrastructure as it is so crucial to the efficient functioning of our towns and cities. I think we will look for new ways for the public and private sectors to collaborate and this could involve JVs where land or debt is the input from a local authority, for example, and capital and development expertise comes from the private sector. From government, it could be debt and policy support.

**Richard Lockhart** – Green infrastructure is key to the recovery. In any new development or retrofit, the scale of ambition should look ahead to 2045, and it is great that Edinburgh is rising to the challenge and planning for 2030 in terms of net zero. In any public sector infrastructure going forward, it will be essential to factor in the net zero agenda, and make sure it is core to any public or private sector development. The government needs to continue to provide both the 'carrot and stick' as it is doing with the Energy Efficient Scotland Programme and related Routemap. As with that Programme, it is not simply about imposing demands (or regulation) on the private sector, it is about offering forms of support, pipeline of opportunity and scale to help assist the development of the sector. So, with affordable housing, for example, targets need to be ambitious, commercially viable and achievable for everyone; it's not just about putting pressure on developers and housing associations to meet energy targets. It needs to be made commercially attractive, sustainable and viable in the wider sense for the public, private and third sectors. The built estate should be considered as a key part of the energy grid; all buildings should be considered as 'energy assets', playing their part in meeting net zero carbon targets. It is important that both local and central government provide consistent regulation and approaches to the investment market so that there is the confidence to invest.

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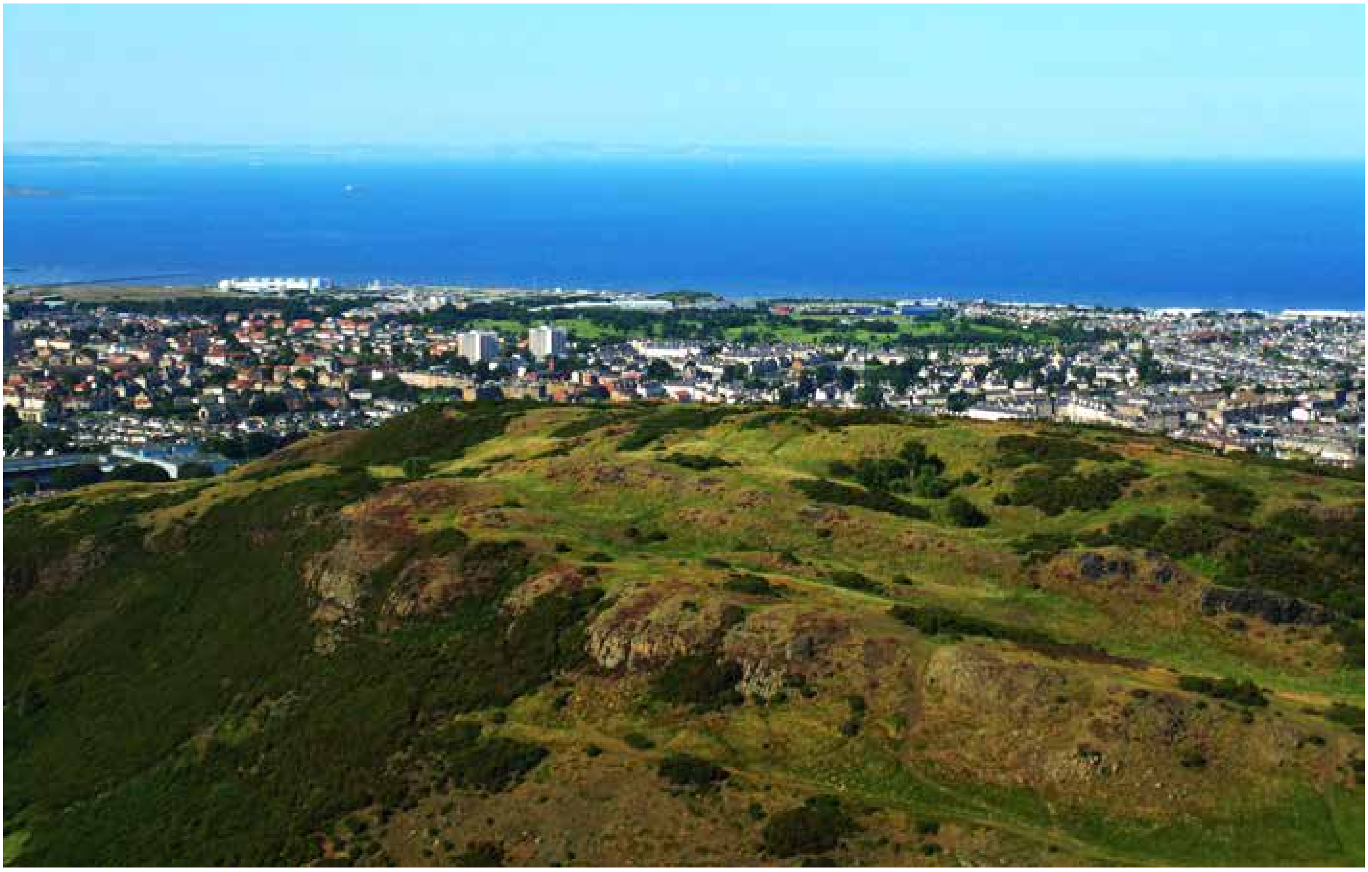
**Stuart Heslop** – We've completed a few ESG-linked loans whereby borrowers get a benefit in terms of the interest rate applied if they meet their own targets, which could be around job creation or improving the quality of the homes they are building or the homes they already have in their portfolio. These are specific targets that are set by the housing association themselves and, if they are met, we discount the loan on a retrospective basis in that year. That is going to become more commonplace as we go forward. What the last few months has highlighted is that a lot of people are living in unacceptable living conditions, and we work with housing associations across the UK to provide funding to create a future development pipeline of new stock, but as important is improving the quality of existing stock. This is from a green agenda point of view but also from a quality perspective. Quite often that means knocking houses down and funding a new development next door, and we are seeing a lot of that activity. But banks and investors are increasingly very interested in ESG-linked loans, and there is evidence suggesting that investor appetite for a green bond issued by a bank has a high uptake and that will make it cheaper for us to raise our own funding in the market based on these credentials. So it's a 'win win' for everybody: the lenders will pass on that benefit but they will also get that benefit in the market  Some day soon I imagine you will not see any form of lending or any public or private institutional lending happening without some link back to ESG.



**If you have any queries or would like to discuss any of the issues raised in this piece, please contact:**

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