

Aberdeen office market activity report

Spring 2008

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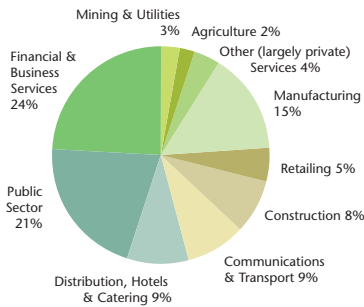
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Executive summary

- Economic output in Aberdeen is projected to increase by 2.0% in 2008, in line with the UK and driven principally by growth in the business services and banking & insurance sectors.
- High and rising oil prices have impacted positively on the Aberdeen office market, with increased take-up in 2007 and an unprecedented level of development activity underway.
- Prime office rents currently stand at £24.50 per sq ft, having increased by an impressive 14% during 2007, while quoting rents on new developments are as high as £28.00 per sq ft.
- With over one million sq ft in the pipeline and the completion of a number of Grade A speculative developments expected this year, the problem of lack of good quality supply is being addressed and should underpin rental growth.
- The strong occupational market, linked to the strength in the oil industry, has protected Aberdeen somewhat from the wider downturn in investment activity, with transactions reflecting covenant strength and long lease terms.

Figure 1
Aberdeen City & Shire Output
2007* (£m, 2003 prices)



Total output (GVA) 100%

Source: Experian Business Strategies

*Oil output is excluded from this analysis due to its overwhelming influence on the local economy.

Economic overview

Aberdeen is a key commercial centre in the UK, recognised as the capital of Europe's energy industry. The city is also a key regional centre for several global business service providers most notably within the professional and financial services sectors. The impact of rising oil prices continues to impact positively on the economy; however, oil output is excluded from Experian Business Strategies' official output figures due to its overwhelming influence on the local economy.

Economic growth in the Aberdeen City & Shire region in 2007 totalled 2.5%, slightly behind the national average of 3.1%. However, particular key sectors with relevance to Aberdeen's office market grew impressively, with Banking & Insurance output increasing by an impressive 10.0% and Business Services output increasing by 8.2%. Current forecasts indicate that total output growth for 2008 will be a robust 2.0% and more in line with projected UK growth of 2.2%. Business Services and Other (largely private) Services are projected to be the key growth sectors in the region during 2008, with growth of 5.5% and 5.3% respectively, with projected growth of 4.0% in the Banking & Insurance sector.

Office occupational market

The Aberdeen office market performed strongly throughout 2007, boosted by continued confidence in the energy sector and high and rising oil prices. Major office occupiers reflect the importance of the oil industry as a key driver in Aberdeen's economy and office market, with the city home to a large number of multinational oil companies and a number of professional services companies, many of which serve the industry, including Accenture and Ernst & Young.

Letting activity in central Aberdeen during 2007 amounted to circa 480,000 sq ft, significantly exceeding the 404,000 sq ft witnessed in 2006. In absolute terms, the impressive level of take-up in 2007 was dominated by two sizeable transactions, although the majority of transactions involved small units ranging from 500 sq ft to 2,000 sq ft. Demand for small units is healthy, evidenced by the development of Twin Spires and Crombie Mills by Business Homes.

The largest letting transaction of 2007 was Shell's acquisition of 118,998 sq ft at Seafeld House, Hill of Rubislaw, at a rent of £21.50 per sq ft while, early last year, VetcoGray acquired 92,600 sq ft of space at Silverburn House, Bridge of Don. A further major transaction, currently in the latter stages of negotiation, is the pre-let of Miller Cromdale's North Esplanade West development on the harbour fringe to energy services company Wood Group. The 150,000 sq ft building is scheduled for completion in 2009.

Table 1 – Key office transactions

Address	Tenant	Size (sq ft)	Rent (£ per sq ft)
Wood Group House, North Esplanade West	Under Offer to Wood Group	150,000	22.00
Seafeld House, Hill of Rubislaw	Shell	118,998	21.50
Silverburn House, Bridge of Don	VetcoGray	92,600	13.00
Southpoint House, Wellington Circle	TOTAL	14,583	All inclusive rent
Scott Sutherland House, 20 Waverley Place	Simmons International	14,230	24.50
Ocean Spirit House/Nautilus House, Waterloo Quay	Bibby Offshore Ltd	12,417	17.00

Source: Knight Frank LLP

"The City's office market performed strongly throughout 2007."



Miller Cromdale's proposed Wood Group House is expected to complete in 2009.

“In 2007, Aberdeen saw a higher increase in prime rents than any other key UK regional market.”



Seletar's proposed New Horizons House at Waterloo Quay.



Stockland Halladale Muir's Aberdeen Gateway, a proposed 153,000 sq ft headquarters building, recently obtained planning consent.



Phase 1 of Rockwater, Stoneywood Park, Dyce, to be developed by Rockwater Property Partnership, will provide in excess of 50,000 sq ft.

Despite the diminishing supply of North Sea oil, substantial increases in oil prices have resulted in renewed demand for office space from oil companies and supporting industries. Thus, following several years of limited new office supply, 2007 was characterised by an unprecedented level of development including, for the first time in many years, a number of speculative schemes. Several completions occurred in the latter half of 2007, although a greater number of developments are due for completion this year, comprising both pre-let and speculative schemes.

Key completions to have occurred include Miller Cromdale's 80,000 sq ft pre-let to Petrofac, to the south of the city, together with Knight Real Estate's Southpoint House, which was let to TOTAL prior to completion, and Wellington House, at Altens, which together provided around 35,000 sq ft of space. At Dyce, to the north of the city, Knight Real Estate also completed Pavilions 3,4, and 5 at Kirkhill Business Park, a speculative scheme of 39,000 sq ft. The city centre and traditional West End office market have also experienced continued activity, albeit on a smaller scale compared with out-of-town. County Properties recently refurbished Princewall House, Huntly Street while C&L Estates completed Scott Sutherland House, 20 Waverley Place, the latter of which set a new headline rent for the city.

Owing to the pattern of strong demand in an environment of limited Grade A supply, last year brought continued and strong rental growth in central Aberdeen. A new prime rent of £24.50 per sq ft was achieved in 2007, by Simmons International's acquisition of 14,230 sq ft at Scott Sutherland House. This new headline rent is a 14% increase on the £21.50 per sq ft achieved in 2006. According to ROMP – Knight Frank's Regional Office Market Presentation – Aberdeen's increase in prime rents in 2007 exceeded that of any other major regional centre. Furthermore, expectations are that headline rents in Aberdeen will rise again this year, supported by current quoting rents of between £27.00 per sq ft to £28.00 per sq ft for developments such as Esson Properties' 9 Queens Road and Carlton Rock's 28 Albyn Place.

There is no Grade A space currently available in central Aberdeen, although occupier demand for high quality office space remains strong, particularly around the city fringes in areas such as the harbour. For example, suites within the Exchange have been re-let without voids following the relocation of Petrofac to Consort House. Bibby Offshore has also relocated to Ocean Spirit House, Waterloo Quay, a building recently refurbished by Seletar Shipping. However, the availability of poorer quality space remains high, with a number of properties failing to meet modern standards of specification and car parking.

During 2007, there were relatively few office sales with vacant possession, the majority of which were below 10,000 sq. ft. However, the market remains extremely competitive in the sector with capital values in excess of £400 per sq ft being achieved, up from around £350 per sq ft in 2006.



Union Plaza, developed by Stewart Milne Group, will provide 125,000 sq ft of Grade A space in the city centre when it completes this summer.

Table 2 – City core development pipeline

Scheme	Size (sq ft)	Developer	Quoting rent (£)	Estimated completion date
Westpoint Business Park Arnhall, Westhill	Ph 1 67,500 Ph 2 77,500	Knight Real Estate	(Ph 1) £18.50	February 2008
Aspect 32 Arnhall Business Park	66,000	Edenroc	£17.50	March 2008
Craigshaw House Craigshaw Road	31,678	Morley FM	£20.00	March 2008
New Horizons House Waterloo Quay	54,810	Seletar Shipping	£22.00	May 2009
Abercrombie Court Arnhall Business Park, Westhill	175,000	Gladman Developments	£17.50	July 2008
Union Plaza Union Row	125,000	Stewart Milne Group Ltd	£23.50	Summer 2008
City Wharf Virginia Street	27,785	WG Mitchell	£21.00	Summer 2008
9 Queens Road	21,500	Esson Properties Limited	£28.00	Spring 2009
28 Albyn Place	10,500	Carlton Rock	£28.00	June 2009
Justice Mill Lane	118,000	Hazledene Group	£24.00	Summer 2009
Rockwater (Ph 1) Stoneywood Park	50,913	Rockwater Property Partnership	£20.00	Requires a pre-let
Aberdeen Gateway Business Park, Cove	153,000	Stockland Halladale Muir	£18.00	Requires a pre-let

Source: Knight Frank LLP

Knight Frank's view

- The lack of Grade A supply which has been a notable feature of Aberdeen's office market in recent years will be addressed by the completion of a significant amount of speculative space over the coming year.
- The realisation of schemes in the pipeline, particularly in the city centre, will help meet strong unsatisfied demand for quality space, helping to underpin rental growth which has been particularly strong in central Aberdeen over the last two years.

Within the city centre, two notable schemes are coming forward. One key scheme under construction is Stewart Milne Group's Union Plaza, a 125,000 sq ft seven storey office block. Completion is expected in the summer and, at the time of writing, four floors are already under offer. At Justice Mill Lane, Hazledene Group have consent for a 118,000 sq ft office block, due for completion in summer 2009. Nearby at the Harbour, 27,785 sq ft of office space is under construction at City Wharf, a mixed-use development recently acquired by W G Mitchell from Kenmore, while Seletar's 54,810 sq ft New Horizons House development at Waterloo Quay is expected to complete in May 2009.

Another sizeable transaction within the city centre is the refurbishment of Marischal College to comprise the new civic headquarters for Aberdeen City Council. This landmark 174,000 sq ft scheme, expected to come to fruition in two to three years, will comprise modern space arranged over four floors.

The majority of space in the pipeline is located out-of-town, with much development occurring at Arnhall Business Park, Westhill, six miles to the west of the city. Phase 2 of the development comprises new office headquarters for Central Insurance Services, ACERGY and Subsea 7 Ltd. In addition, 386,000 sq ft of speculative space is due for completion at Arnhall throughout the course of 2008. Knight Real Estate's Phase 1 of Westpoint Business Park, totalling 67,500 sq ft, is nearing completion while Edenroc's Aspect 32, totalling 66,000 sq ft, will complete in March. Gladman are also bringing forward Abercrombie Court here, a 175,000 sq ft development. Quoting rents at Arnhall are in the range of £17.50 per sq ft to £18.50 per sq ft.

Further development is underway to the south of the city. Morley are bringing forward Craigshaw House, a 31,678 sq ft block in West Tullos, with completion expected in March this year, while another key scheme in the pipeline is Stockland Halladale Muir's Aberdeen Gateway Business Park, where a 153,000 sq ft HQ building recently obtained planning consent. Elsewhere, at Dyce, to the north of the city, Phase 1 of Rockwater, Stoneywood Park, developed by Rockwater property Partnership, will provide in excess of 50,000 sq ft of Grade A space.

“The strengthening oil industry has lessened the impact on Aberdeen of the investment slowdown.”

Investment market

In line with many other markets, Aberdeen witnessed a surge of investment activity in late 2006 and the first half of 2007. The market then slowed during late 2007, as it did across the UK generally, following the impact on investment activity associated with the global squeeze in the credit markets. Compared with London and the South-East, however, its impact has arguably been less pronounced in Aberdeen, protected by positive developments in the oil industry which have helped fuel record levels of rental growth, a return to longer lease terms and fewer break options.

Table 3 – Key investment transactions

Property	Size (sq ft)	Price (£ millions)	Net initial yield (%)	Purchaser
Talisman House, 163 Holburn Street	96,000	£28.7	5.80%	Morley Pooled Pensions Ltd
St Magnus House, Guild Street	80,180	£23.7	5.76%	Warner Estates Holdings/ APIA Property Fund
Consort House, Stell Road	78,215	£23.4	5.30%	Ulster Estates
Grampian House, Union Row	45,333	£14.8	5.40%	Morley Fund Managers
Riverside House, Riverside Drive	52,691	£13.1	6.98%	Upland Developments
Enterprise Drive, Westhill	58,297	£11.5	6.00%	Park Lane Estates
Excel Centre, Exploration Drive	62,970	£11.4	6.95%	AWG/WG Mitchell
Union Buildings, Union Street	17,674	£2.5	6.15%	Sibir Energy plc

Source: Knight Frank LLP

Although the investment market has cooled, two of the best transactions occurred after the market downturn. In December last year, West Coast Estates purchased 6 Golden Square for £1.8m at a net initial yield of just 5.3% while, last September, Consort House was purchased by Ulster Estates for £23.4m, at an initial yield of circa 5.3%. These transactions reflect the higher demand and price purchasers are willing to pay for assets with longer lease terms and good covenants.

A number of other notable transactions occurred in the first half of last year reflecting net initial yields of between 5.4% and 5.8%. Warner Estates Holdings purchased St. Magnus House in Guild Street, a refurbished 1980s office building, for £23.7m reflecting a net initial yield of 5.76%. Morley also purchased two office buildings in Aberdeen last year, acquiring Grampian House on Union Row for £14.8m and Talisman House, Holburn Street for £28.7m, at net initial yields of 5.4% and 5.8% respectively.

In Aberdeen, the main impact of the squeeze in credit markets has been on properties which are either secondary in nature or possess shorter, unexpired terms, unless they exhibit a strong potential for re-letting or options for vacant possession. Indeed, the vacant possession market for prime stock in the West End has remained strong with developers and owner-occupiers bidding against each other. This situation has been inflamed by rapid rental growth over the last 12 months, and the shortage of both supply and development opportunities in the city centre.



St Magnus House, Guild Street, was purchased by Warner Estates Holdings for £23.7m, at an initial yield of 5.76%.

Knight Frank's view

- Assuming a relatively stable economy, our expectation is that the UK investment market as a whole will stabilise in the latter half of 2008 following a period of further yield correction.
- In such market conditions, factors such as lease terms and covenant strength are returning as key considerations in investment decisions. Thus the strength of Aberdeen's occupier market should continue to make it comparatively attractive to investors at a time when activity is stalling elsewhere.

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