



SPRING 2011 ABERDEEN

Office market activity report

Knight Frank

HIGHLIGHTS

- Aberdeen's office market has been buoyed by improving conditions in the local economy and rising oil prices. Total 2010 take-up of 348,400 sq ft was 33% above the 2009 level, with eight transactions in excess of 10,000 sq ft, double that of 2009.
- Reflecting an acute shortage of Grade A supply in the city centre, Aberdeen's prime headline office rent was re-confirmed at £30.00 per sq ft in 2010. The discount from headline to net effective rent also remains at just 5%, far below the level of any other key UK office market.
- Investment activity in 2010 improved substantially from the very low levels witnessed in 2009. Demand remained focused on prime assets, together with good quality, well-let properties and those offering asset management opportunities.

Economic overview

As the centre of Europe's oil and gas industry, Aberdeen is an important driver of the wider Scottish and UK economies. Aberdeen has also demonstrated marked resilience to the recession and continues to offer opportunities for future growth. During 2009, at the height of the recession, Aberdeen and Oxford were the only two UK cities with a positive rate of business churn, meaning more businesses were created than lost.

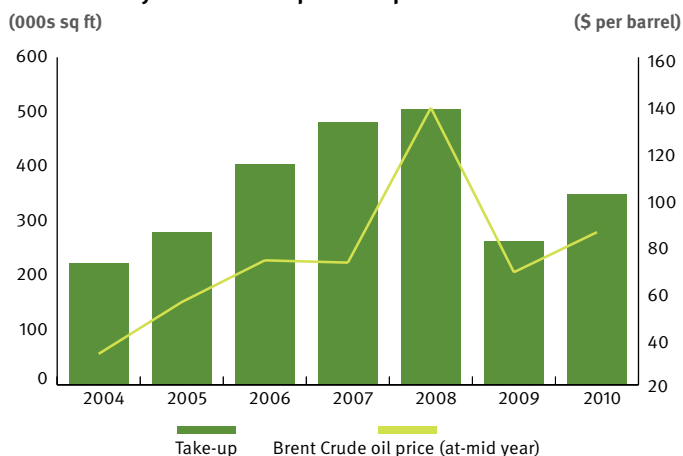
According to the recent 2011 Cities Outlook report, undertaken by the Centre for Cities, Aberdeen is set to be one of the most economically successful UK urban centres over the medium-term. With a low proportion of the city's workforce employed in the public sector, and among the lowest claimant count rates of any urban centre, Aberdeen is regarded as one of the most well-insulated cities from the economic impact of the spending squeeze (see Table 1). Nevertheless, oil prices have jumped sharply this year, which could leave Aberdeen exposed should prices suddenly reverse.

Table 1
Top five cities with high potential for growth
(Rank out of 64 UK cities)

City	Claimant count (Nov 10)	Employment rate (Jul 09-Jun 10)	Potential job losses in public sector by 2014/15	Residents with high level qualifications (2009)	Business stock per 10,000 population (2009)
Aberdeen	3	2	5	4	8
Bristol	13	11	24	14	15
Leeds	35	2	5	15	33
Milton Keynes	23	14	2	12	4
Reading	3	6	9	9	5

Source: Centre for Cities (Cities Outlook 2011)
The results show that Aberdeen is ranked in the top 10 cities for all five criteria, placing it top overall.

Figure 1
Aberdeen city centre take-up and oil prices



Source: Knight Frank Research / Thomson Reuters



In July 2010, Neptune Deeptech acquired 6,823 sq ft at 40 Queen's Road, at an agreed headline rent of £30.00 per sq ft.

Office occupational market

Following a subdued year in 2009, Aberdeen saw a notable improvement in office market activity in 2010. Rising oil prices helped to underpin this revival, providing a renewed confidence in the energy sector and associated services that are so vital to the Aberdeen market. Total office take-up in 2010 was 348,400 sq ft, 33% above the 2009 total and back into line with the medium-term annual average. 2010 also brought eight transactions in excess of 10,000 sq ft, double that seen in the previous year.

As Figure 1 demonstrates, office market activity in Aberdeen has been closely linked to oil price movements. From a low point of \$38 per barrel in late 2008, Brent Crude oil prices have climbed to well in excess of \$100 per barrel, with the price generally above \$70 per barrel throughout 2010. This positive economic backdrop led to a number of contracts and projects being re-activated, resulting in increased transactional activity.

Aberdeen's prime headline rent of £30.00 per sq ft was reconfirmed by C&L Properties' lease of 40 Queen's Road to Neptune Deeptech in July 2010. Aberdeen continues to command the highest prime headline office rent of the UK's 11 key regional markets outside the South East (Figure 2). Moreover, this headline rental level has stood unchanged since rising from £28.00 per sq ft in Q2 2008, which is remarkably resilient considering the rental falls seen in many of the UK's office markets during the recession.

Recent market activity indicates that headline rents have increased further in 2011, with strong demand and a lack of supply in the city centre, especially of large office floor plates, placing continued upward pressure on rental levels. At Hazeldene Estates' 125,000 sq ft IQ building in the city centre, Wood Group and Centrica have leased



66,584 sq ft and 58,339 sq ft respectively. It is understood Centrica have agreed to a headline rent of £31.00 per sq ft, setting a new record rent for Aberdeen and Scotland.

Levels of incentives also remain limited in comparison with the UK's other key regional office markets (Figure 3). The discount from headline to net effective rent, which takes into account the incentives offered by landlords to tenants, remained at only 5% (equivalent to six months rent free on a ten year lease) for a prime city centre building. This contrasts sharply with Scotland's two largest cities, where the differential in Edinburgh and Glasgow equates to 30% and 22% respectively.

Sales of offices for feuhold occupation were again limited in 2010 and mostly consigned to smaller properties of under £1.0m. However, Knight Property Group's purchase of 13 Queen's Road provided one notable exception and was the largest vacant possession sale of 2010. The developer bought the property for a price rumoured to be £3.5m, reflecting a capital value of £355 per sq ft.

Aberdeen's out of-town market saw reasonable levels of activity in 2010, with 141,000 sq ft of take-up, or 40% of the Aberdeen total. The largest transaction of 2010 took place at Westpoint Business Park in Westhill, where, in April, TAQA acquired pavilions 4 & 6 totalling 33,483 sq ft. Other notable transactions last year included Total's lease of 15,250 sq ft at Loirston House, Altens, and Superior Wild Well Control's lease of 15,957 sq ft at Aberdeen Business Park in Dyce.

By January 2011, just 38,500 sq ft of Grade A office space remained available in the city centre. With the current rate of take-up likely to continue, Grade A supply is expected to diminish steadily throughout 2011. That said, not all of the available Grade A buildings appear to be in favour with prospective occupiers. For example, Esson Properties' Deebridge House, located on the edge of the city core, remains unoccupied since its completion in 2008.

The recent completion of IQ and City Wharf has left Aberdeen city centre without a single speculative scheme under construction. The only city centre development underway is Aberdeen City Council's 180,000 sq ft pre-let redevelopment of Marischal College for its new headquarters. Out-of-town, Gladman has just speculatively completed six pavilions



RECENT MARKET ACTIVITY INDICATES THAT HEADLINE RENTS HAVE INCREASED FURTHER IN 2011.



Table 2

Key office transactions in 2010

Address	Tenant	Size (sq ft)	Rent (£ per sq ft)	Date
1st Fl. North and Gr. Fl. South Union Plaza, Union Row	Deloitte	12,471	£23.50	Mar 10
Seafield House, Hill of Rubislaw	Conoco Phillips	12,907	£22.50	Mar 10
Marathon House, Hill of Rubislaw	Conoco Phillips	22,163	£22.50	May 10
4th & 5th Floors City Wharf, Shiprow	Maersk	11,814	£21.50	Oct 10
4 & 6 Westpoint Business Park, Westhill	TAQA	33,483	£18.50	Apr 10
Loirston House, Wellington Road	Total	15,250	£18.00	Oct 10
Pavilion 2, Aberdeen Business Park, Dyce	Superior Wild Well Control Inc	15,957	£15.68	Feb 10
Peregrine Road, Westhill Business Park, Westhill	Expro North Sea Ltd	11,523	£14.83	Mar 10

Source: Knight Frank Research



Table 3

City core development pipeline

Scheme	Size (sq ft)	Developer	Estimated completion date
Marischal College	180,000	Aberdeen City Council	Summer 2011
Ardent House	173,460	Miller Cromdale	Planning consent pending / requires pre-let
Triple Kirks	95,000	Stewart Milne Developments	Planning consent pending
140 Causewayend	37,000	Private Client	Requires Pre-let
Pilgrim House	20,944	Miller Cromdale	Requires Pre-let
Crathie House	17,000	C&L Properties	Requires Pre-let
Grove Point	11,860	C&L Properties	Requires Pre-let

Source: Knight Frank Research

of its second phase at Abercrombie Court, Westhill, which comprises 52,600 sq ft in small units ranging from 1,000 sq ft to 5,000 sq ft.

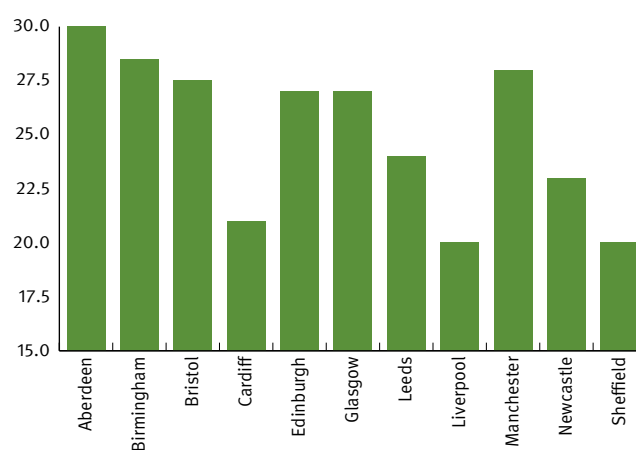
There is circa 1.2m sq ft of office space in the pipeline across the wider Aberdeen market. Approximately two thirds of this is now located to the south of the city, at Stewart Milne Developments' Axxess Business Park, Portlethen and Stockland Muir's Aberdeen Gateway, Cove. The latter has already established itself as a popular Business Park, with occupiers including NOV Reed Hycalog, Hyrdasun and the Driving Standards Agency choosing to locate there.

Despite evidence of strong demand and a number of unsatisfied requirements, the loan terms offered by banks remain unattractive, rendering further speculative development financially unviable at present. Consequently, the status of core city centre developments in the pipeline (Table 3) remain largely unchanged from that detailed in our 2010 report, with the most notable exception comprising Miller Cromdale's Ardent House.

Figure 2

Regional office prime headline rents

(£ per sq ft)

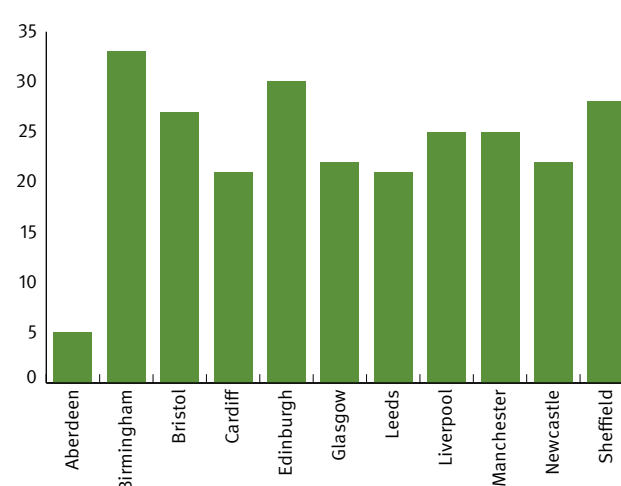


Source: Knight Frank Research

Figure 3

Regional office discounts to net effective rents

(%)



Source: Knight Frank Research

KNIGHT FRANK VIEW

- With oil prices well in excess of \$100 per barrel at the time of writing, activity is expected to remain healthy in 2011, backed-up by a number of active enquiries presently in the market. Take-up has already risen significantly in the first quarter of the year, following the conclusion of the IQ deals and a number of other properties.
- Prime headline rents have increased to a new record rent for Aberdeen and Scotland at £31.00 per sq ft. In addition, the differential between headline and net effective rents is expected to reduce even further, as the supply of Grade A office accommodation diminishes.
- Although prime headline rents are unlikely to rise again in 2011, the acute shortage of Grade A supply and an absence of new completions will lead to strong upward pressure being placed on good quality second-hand space.

Investment market

Investment turnover for Aberdeen offices improved substantially in 2010, with £95m of transactions following just £11m in 2009. However, the majority of the 2010 total was accounted for by four large lot-size sales, which together equated to 90% of the total turnover.

In keeping with the UK regions, investment demand remains selective. Apart from several forced sales of secondary assets, transactional activity continues to focus on the prime end of the market, together with well-let properties and those offering asset management opportunities. The scarcity of bank funding and low loan to value criteria has caused a flight to quality, in terms of covenant, location and lease terms, to the detriment of more secondary opportunities.

Last year's largest investment deal was Stewart Milne's £36.0m sale of Acergy's HQ, Westhill to PRUPIM's M&G portfolio, reflecting a net initial yield of 7.1%. The campus, consisting of offices, workshops and a leisure facility, is let on three separate leases to Acergy with an unexpired term of 19 years and geared uplifts at reviews. More recently in December 2010, Britannia A/S purchased Talisman House for £26.5m reflecting a net initial yield of 7.12%. The office is let to Talisman Energy (UK) on a 15 year FRI lease with fixed uplifts at review.

Although the larger lot sizes have made the headlines, the majority of investor activity remains at the smaller end of the market and is dominated by local private cash buyers. The market for lot-sizes under £1m was very active in 2010, demonstrated by a number of transactions at Gladman's Abercrombie Court scheme at Westhill. Here, six pavilions sold, with yields at or below 8.0% on circa five year terms. This compares favourably with 2009, with yields approximately 50-75 basis points lower, demonstrating improved investor confidence.

Despite the resilience of Aberdeen's occupational market, secondary office yields have moved upwards over the last 12 months. A significant pricing disparity has emerged between prime investments – sought after by large funds and institutional investors – and those investments that do not display all the necessary property fundamentals, but where opportunities may exist for value added asset management.

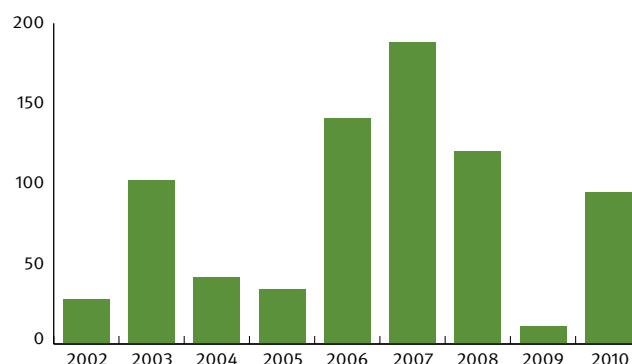
For example, in July 2010, Broadfold House was subject to a sale and leaseback by TWMA and sold to Ensco 325 for £3.22m, reflecting

an initial yield of 9.54%. Similarly, Silverburn House was sold to Highcross in October 2010 for £16.27m at an initial yield of 9.65%. The property was let to Vetco Gray with an unexpired term of 6.5 years. Despite not being classed as 'prime' assets, both properties did benefit from fixed uplifts at reviews.

KNIGHT FRANK VIEW

- An ongoing combination of strong demand for prime stock and a lack of buying opportunities will ensure that prime office yields remain stable over the coming year. In contrast, secondary assets on short leases may continue to drift outwards due to a lack of buyers outside the fund market.
- Although many funds may not have considered Aberdeen offices, the city's strong occupational market is expected to generate increased interest this year, particularly as pricing looks good value in comparison with other key UK regional office markets.
- With saving rates presently unattractive, the market for smaller lot sizes is expected to remain buoyant throughout 2011. However, in the absence of any short-term yield compression, landlords will continue to focus on long leases wherever possible.

Figure 4
Office investment transactions
(£m)



Source: Knight Frank Research/Property Data

Table 4

Key investment transactions in 2010

Property	Size (sq ft)	Price (£ millions)	Net initial yield (%)	Purchaser
Talisman House, 163 Holburn Street	95,956	26.50	7.12	Britannia B/S
Acergy HQ, Westhill	210,500 (116,000 offices)	36.00	7.10	Prupim
Silverburn House, Claymore Drive, Bridge of Don	145,340	16.27	9.65	Highcross
City Gate, Wellington Road, Altens	38,541	7.35	8.37	Marius Properties LLP
Broadfold House, Broadfold Road, Bridge of Don	29,117	3.22	9.54	Ensco 325
Braemar House, Union Street	20,218	2.75	8.09	Munro Tourist Agency

Source: Knight Frank Research

RESEARCH



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