RESEARCH

Knight Frank

SPRING 2013

ABERDEEN

Office market activity report

HIGHLIGHTS

- Significant investment in the North Sea oil and gas industry propelled Aberdeen's office market to another record year in 2012. The city saw total take-up of 883,000 sq ft last year, 14% above 2011's previous high.
- With space and development opportunities limited in the city core, out-of-town locations dominated 2012 activity, accounting for 76% of annual take-up.
- At £31.50 per sq ft, Aberdeen's office market commands the highest prime headline rent of any key market outside London and the South East.
- Office investment turnover reached £203m in 2012, more than double the level seen in each of the previous two years. Investors are attracted to the relative strength of Aberdeen's occupier demand, evidence of rising rental levels and the quality of covenants associated with the oil and gas industry.

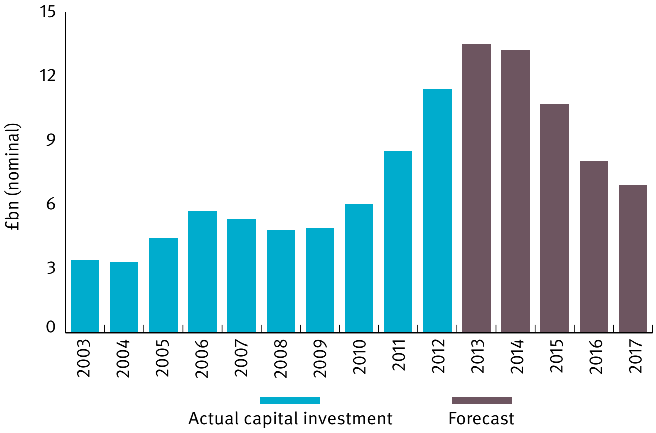
Economic overview

Aberdeen has been one of the UK's real economic success stories amid tough macro-economic conditions in recent years. According to the latest annual report from leading think tank Centre for Cities, Aberdeen's economy ranked as the best performing of 64 UK cities in the initial downturn of 2008-09, and subsequently ranked in the top five UK cities for performance over the 'recovery' period of between 2009 and 2012.

Unlike any other city in the UK, Aberdeen's economic performance depends heavily on the fortunes of the North Sea oil and gas industry. While falling oil production has impacted on UK economic growth over the past two years, sustained high oil prices and Government tax relief measures have spurred massive capital investment to support future extraction, stimulating economic activity in the city. Major commitments include the £4.5bn Claire Ridge project to the West of Shetland and Statoil's £6bn commitment in the Mariner and Bressay fields.

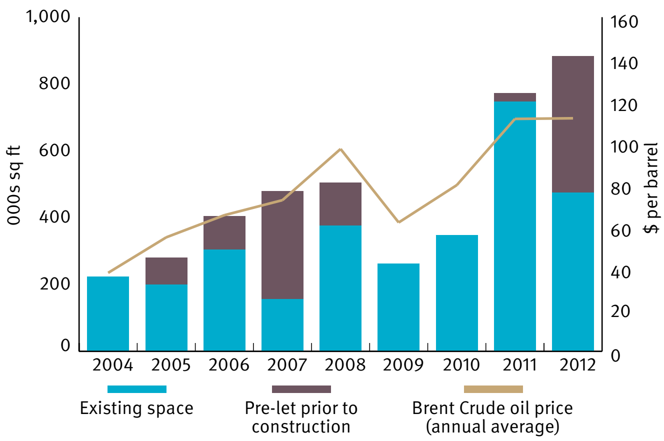
Key infrastructure projects will also enhance Aberdeen's long term inward investment and growth prospects. Capacity at Aberdeen International Airport has been increased with a £124m extension of its runway, while the Aberdeen Western Peripheral Route (AWPR) will now go ahead following a judgement by the UK Supreme Court, with completion currently scheduled in 2018.

Figure 1
Capital investment in the North Sea oil and gas industry



Source: Oil & Gas UK

Figure 2
Aberdeen office take-up and oil prices



Source: Knight Frank Research / Thomson Reuters

In May 2012, Bibby Offshore pre-let 53,427 sq ft at Pavillion 1, Prospect Park, Westhill. Knight Frank acted for Bibby Offshore and completion is scheduled for April 2013.

Occupier market

Significant investment in the North Sea oil and gas industry propelled Aberdeen's office market to another record year in 2012. The city saw total take-up of 883,000 sq ft last year, 14% above 2011's previous high and almost double the 10-year annual average.

Aberdeen's performance is striking when viewed in context with the UK's other key markets, almost all of which saw 2012 take-up lag their 10-year average. This clear divergence of fortunes reflects the uniqueness of the energy sector to Aberdeen's market, which directly accounted for three quarters of all space transacted in 2012.

Pre-let agreements have become a prominent feature of the market, reflecting strong demand and a shortage of suitable supply. 2012 saw eight pre-let deals which together accounted for 50% of annual take-up. Headline deals included Nexen, Apache and Transocean committing to Phase 1 of Prime Four, Kingswells, totalling 300,000 sq ft, and Bibby Offshore's pre-let of 54,000 sq ft at Prospect Park, Westhill.

Availability across the city is restricted and equates to a vacancy rate of 4.5%, significantly below the majority of UK office markets. Moreover, less than 15,000 sq ft is Grade A quality, with much of the remainder deemed unsuitable by current occupiers. Indeed, corporate occupiers in the city are increasingly using the quality of their accommodation to attract a limited pool of highly skilled professionals in the energy sector.

There is an acute shortage of supply in the city core, with the only Grade A space available confined to 9,400 sq ft at Dee Bridge House, Leggart Terrace. The lack of choice and limited development opportunities in the city core partly explain the recent dominance in out-of-town activity, which accounted for 76% of 2012 take-up, with many of 2012's headline deals involving an outward relocation from the city core.

For the last four years, Aberdeen has commanded the highest prime headline rent of any key markets outside London and the South East. Headline rents currently stand at £31.50 per sq ft although, aside from several small deals in Aberdeen's West End, the lack of prime space in the city centre resulted in no significant transactional evidence at this level over the past 12 months.

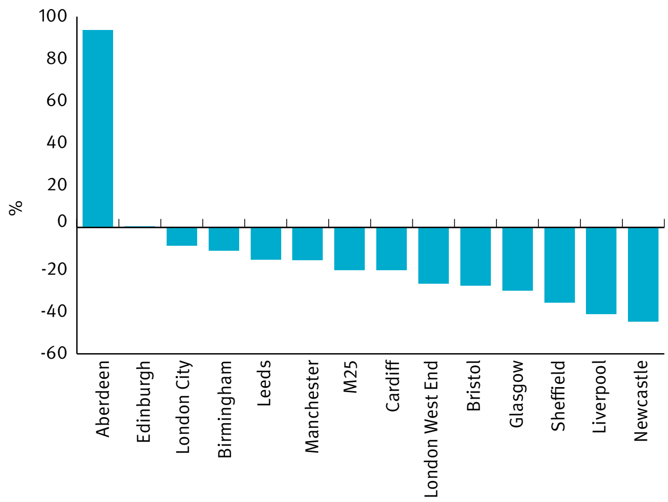
The Aberdeen market is also unique in terms of the limited incentives on offer. While occupiers in the UK's other regional markets can typically expect a two to three year rent free period for a ten year lease, in Aberdeen, occupiers currently receive a maximum of three months' rent free for good quality space, down from an average of six months' rent free a year ago.

The current strength of demand has also brought about a rapid erosion in the rental differential between the city core and out-of-town locations along the 'Western Corridor'. By way of example, at the North Dee Business Quarter, GDF Suez's 40,375 sq ft pre-let from Miller Cromdale was agreed at £29.50 per sq ft and set a new rental high for the area. More recently in 2013, Premier Oil's 62,000 sq ft lease at Phase 2 Prime Four was agreed at £27.75 per sq ft, a dramatic rise on levels seen last year.

SIGNIFICANT INVESTMENT IN THE NORTH SEA OIL AND GAS INDUSTRY PROPELLED ABERDEEN'S OFFICE MARKET TO ANOTHER RECORD YEAR IN 2012.

Figure 3

2012 office take-up vs 10-year average



Source: Knight Frank Research

In May 2012, GDF Suez pre-let 40,375 sq ft at North Esplanade West. The agreed rent of £29.50 per sq ft is a new high for the North Dee Business Quarter.

Table 2

Key office transactions in 2012

Address	Tenant	Size (sq ft)	Rent (£ per sq ft)	Date
Abercrombie Court, Arnhall Business Park	Fairfield Energy	25,504	£17.50	Jan 12
Quattro House, Wellington Circle, Altens	Petrofac	44,425	£21.50	Apr 12
Plot 1, Prime Four, Kingswells	Nexen Petroleum UK Ltd	100,000	£23.25	May 12
Plot 2, Prime Four, Kingswells	Apache North Sea Ltd	100,000	£23.00	May 12
Plots 3/4, Prime Four, Kingswells	Transocean Drilling UK Ltd	96,795	£21.77 (office element)	May 12
Pavilion 1, Prospect Park, Westhill	Bibby Offshore Ltd	53,427	£20.00	May 12
GDF Suez House, North Esplanade West	GDF Suez E & P UK Ltd	40,375	£29.50	May 12
Pavilion 2, Prospect Park, Westhill	Bluesky	18,785	£21.50	Jul 12
Pavilion 3, Westpoint Business Park, Westhill	AMEC Plc	12,573	£22.50	Nov 12
Pavilion 3, Prospect Park, Westhill	Teekay Petrojarl	18,785	£22.85	Dec 12

Source: Knight Frank Research

Table 3
Selected schemes in the pipeline (March 2013)

Scheme	Size (sq ft)	Owner/Developer
D2 Business Park	800,000+	Miller Developments
Aberdeen Energy & Innovation Parks	700,000+	Buccleuch Property / Scottish Enterprise
Axcess, Portlethen	750,000	Stewart Milne Developments
Aberdeen International Business Park	400,000	Abstract Group
St Nicholas House, Broad Street	350,000	Aberdeen City Council (For Sale)
Phase 2, PrimeFour, Kingswells	c.300,000	Drum Property Group
Ardent House, North Esplanade West	173,460	Miller Cromdale
RGU Schoolhill Campus, St Andrew Street	150,000	Robert Gordon University
Aberdeen Gateway Business Park, Cove	150,000	StocklandMuir
Former Seafood Park Site, Poynernook Road	120,000	Jacaranda Holdings Ltd (Under Offer)
The Pinnacle, Shiprow	100,000	Ardent Group
City View Business Park, Wellington Road	94,500	Knight Property Group
Triple Kirks, Schoolhill	72,600	Stewart Milne Developments
Silver Fin, Justice Mill Lane	70,000	Titan Investors

Source: Knight Frank Research

Despite the constraints on development finance, Aberdeen is one of the few UK markets to have seen concerted speculative development since the downturn, with 92,000 sq ft delivered in 2012 and 70,000 sq ft presently under construction. Knight Property Group and Gladman have been the most active developers, with newly completed schemes at Prospect Park and Westpoint Park letting-up aggressively on completion, while City View, Wellington Road is understood to be attracting strong interest.

Aberdeen has a considerable 3.2m sq ft of consented office space in the pipeline. While much of the new development will continue to come via pre-lets, additional schemes are expected to progress in 2013, with prominent schemes in Dyce comprising Miller Developments' D2 Business Park and Abstract's Aberdeen International Business Park, Dyce. Development opportunities are far more restricted in the city centre, with possible schemes in the pipeline first requiring development funding or a pre-let.

The Hub, Aberdeen Energy Park comprises 15,000 sq ft of flexible office accommodation and completed in 2012. Its developer, Buccleuch Properties/SE, has instructed Knight Frank as the joint letting agent.

FOR THE LAST FOUR YEARS, ABERDEEN HAS COMMANDED THE HIGHEST PRIME HEADLINE RENT OF ANY KEY MARKET OUTSIDE LONDON AND THE SOUTH EAST.

KNIGHT FRANK VIEW

- While take-up in 2013 is not expected to surpass 2012's record total, the expansion of investment in the North Sea oil and gas industry points to another exceptional year for the market. Active demand remains strong, with a range of prominent requirements including Wood Group, Senergy, AMEC and Statoil.
- With Grade A supply constrained, much of this demand will continue to manifest itself via new build pre-let arrangements. Demand will also remain focused in the key out-of-town locations, where there is greater development opportunity.
- Headline rents are expected to remain under upward pressure throughout 2013. However, any further increase in city core prime headline rents beyond £31.50 per sq ft will be contingent on new supply coming forward via a pre-let arrangement.
- The longer term prospects for the office market have been enhanced by announcements on key infrastructure improvements, particularly AWPR. This new link-road will boost accessibility to Aberdeen's most prominent out of town locations and boost the prospects of major new developments in the pipeline.

Investment market

Aberdeen has emerged as one of the few bright spots of investment demand across the UK's office markets beyond Central London. The number and type of investors looking at the city has increased, attracted to the relative strength of occupier demand, clear evidence of rising rental levels and the quality of covenants associated with the oil and gas industry.

Investment in Aberdeen's offices reached £203m in 2012, more than double the level seen in each of the previous two years. The result is impressive when placed into context with the subdued picture for Scotland as a whole. In 2012, Aberdeen accounted for 45% of investment in Scottish offices, set against a ten-year average of 17%.

However, two deals accounted for over two thirds of 2012 volumes. The largest by far was F&C REIT's purchase of Phase One, Prime Four, Kingswells for £94.0m from developer Drum Property Group, with the deal signed following confirmation of the three pre-let agreements by Nexen, Apache and Transocean.

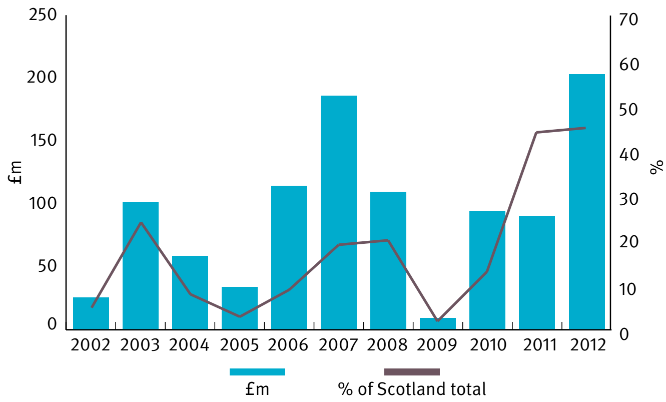
The other major deal saw Middle Eastern investor Gatehouse Bank debut in the city with their £59.9m purchase of Bridge View & Consort House at North Esplanade West. The deal reflects the widening of interest from a range of investors than in previous years, with the traditional UK Funds competing with new overseas investors for assets offering long-term income.

Prime yields for Aberdeen offices stand at c.6.50%, which is perceived to offer relatively good value given the more challenging occupier market conditions evident in the UK's other key regional markets. However, due to the limited availability of prime stock in the city centre, there was no transactional evidence to confirm pricing at this level in 2012.

However, that said, the prices paid in 2012 indicate that yields are hardening elsewhere beyond the city core, reflecting Aberdeen's positive occupier story and investor demand for long income assets. For example, Ignis' £13m purchase of Technip's 58,000 sq ft HQ in Westhill at 7.25% and the 6.83% yield paid for Phase One, Prime Four, Kingswells illustrates the sharp improvement in sentiment towards out-of-town assets.

Despite the strong occupier market, investors continue to exercise caution towards secondary assets and are much more sensitive on pricing. However, when priced correctly, sales are taking place - Ediston purchased Caledonian House, Union Street reflecting a net initial yield of 9.10%, with several other secondary assets under offer at the time of writing.

Figure 4
Office investment transactions



Source: Knight Frank Research/Property Data

KNIGHT FRANK VIEW

- As long as buying opportunities are made available, Aberdeen is expected to remain a key hotspot of investment demand in 2013. Pre-let developments and new-build sale and leasebacks will be particularly sought-after, both in the city centre and out-of-town, with investors buying long income streams backed by strong covenants from the energy sector.
- In contrast with the dynamics of other key regional markets, another important draw to Aberdeen's office market is the prospect of further rental growth for both prime and secondary assets. Buoyed by the strength of the occupier market, investors are expected to increasingly venture further up the risk curve, with a view to exploiting the potential for reversionary rental uplift.

Table 4
Key investment transactions in 2012

Property	Size (sq ft)	Price (£ millions)	Net initial yield (%)	Purchaser
Prime Four, Kingswells	299,749	£94.00	6.83%	F&C REIT
Bridge View/Consort House, North Esplanade West	159,170	£59.90	7.15%	Gatehouse Bank
St Magnus House, Guild Street	80,180	£18.30	8.66%	British Airways Pension Fund
Duncan House, Enterprise Drive, Westhill	58,322	£13.00	7.27%	Ignis Asset Management
Quattro House, Wellington Circle, Altens	44,997	£11.65	7.99%	Lumina Real Estate
Caledonian House, 232-234 Union Street	48,535	£7.75	9.10%	Ediston

Source: Knight Frank Research

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