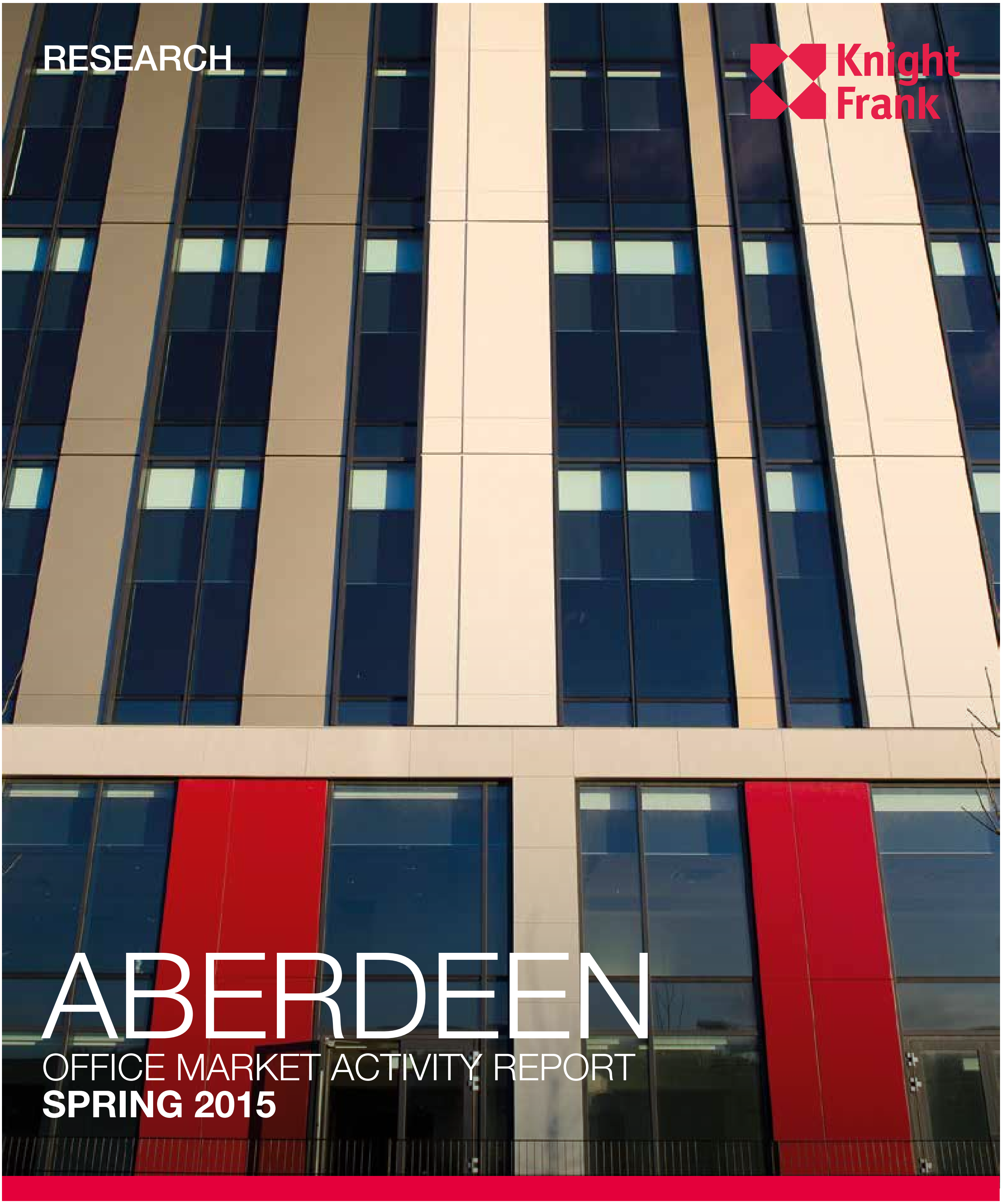


RESEARCH

ABERDEEN

OFFICE MARKET ACTIVITY REPORT

SPRING 2015

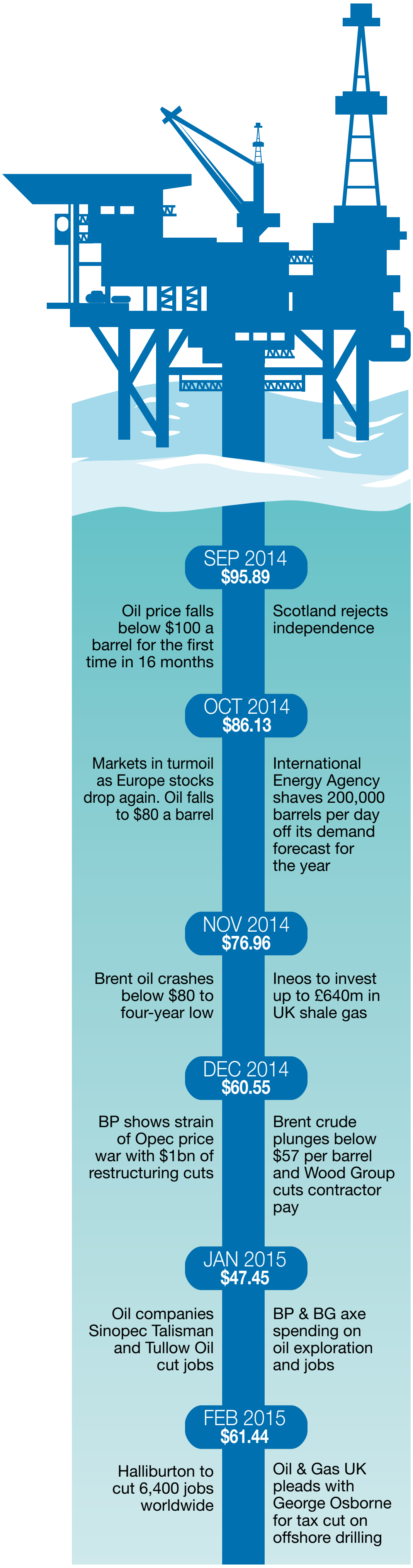
HIGHLIGHTS IN 2014

Aberdeen recorded the highest annual take-up ever, surpassing 1 million sq ft

Norwegian oil services firm AKER Solutions ASA signed Scotland's largest ever leasing deal

Investment transaction volumes reached a record breaking £641m

A new prime headline rent was achieved at £32.00 per sq ft



Source: Knight Frank Research

ECONOMIC OVERVIEW

Aberdeen is the centre of the UK's offshore energy industry, and supply and demand for energy shape its economic outlook.

OPEC's decision to allow oil prices to fall last year was prompted by concerns over a global oversupply. The latest Baker Hughes survey reported that the number of oil rigs operating worldwide has dropped by 10% in the three months to January 2015. This has encouraged some commentators to predict that prices are now past the low point; such as Standard Chartered Bank forecasting Brent Crude to reach $76 a barrel by the end of the year.

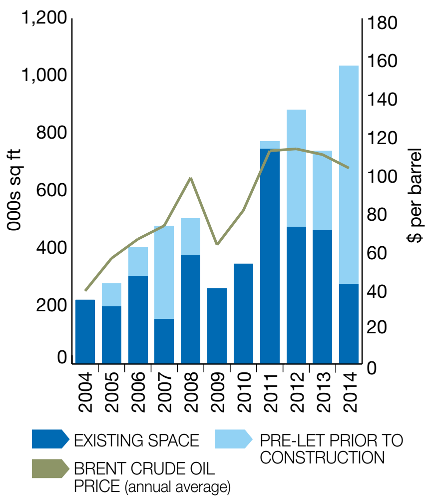
Aberdeen will have to weather oil industry consolidation this year. Job losses and contractor rates cuts have been announced, and industry figures are predicting more cuts ahead. Pressure is growing on the Treasury to reduce taxes to support North Sea oil, and it could prove fortunate that 2015 is an election year.

While not understating the difficulties ahead for Aberdeen, cheap oil should boost global economic growth this year and in the long-run create more demand for energy. Aberdeen is a centre of oil industry expertise that firms will want to utilise on future projects, both in the North Sea and elsewhere in the world. This should help to protect specialist jobs.

It should also be noted that the general UK economy is strengthening, with low inflation now lifting real incomes for consumers. Employment levels are at their highest since 1971, and the Bank of England is forecasting 2.9% GDP growth in 2015, compared with 2.6% last year.

FIGURE 1

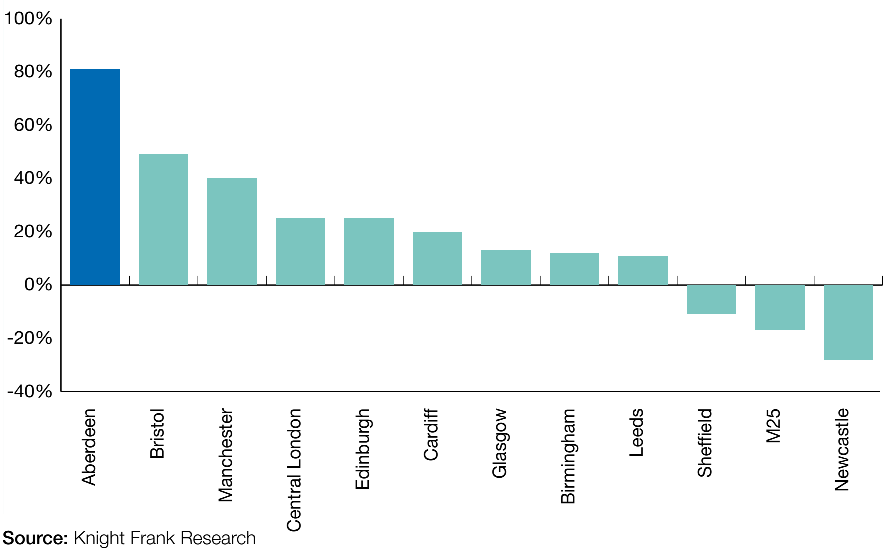
Aberdeen office take-up and oil prices



Source: Knight Frank Research / Thomson Reuters

FIGURE 2

2014 take-up vs 10 year average



Source: Knight Frank Research

OCCUPIER MARKET

Aberdeen remained one of the UK's best performing office markets in 2014, with take-up surpassing 1 million sq ft, the highest level ever.

The continued shortage of existing supply resulted in the bulk of transactions being by way of pre-lets. Significant pre-let transactions included; DOF Subsea taking over 40,000 sq ft at Horizons House, PD & MS Energy taking Miller Cromdale's 46,920 sq ft at Ardent West in the North Dee Business Quarter (NDBQ), and Statoil committing to a 45,000 sq ft new build at Drum Property Group's Prime Four Development at Kingswells.

The market was dominated by two major pre-lets in 2014 namely Wood Group PSN committing to 215,000 sq ft at City Park in Altens from Argon and a letting to Norwegian oil services firm Aker Solutions ASA for a new HQ facility at Abstract's Aberdeen International Business Park totalling 334,795 sq ft. The latter was Scotland's largest ever leasing deal.

Transactions involving existing stock represented only 26% of total take-up in 2014. There were two significant deals including Wood Group taking 59,723 sq ft at Nexen House, and AMEC acquiring 32,750 sq ft at City View Business Park.

Despite a large number of transactions both in the City Core and out of town, there was less activity in the West End. The letting of 20 Queen's Road to Iona Energy however, recorded a new prime headline rent of £32.00 per sq ft.

At the end of 2014, existing Grade A office availability totalled 78,617 sq ft with newly refurbished AB1 on Huntly Street and the recently completed Pilgrim House in the NDBQ accounting for 83% of this total.

As predicted previously, the acute shortage of Grade A supply witnessed since 2012 has resulted in a number of schemes, predominately in the City Core, coming forward speculatively. These schemes include Dandara's The Point development of 80,000 sq ft, KPG/M&G's Capitol development extending to 73,000 sq ft and Titan Investors/BA Pension Fund's Silver Fin totalling over 132,000 sq ft.

The controversial Marischal Square Development by Muse on the former City Council St. Nicholas House site will add an additional 170,000 sq ft of offices bringing the potential new build stock in the City Core alone to 455,000 sq ft.

The numerous relocations witnessed during 2014 is having a dramatic effect on the supply of second hand stock.

The total available office stock, both new and second hand, at the time of print in Q1 2015 is a staggering 1.3 m sq ft.


AB1, recently refurbished, offering suites from 5,000 sq ft to 48,500 sq ft in the city centre

TABLE 1 **Key office transactions in 2014**

Address	Tenant	Size (Sq ft)	Rent (£ per sq ft)	Date
Aberdeen International Business Park, Dyce	Aker Solutions ASA	335,000	£23.75	Nov-14
Site 38, City Park, Hareness Road, Altens	Wood Group	215,000	c.£24.00*	Sep-14
Nexen House, Hareness Road, Altens Industrial Estate, Altens	Wood Group PSN (Assignee)	59,723	£19.33	Mar-14
Ardent West, North Esplanade West	PD & MS Energy Aberdeen Ltd	46,920	£29.00	Oct-14
Phase 2, Prime Four Business Park, Kingswells	Statoil	45,000	Undisclosed	Sep-14
2nd, 3rd & 4th floors, Horizon House, Waterloo Quay	DOF Subsea UK Ltd	40,919	£28.00	Nov-14
Peregrine Road, Westhill	Undisclosed	31,890	£21.50	Oct-14

Source: Knight Frank Research
*Unconfirmed

KNIGHT FRANK VIEW

- The volatility in the oil price is expected to impact the office market for the remainder of 2015 and into 2016.
- The already unprecedented supply is likely to increase further throughout the year reaching record levels by the end of 2015.
- Occupier demand is expected to be subdued until the oil price recovers.
- In the last three "oil price crashes" recovery has taken between 18-24 months.
- What we will encounter in this current cycle is a "perfect storm" of low demand and high supply. This will lead to significantly increased tenant incentives, possibly with shorter lease terms and inevitably rent reductions in older stock.

INVESTMENT MARKET

Investment turnover in Aberdeen reached a record high of £641m in 2014, despite the notable impact caused by the historic Scottish Referendum in September.

The year was categorised by three distinct periods of activity; in the first four months of the year we saw a flurry of activity as investors went after quick sales and closing dates became common place for almost all but the poorest or over-priced assets. As expected, the middle of the year was much quieter as investors waited for the outcome of the Scottish Referendum in September. Following the ‘No’ vote, the final quarter of the year was predicted to bring a return to activity witnessed earlier in the year. However, this did not materialise as the impact of future Scottish Devolutionary powers and a general upturn in other UK regional markets meant that the return of the investment market in Aberdeen, and Scotland as a whole, was ‘lukewarm’ rather than spectacular.

Investment in Aberdeen’s office market reached £641m in 2014, a near 150% increase on an annual basis. In total, 14 investment deals, above £10m, were recorded in 2014 which included Legal & General Property’s acquisition of Aberdeen International Business Park, Aviva Investors’ purchase of Marischal Square for £107m and Kennedy Wilson Group securing Seafield House for £124m.

As witnessed in the two preceding years, the number of Institutions and Funds investing in Aberdeen increased. Although Aberdeen’s record investment turnover of £641m was in a large part due to the three mentioned investment sales, all in excess of £100m, total turnover without these three ‘outliers’ would still have been in excess of the previous record year in 2013.

Prime yields for Aberdeen offices have hardened from 6.00% at the end of 2013 to 5.75% throughout 2014. Despite this, Aberdeen still trades at a discount compared to other regional cities.

With further pre-let’s, Aberdeen again provided a key foothold for investors looking to source long-income stock let to strong covenants. For the first time ever, Aberdeen recorded Scotland’s largest office investment transaction of the year with Abstract Cornwall’s sale of the Aker HQ at Aberdeen International Business Park for £127m, reflecting a yield of 5.75%, to Legal & General. This Grade A building contained all the necessary attributes sought by Institutional investors; long lease, excellent covenant, guaranteed rental growth, top grade specification and a good commercial location.

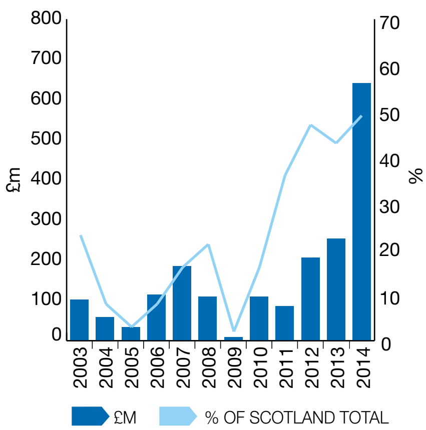
The focus on big ticket sales stole the limelight in 2014 as buying opportunities for private investors and small property companies remained scarce with no new product completed. However, during the year we saw a handful of West End investment sales transacted which re-affirmed the sub-sector’s popularity with local affluent investors.

Despite a year dominated by record highs, there are fears that investment activity will be affected following the significant fall in oil prices which occurred in the final months of 2014.

Aker Solutions new HQ – the largest deal in Scotland

“For the first time ever, Aberdeen recorded Scotland’s largest office investment transaction of the year.”

FIGURE 3
Aberdeen offices investment volumes



Source: Knight Frank Research/Property Data

Miller Cromdale's Ardent West development at NDBQ is currently under construction

"The impact of the oil price drop has already had a profound effect on property decision making."

TABLE 2

Key office investment transactions in 2014

Address	Size (Sq ft)	Price (£m)	Net initial yield (%)	Purchaser
Aker HQ, Aberdeen International Business Park, Dyce	335,000	£127.00	5.75	Legal & General
BP HQ, Dyce	192,837	£68.05	6.62	LaSalle IM
Maersk House, Altens	99,648	£28.50	6.20	Private investor
Johnstone House, Rose Street	52,378	£19.39	6.75	Private Family Trust
Caledonian House, Union Street	48,535	£15.10	6.63	Tesco Pension Fund
Ardent West, North Esplanade West	47,650	£16.95	7.40	LaSalle IM
Admiral Court, Poynernook Road	40,488	£11.75	8.90	Aston Property Ventures
Pilgrim House, Old Ford Road	27,716	£10.00	6.54	CBREGi
Aberdeen Energy & Innovation Parks, Bridge of Don	Mixed *1	£35.45	8.42	Moorfield

Source: Knight Frank Research

*1 - Mixed portfolio of office, industrial and ground leases. 65% of the rental income attributable to offices

KNIGHT FRANK VIEW

- The impact of the oil price drop has already had a profound effect on property decision making. Many investors are adopting a "wait and see" approach to how the local market performs before deciding to purchase, or indeed sell, commercial property in Aberdeen.
- The oil price is not the only pressure on the local investment market – the accelerating recovery in the other main regional cities has led investors to have a greater number of buying opportunities elsewhere and therefore the pool of potential buyers for the majority of assets is expected to reduce.
- We expect a softening of yields going forward for non-prime stock as investors appraise opportunities in light of 'new' market conditions not seen before in Aberdeen's property market.

Recently completed Pilgrim House in the NDBQ

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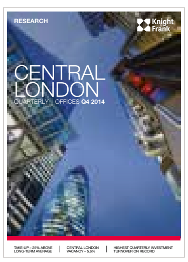

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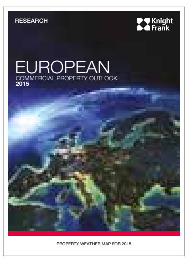

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