RESEARCH

Knight Frank

ABERDEEN

OFFICE MARKET ACTIVITY REPORT

SPRING 2017

Jan 2016
$29.00

SEP 2016
$50.00

New Statoil Headquarters in Aberdeen

OPEC agrees to cut oil production

OCT 2016
$48.50

Aberdeen City Council becomes the first local authority in Scotland to be assigned a credit rating

Plexus Holdings report £6.9m loss as North Sea sales fall 88%

NOV 2016
$51.48

£250m city deal for Aberdeen to create more than 3,300 jobs

Aberdeen City Council raises £370m to enter the corporate bond market

DEC 2016
$56.85

Construction deal signed for £350m Aberdeen harbour expansion

Scotland's economic growth forecast cut for 2016 and 2017

JAN 2017
$55.42

Russia cut its oil production in early January by around 100,000 barrels per day

Shell announces the potential sale of $3bn North Sea Assets to Chrysaor

FEB 2017
$55.94

Centrica profits double from its North Sea-focused oil and gas operation after shedding jobs in Aberdeen

New £180m Oil and Gas Technology Centre to open in Aberdeen

Source: Knight Frank Research
Spot price 1st of each month

ECONOMIC OVERVIEW

Given its high exposure to the energy sector, the good news for Aberdeen's economy is that the oil price has rallied through much of the last year.

At the time of writing Brent crude oil is trading at around US $56 a barrel, which is almost double its January 2016 low point. However, this is also well below levels seen during the period from early 2011 to late 2014, when oil was generally trading over the US $100 a barrel mark – a time when the Aberdeen economy was boosted by strong oil industry investment.

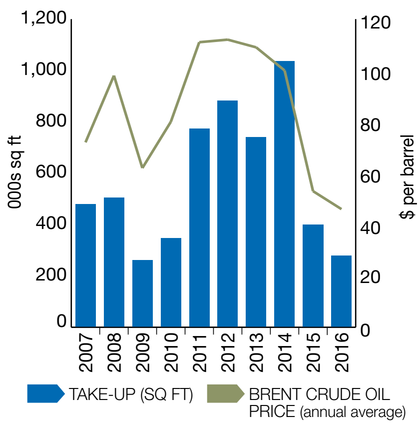
Global indicators point to renewed activity in the oil industry, as it moves beyond the recent downturn. In February 2014, there were over 3,700 oil rigs operating around the globe, according to Baker Hughes, marking the high point for production in the last energy cycle. This tumbled to 1,405 rigs at its lowest point in May 2016. Yet, by January 2017 the number of rigs in operation had increased to 1,918, as a rising oil price justified re-opening wells.

This shows improving business confidence in the oil industry, but is also gradually increasing supply, thus slowing the pace of price growth. Consequently, North Sea oil could be facing a gradual recovery, not a rebound. Also, political risks are on the rise, with the UK moving towards Brexit, which has re-awakened the debate on independence.

However, Aberdeen looks set to benefit from infrastructure and research investment. A £350 million project to extend Aberdeen Harbour is expected to create 7,000 new jobs, and a new £180 million Oil and Gas Technology Centre in the city is planned. The Aberdeen Western Peripheral Route (AWPR) is also now well underway.

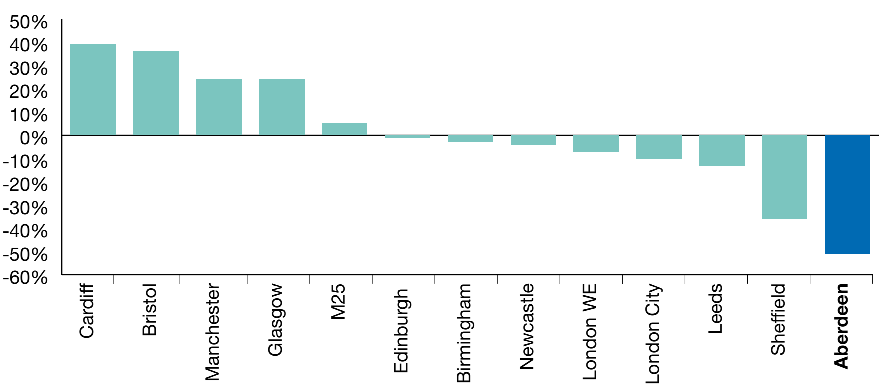
This should provide some additional growth in the next few years, and the research centre will help further develop Aberdeen as a global centre of energy industry expertise, reducing its dependence upon production in the North Sea itself. Numerous future initiatives will help Aberdeen claim a share of the future market for oil rig decommissioning.

FIGURE 1
Aberdeen office take-up and oil prices



Source: Knight Frank Research / Thomson Reuters

FIGURE 2
2016 take-up vs 10 year average



Source: Knight Frank Research

Aberdeen 10-year average: 570,873 sq ft

OCCUPIER MARKET

Although market conditions remained very difficult in 2016, the market is cautiously optimistic that the worst has now passed.

The downturn in the office market continued throughout 2016, which meant that annual take-up fell to 279,000 sq ft. The lowest take-up recorded was 262,400 sq ft in 2009. In contrast to 2015, there were no out-of-town pre-lets, with 72% of transactions in the sub 5,000 sq ft category. Notably, only 12 transactions over 5,000 sq ft completed, half of which were over 10,000 sq ft.

The key transactions in 2016 included the first letting at The Capitol for Knight Property Group/M&G with PWC taking 10,600 sq ft of this city centre development. Also, Kennedy Wilson let over 31,000 sq ft to Marathon at Hill of Rubislaw, whilst AAM's/Manse's AB1 refurbishment in the city centre secured further public sector tenants, including the Crown Office & Procurator Fiscal Service. In addition, Northridge Capital leased 36,254 sq ft to the charity, Somebody Cares. This was the largest occupier deal of 2016.

The remaining notable transactions were "non-conventional leases", with two new serviced office providers entering the market on management style agreements. Citibase took a 22,000 sq ft sub-let of Anderson, Anderson, Brown's West End office at 9 Queen's Road. At year-end, Orega pre-let 26,000 sq ft at Titan/BA Pension Fund's Silver Fin building.

Lease renewal/regear activity was strong throughout 2016 as landlords sought to secure their tenants for the longer term, with many occupiers taking full advantage of their unique negotiating position by first "testing the market". This trend led to the withdrawal of a number of new requirements. The number of active requirements at the end of 2016 stood at only 31.

On a more optimistic note, we have already seen a significant increase in activity in 2017 reflecting the positive sentiment in the energy sector, this includes TOTAL's relocation from Altens to a 138,535 sq ft office HQ in Westhill. In the city centre, The Care Inspectorate are committing to space within AB1 and Maclay Murray and Spens are moving to The Capitol.

In terms of supply, levels continued to increase in 2016 standing at 2.2 million sq ft at the year-end. A further increase is expected in 2017 as new buildings such as Muse's/Aviva's 170,000 sq ft Marischal Square and Titan/BA Pension Fund's 132,000 sq ft Silver Fin come on stream, both of which are scheduled for completion in Summer 2017.

Availability will be further increased by the significant level of 'grey space' coming to the market. We believe that this trend will be particularly acute in out-of-town locations such as Kingswells and Dyce.

Prime headline rents, in theory, remained unchanged in 2016, at £32/sq ft, however the reality is that generous incentives created substantially reduced net effective rents. Such incentives are typically the subject of Non-Disclosure Agreements, however as a generality, rent free periods are now quoted in years as opposed to months or weeks.

The Capitol

TABLE 1
Key office transactions in 2016

Address	Tenant	Size (Sq ft)	Rent (£ per sq ft)
Trafalgar House One, Harness Road	Somebody Cares	36,254	Nominal Rent
Marathon House, Hill of Rubislaw	Marathon	31,328	£23.50
Silver Fin, Union Street	Orega	26,000	Undisclosed
9 Queen's Road	Citibase	22,082	Undisclosed
The Capitol, Union Street	PWC	10,600	£32.00
AB1, Huntly Street	Crown Office & Procurator Fiscal Service	10,537	Undisclosed
20 Queen's Road	The Oil & Gas Technology Centre	8,856	£25.41
AB1, Huntly Street	Department of Energy & Climate Change	7,800	£25.00

Source: Knight Frank Research

INVESTMENT MARKET

Investor sentiment remained subdued in 2016 meaning investment transactions were fewer in number. Yields have certainly moved out although evidence of prime pricing during the year was limited.

A combination of the prolonged downturn in the energy sector, 'Brexit' and the renewed uncertainty over a second Scottish independence referendum, contributed to the office investment market's lowest activity since 2009.

The general feeling was that most investors with income were prepared to 'ride the storm' whilst others wishing to sell had not yet adjusted their pricing to attract buyers.

Total investment volumes were £19.03m in 2016, 79% less than recorded in 2015. Only three investment deals were completed during the year compared with six in 2015. The acquisition of Anderson, Anderson, Brown's new HQ at Drum Property's Prime Four Business Park by an overseas private investor for £17.2m, was not only the largest transaction in 2016, but accounted for 91% of the total investment volume.

All investment sales in 2016 were to private investors. This compares to just 28% in 2015. In parallel to the other regional UK cities, UK institutions were absent from the market.

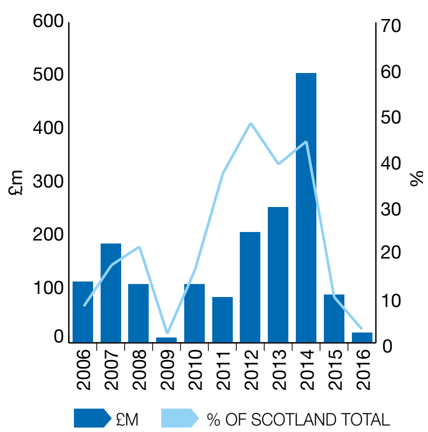
The last transaction of 2016 perhaps gave an indication of what to expect in 2017. The pre-auction sale of 12&13 Albyn Terrace in December illustrated buyers can be found if the price is right. Already in 2017, we have seen further evidence that buyers and sellers expectations are converging which should allow for a more fluid transactional market.

Prime office yields moved out by 25 basis points to 6.50% in 2016. This was driven by sentiment as few opportunities transacted during the year to test this level. This reflects a discount of 100 bps on Scotland's two major cities (Glasgow and Edinburgh) and 150 bps from other major regional cities within the UK. Notably, yields are 100 basis points above the market peak of 5.50% recorded in 2007. The gap illustrates the current sentiment towards risk in the market.

"The pre-auction sale of 12&13 Albyn Terrace in December illustrated that buyers can be found if the price is right."

AAB, Prime Four Business Park

FIGURE 3
Aberdeen offices investment volumes



Source: Knight Frank Research/Property Data

12&13 Albyn Terrace

"The greatest activity could be in secondary 'value added' investments with opportunistic buyers monitoring the market closely."

TABLE 2

Key office investment transactions in 2016

Address	Size (Sq ft)	Price (£m)	Net initial yield (%)	Purchaser
AAB, Prime Four Business Park, Kingswells	46,143	£17.2	7.24%	Overseas Private Individual
12 & 13 Albyn Terrace	6,403	£1.6	10.38%	Local Private Investor
492 Union Street	1,261	£0.2	9.38%	Local Private Investor

Source: Knight Frank Research

KNIGHT FRANK VIEW

Occupier market

- Going forward, the volume of 'grey space' on the market will continue to increase. This, coupled with City Centre new build completions will lead to a further significant increase in available supply during the course of 2017.
- The consensus in the market is that the worst of the Oil & Gas downturn is now behind us and with most companies having rationalised their operations, there is a guarded optimism returning to the office sector. There will however, be a considerable time lag before this will significantly impact on the supply figure.

Investment market

- With sentiment in the energy sector beginning to turn more positive we predict the property investment market will reach the 'bottom' of its current cycle in the second half of this year.
- We expect a steady increase in activity at all levels but greatest activity could be in secondary "value added" investments with opportunistic buyers monitoring the market closely.
- As businesses weather the last of the storm and prepare for growth we may see a return of sale and leaseback activity.
- We may also see further auction activity as some investors choose to exit as leases run down or expire. Auctions have become an increasingly more mainstream medium for smaller commercial sales.

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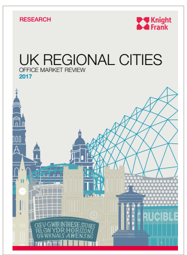

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