



SPRING 2009 ABERDEEN

Office market activity report

Knight Frank

HIGHLIGHTS

- Although Aberdeen will not be immune to the current economic downturn, economic output in the city is forecast at a higher level than Scotland as whole over the next five years.
- In part boosted by the completion of a number of key developments, office take-up reached a cycle high of 550,000 sq ft in 2008. Prime headline rents also increased by 22% in 2008, to stand at £30.00 per sq ft.
- Circa 400,000 sq ft of speculative office development is scheduled to complete over the next 18 months, while in excess of 1.5m sq ft of office development has outline consent. Nevertheless, the downturn is likely to curtail speculative starts which should keep rents relatively stable.
- As elsewhere, investment activity was subdued in 2008, with just four deals taking place in excess of 10,000 sq ft. Investment activity will remain limited in 2009 and focused on the fundamentals of location, sound covenant and tenure.

IN SPITE OF THE ECONOMIC DOWNTURN, ABERDEEN'S OCCUPATIONAL MARKET PERFORMED REMARKABLY WELL IN 2008.

Economic overview

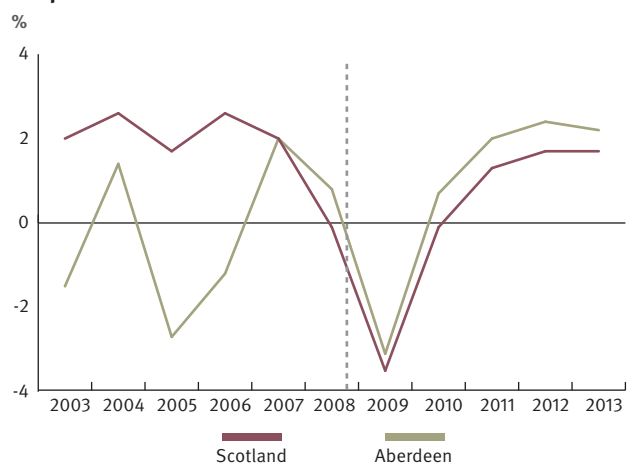
Aberdeen is a key commercial centre in the UK. The city occupies a unique status as the energy capital of Europe and also serves as a regional centre for a number of global business service providers within the professional and financial services sectors. Energy related occupiers and supporting services have also seized upon the opportunities created by high oil prices in recent years by expanding and, although oil prices have fallen substantially from their peak last year, there remain opportunities for continued growth in the future.

Official output figures indicate that Aberdeen has previously underperformed the wider Scottish economy, although it is important to stress that the oil sector, so buoyant in recent years, is excluded from the figures. In spite of this, in terms of the outlook for the economy over the next five years, Aberdeen is set to outperform the wider Scottish economy throughout the current downturn and thereafter, with average annual GDP growth of 0.8% and 0.2% per annum respectively.



Figure 1

Output trends and forecasts



Source: Experian Business Strategies



Hazledene's IQ Aberdeen at Justice Mill Lane extends to 125,000 sq ft and is scheduled for completion in 2010.

Office occupational market

In spite of the economic downturn, Aberdeen's occupational market performed remarkably well in 2008. In reflection of the high oil prices witnessed over recent years, oil and energy related service companies were key to letting activity although, encouragingly, 2008 also brought strong letting activity among the traditional professional and financial sectors within the city centre and West End.

Take-up in Aberdeen reached a cycle-high in 2008, totalling 550,000 sq ft and up 25% on the 2007 level. The broad confidence in the market in 2008 was reflected by the occurrence of a flurry of medium-sized lettings, while in 2007 the majority of Aberdeen's take-up was accounted for by just three major deals. Last year's improvement is also notable given that the majority of the UK's key office markets experienced lower take-up in 2008 relative to the year before.

Central to Aberdeen's strong performance was the completion of a number of key developments, totalling circa 405,000 sq ft, which helped to relieve the pattern of strong pent up demand for Grade A space. This was particularly true of the city centre where letting activity



was boosted by several completions, the largest of which was Union Plaza, a 125,000 sq ft development by Stewart Milne and the first major city centre speculative office completion since 2002.

Within Union Plaza, two notable lettings took place prior to completion. Aberdeen Asset Management's acquisition of 27,000 sq ft and Paull & Williamson's acquisition of 26,692 sq ft were both at an agreed rent of £23.50 per sq ft. Smaller suites at Union Plaza have achieved higher rents, as evidenced by Barclays' 6,995 sq ft acquisition of the ground floor south suite at a rent of £25.00 per sq ft and, more recently, GDF Suez E&P UK Ltd's agreement to take a sub-lease of 8,777 sq ft from Aberdeen Asset Management at a rent of £26.00 per sq ft.

Elsewhere in the city centre, new completions brought about a second increase to Aberdeen's headline rent in as many years. Represented by three transactions at separate city centre locations, prime headline rents increased to £30.00 per sq ft in 2008, an increase of 22% from the 2007 level. At Hill of Rubislaw, Chevron acquired 19,142 sq ft at Seaford House while, in the West End, Lloyds TSB acquired 6,839 sq ft at 33 Queens Road and Thorpe Molloy acquired 6,148 sq ft at 38 Albyn Place.

According to ROMP, Knight Frank's Regional Office Market Presentation, Aberdeen has recorded the strongest growth in prime headline rents compared with any other major regional centre for the second year running. Furthermore, despite the worsening economic climate in 2008, landlord incentives in the Aberdeen market were kept to a minimum, reflecting ongoing occupier demand for high quality space.



Out-of-town, new completions also alleviated pent up demand with Arnhall Business Park at Westhill experiencing strong letting activity. TAQA Bratani's 43,000 sq ft acquisition of Pavilion 1, Westpoint Business Park at £18.50 per sq ft comprised the largest letting of 2008 while, also at Arnhall, Technip acquired 25,000 sq ft at Edenroc's Aspect 32 at an agreed rent of £17.50 per sq ft.

The well publicised relocation of Aberdeen City Council from St Nicholas House to new civic headquarters at Marischal College has moved a step further. Development of the landmark 180,000 sq ft

Table 1

Key office transactions

Address	Tenant	Size (sq ft)	Rent (£ per sq ft)
Pavilion 1, Westpoint Business Park	TAQA Bratani	43,000	18.50
Craigshaw House, Craigshaw Road, West Tullos	Production Services Network	31,678	20.50
5th & 6th Floor (part) Union Plaza, Union Row	Paull & Williamson	26,868	23.50
4th & 5th Floor (part) Union Plaza, Union Row	Aberdeen Asset Management Plc	26,692	23.50
Aspect 32, Arnhall Business Park, Westhill	Technip	25,000	17.50
9 Queens Road	Anderson, Anderson & Brown	21,535	28.00
Wellington House, Wellington Circle, Altens	Total	20,385	18.00
New Telecom House, South College Street	Wood Group	18,350	11.00*
Seaford House, Hill of Rubislaw	Chevron	19,142	30.00
2nd Floor, Union Plaza, Union Row	Altra Energy	17,925	23.50
3rd Floor, Union Plaza, Union Row	AGR Peak Group	17,896	23.50
3rd & 4th Floors Caledonian House, 232/234 Union Street	J.P. Kenny	17,454	12.89
Princetown House, 50 Huntly Street	Transocean	14,500	27.50
Pavilion 5, Kirkhill Business Park, Dyce	Seawell Ltd	14,175	14.50
Pavilion 3, Westpoint Business Park, Arnhall, Westhill	Bluesky Business Space	12,572	18.50
Pavilion 2, Craigshaw Business Park	Wood Group	10,945	22.50

*subject to change, on settlement of outstanding rent review

Source: Knight Frank Research



Table 2

City core development pipeline

Scheme	Size (sq ft)	Developer	Estimated completion date
Phase 1, Abercrombie Court, Arnhall Business Park, Westhill	25,000	Gladman Developments	February 2009
28 Albyn Place	10,500	Carlton Rock	Summer 2009
Freedom House & Pilgrim House	31,012 & 20,382	Miller Cromdale	Summer 2009 (Freedom House)
Phase 2 Westpoint Business Park Arnhall, Westhill	79,500	Knight Real Estate	Summer 2009 (32,500 sq ft)
City Wharf, Virginia Street	27,785	Kenmore	October 2009
IQ Aberdeen, Justice Mill Lane	125,000	Hazledene	April 2010
Phase 2 Abercrombie Court, Arnhall Business Park, Westhill	70,000	Gladman Developments	Early 2010
Crathie House, Holburn Street	18,000	C & L Group	Early 2010
Aberdeen Gateway Business Park, Cove	153,000	Stockland Muir	Requires pre-let
Rockwater House Stoneywood Park, Dyce	50,913	Rockwater Property Partnership	Requires pre-let
Triple Kirks	85,000	Stewart Milne	Requires pre-let
New Horizons House, Waterloo Quay	53,500	Waterloo Quay Properties	Requires pre-let
140 Causewayend	37,000	Private client	Requires pre-let

Source: Knight Frank Research

office building is planned to commence on site in Spring and is expected to be operational in early 2011. However, the long anticipated 150,000 sq ft pre-let of Miller Cromdale's North Esplanade West development on the Harbour Fringe to energy services company Wood Group recently fell through, reflecting the fact that Aberdeen is not immune from the downturn.

Demand for good quality feuhold accommodation remains healthy but supply has become limited. Consequently, few such deals occurred in 2008 but prices were high reflecting constrained supply. The largest feuhold transaction was Seabroker's acquisition of Knight Real Estate's 15,080 sq ft Pavilion 2, Westpoint Business Park, at a price of £4.0m and reflecting a capital value of £265.25 per sq ft. In the West End, the 5,133 sq ft 12 Queens Road was sold to owner-occupier Craig Group at a capital value reported to exceed £550 per sq ft while, at the time of writing, 10 Queens Road, which extends to 6,296 sq ft, was under offer at a figure in excess of the asking price of £2.5m.

In terms of future supply, there is close to 400,000 sq ft of speculative development currently underway with completion scheduled over the next 18 months. For example, in the city centre, Miller Cromdale's 31,000 sq ft Freedom House at Old Ford Road and Kenmore's City Wharf development, extending to 27,785 sq ft, are both scheduled for completion in 2009. The city centre will receive a further necessary boost in Grade A supply from Hazledene's 125,000 sq ft IQ development at Justice Mill Lane, scheduled for completion in 2010.

Out-of-town, Gladman Developments' 25,000 sq ft pavilion at Abercrombie Court is nearing completion and they are expected to embark on Phase 2 thereafter. Knight Real Estate have also

commenced Phase 2 of their Westpoint Business Park development at Westhill, with 32,000 sq ft scheduled for completion this summer.

In a market normally characterised by a pattern of tight supply, there is now in excess of 1.5m sq ft of office space with outline consent in the pipeline. A number of speculative schemes intended to commence over the coming year have been postponed due to a current lack of funding while some key schemes, such as Stockland Muir's Aberdeen Gateway Business Park, require a pre-let before work can commence. Nevertheless, willing prospective occupiers with large requirements have many options to take a pre-let where none existed before.

KNIGHT FRANK VIEW

- Over the next 18 months, the recession will undoubtedly lead to a reduction in take-up relative to recent years. However, in contrast with the majority of the UK's key markets, we expect headline quoting rents to remain at their current level rather than fall. This is partly due to the continuing pattern of undersupply of Grade A space in the city centre, albeit this will be addressed by Hazledene's IQ development next year.
- However, we anticipate that landlords will act much more aggressively to attract and retain tenants by increasing incentives and offering more flexible terms. In particular, we expect that landlords in out-of-town locations will have to offer the most generous incentives in light of anticipated new supply, while city centre locations may fare better.

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THE AVERAGE CAPITAL VALUE IN 2008 FELL BY ONLY 5% RELATIVE TO THE PREVIOUS YEAR.

Investment market

As in any UK or European market, investment activity in Aberdeen has continued to slow considerably. 2008 saw only half the number of office transactions as in the previous year, with just four investment deals in excess of 10,000 sq ft. However, these transactions totalled £95.8m which, in terms of value, represented a year-on-year decrease of only -26%.

This disparity between volume and value was principally due to a single major transaction which, at £52.6m, accounted for 56% of the total. In May 2008 Pramerica Real Estate purchased BP's headquarters building at Stoneywood, Dyce from Goodman Property Investors, reflecting a net initial yield of 6.41%.

Another significant indicator of the slowdown during 2008 was the withdrawal of two major office investments from the market. These were The Exchange, with a quoted sales price of £21m, and Union Plaza, which carried a quoted sales price of £45m. In both cases it is understood that the vendor's expectation on price could not be achieved.

Interestingly, the average capital value of those four key 2008 deals was £249 per sq ft, which is only 5% below the average capital value of £262 per sq ft achieved in 2007. Thus, although the impact of the investment downturn was felt in Aberdeen as elsewhere, there is some evidence that continued expectations of rental growth and general positive sentiment towards the energy market was reflected in comparatively resilient pricing during 2008.



In May 2008, Pramerica Real Estate purchased BP's headquarters building at Stoneywood, Dyce for £52.6m reflecting an initial yield 6.41%

KNIGHT FRANK VIEW

- Investment activity will remain subdued as long as the availability of debt remains restricted and margins remain high. 2009 will see a continued decline in pricing and outward yield shift, although equity-backed investors will increasingly be presented with excellent opportunities to buy prime assets at attractive prices.
- What activity does occur will remain highly selective in 2009, with purchasers returning to the core principles of tenure, location and sound covenant. Our view is that prime yields for West End stock will hold up comparatively well while peripheral stock outside the city centre will see yields move out more markedly.
- Encouragingly, at a time when nationally investor concerns regarding the occupational market are increasing, the fact that Aberdeen's occupier base is uniquely biased towards the recently buoyant energy sector should leave the city well placed relative to other UK regional centres.

Table 3

Key investment transactions

Property	Size (sq ft)	Price (£ millions)	Net initial yield (%)	Purchaser
Talisman House, Holburn Street	96,000	26.0	6.40	Private Client
Altec Centre, Minto Drive	29,133	4.1	8.10	Braefoot Cox Ltd
Riverside House, Riverside Drive	52,475	13.1	6.98	Upland Developments
BP HQ, Stoneywood, Dyce	207,377	52.6	6.41	Pramerica Real Estate

Source: Knight Frank Research

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