Aberdeen Office Market Update

BRIEFING PAPER

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It is common knowledge that the office market in Aberdeen is intrinsically linked to the fortunes of the energy sector and the price of a barrel of oil. We now have the added impact of COVID-19 and Government enforced restrictions on almost all aspects of our daily lives. So how has Aberdeen's office market fared in the face of a perfect storm of energy sector austerity and a global pandemic, reducing need for the very commodity that makes Aberdeen tick?

Since 2015, when the oil price fell from the US$100 to mid-$20's, office demand and supply was turned on its head. Annual take up figures in excess of 1M sq.ft and total supply of 300,000 sq.ft, quickly turned into take up of 190,000 sq.ft and supply of 2.8M sq.ft as large swathes of office premises were placed on the market. These conditions largely continued throughout the next 4 years. Whilst office take up increased to c 375,000 sq.ft in 2018, office supply remained reasonably constant at the previously mentioned figure, which is approx. 6 years average annual take up.

2019 however provided evidence that the office market was reacting to sustained oil pricing in the region of $60 per barrel. Office take up increased dramatically throughout the year with Q4 showing take up in excess of 230,000 sq.ft, the biggest quarterly take up since the oil crash in 2015. A glimmer of light at the end of a very long tunnel. Could it be sustained?

Office agents marched into 2020 with the hope rather than an expectation that the previous optimism would be continued and their wishes were granted with c 170,000 sq.ft of transactions in Q1. An improved office market environment was cautiously predicted for the remainder of the year.

The glass half full attitude was quickly dashed however with COVID-19 impacting on all parts of our lives, both from a personal and commercial perspective. The life blood of Aberdeen again bore the brunt of the restrictions and at one point, futures in West Texas Oil fell into negative territory, an unprecedented situation. The impact was immediately seen in office take up. A meagre 26,000 sq.ft of office space was transacted in Q2, the lowest quarterly figure that I can recall in 20 years of working in the sector. There were no viewings, deals were put on hold, and a general bunker mentality prevailed. Optimism was replaced with uncertainty yet again.

Against all the odds however, Q3 take up bounced back to c 80,000 sq.ft, a reasonable return in the circumstances, albeit significantly made up of transactions delayed from Q2, and this was followed in Q4 by take up of 163,000 sq.ft, albeit a significant chunk of this 110,000 sq.ft or so was attributed to BP's lease of Aberdeen International Business Park. We always need big deals to make the numbers look good. In terms of supply, it remains at c 2.7M sq.ft with new space coming onto the market to make up for the space being let. 1 step forward, nearly 1 step back!

As we enter 2021 and another phase of restrictions, it will be interesting to see what impact this will have on take up. Initial indications are reasonably encouraging and perhaps the existence of a vaccine is encouraging a 'let's get on with it' attitude. Time will tell.

What is important to consider however over the last 2 years is where the office deals are occurring and more importantly the number of transactions. 2019 saw 86 office transactions in the city, 56 of which were transactions in the city centre and west end, both showing 28 deals each. The remainder was made up of Westhill / Kingswells 13, Dyce, 7 and the remainder split between Altens and Bridge of Don.

By contrast, 2020 saw 55 office transactions - a reduction of 36%, which is not surprising having effectively lost a quarter at the onset of Lockdown. Interestingly, the west end and city centre again, matched each other in terms of popularity with 15 transactions each and a similar percentage to the previous year. Dyce saw the most improvement with 11 transactions and Westhill fell to 6. Altens and Bridge of Don, again made up the numbers.

It is clear that Dyce is witnessing a renaissance, largely due to the AWPR and also the quality of the product on offer, especially at Aberdeen International Business Park. Fully fitted out high quality open plan space, finished to a high specification with exceptional amenity, café, gym, crèche and coffee provision on site has attracted a considerable amount of interest and c 200,000 sq.ft of space has been let in the last 2 years in this building alone.

Altens on the other hand, once the preferred location for speculative office development has only witnessed 7 office deals in the last 2 years and only 5% of total take up. Westhill and Kingswells (Prime Four Business Park), continue to perform well with quality new and second hand stock remaining popular.

The average letting size in 2019 was c 6,000 sq.ft whereas 2020 saw this increase to 8,000, albeit several sizeable transactions slightly skew the figures and the vast majority of office requirements remain in the sub 10,000 sq.ft range.

The final reckoning saw office take up of c 440,000 sq.ft in 2020 compared with c 505,000 sq.ft in 2019. A sporting effort in the circumstances.

The impact of COVID is yet to be fully established on office occupational strategy. Home working protocols have been advanced by a decade in the last 12 months with many employees opting to split their working life between home and the office. In tandem with this however is the likely change to occupational densities with more social distancing required between work stations. The call centre mode of occupation might well be a thing of the past. And what of hot desking……will this feature as prominently in a post COVID era? Might hygiene requirements and a reluctance to desk share see this occupational strategy diminish? Office buildings are being designed and retrofitted with low touch technology – the legacy of COVID-19 may be long lasting.

There is no doubt that companies are reconsidering their spatial requirements in light of COVID, but there will always be a need for a quality working environment.

A final, but equally important factor is the impact on rent and lease terms. In general, office rents have fallen across the board, incentives have increased and lease terms are now as flexible as ever. Tenants prefer shorter lease terms with the added flexibility of break options and landlords are generally happy to accommodate in order to alleviate a penal Local Authority Rates obligation. As such, it can be a race to the bottom when tenants play landlords off against each other to negotiate the best deal possible. Even the new Grade A stock, whilst maintaining healthy headline rents, are showing increased incentives making these options highly competitive.

Finally, tenants are looking for the path of least resistance when considering office relocations. Those properties offered in a refurbished condition, fitted out with offices, meeting rooms, welfare and IT are often preferred. It saves on time, management involvement on fit-outs and not to mention the considerable cost. The cost of the fit-out is likely to be factored into the deal, and recovered through an increased rent or reduced incentives, but this is preferable to a considerable initial CapEx. There is a significant amount of high quality competition and those properties offered in un-refurbished condition often find themselves left on the shelf.

So, how to conclude – There remains unprecedented supply, and demand, whilst still modest, is showing encouraging signs. Locational preference remains strongly in favour of city centre and west end. Rents have fallen, incentives have moved out and flexibility is key. Refurbished and fitted out space is favoured and the sweet spot is in the sub 6,000 sq.ft size, notwithstanding there were a number of larger deals over the course of the past 2 years.

As we proceed into 2021 with bated breath, and an oil price at the time of writing of $60, we know it is going to be challenging, but there is sufficient evidence to justify a sense of cautious optimism.

During 2020, FG Burnett was involved, either directly or jointly in 20 of the office transactions and as an agency team as a whole, concluded 56 transactions throughout the year, which is in excess of one transaction per week across, office, retail and industrial sectors.

If there are any aspects of this briefing note that you would like to discuss please contact Jonathan Nesbitt.

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