FG Burnett

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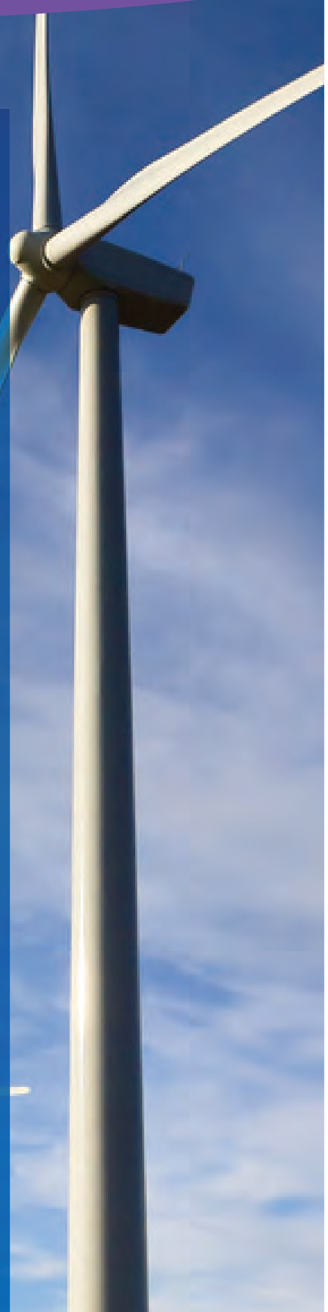
property MATTERS



Business Rates

Renewable Energy Producers Relief

At this stage of the Business Rates cycle, with the vast majority of the 2010 Revaluation appeals resolved and the April 2017 Revaluation still some way off on the horizon, there is an opportunity to focus on alterations and extensions to existing properties and new properties entering the valuation roll for the first time.

Fortunately, the buoyant economy in the North East of Scotland has ensured that there continues to be a steady flow of commercial development however it is important to ensure that when these new facilities are assessed for business rates, the rateable values are fixed at the appropriate level in-line with established values on similar properties in comparable locations.

However, in some instances, comparable properties are few and far between – one such property where our advice was sought in relation to the proposed rateable value of £250,000 is the Hill of Banchory Biomass District Heating System operated by HOBESCO, a local renrewable energy company.

The Heat Network, operational since April 2013, provides highly efficient, low cost and low carbon heat to a new development of both residential and commercial buildings at Hill of Banchory. Heat is generated from locally sourced woodchips and the process provides significant environmental, economic and social benefits.

The Heat Network is sized to meet the future expansion of the development over the next twenty plus years, which has required significant initial capital expenditure. Whilst heat sale revenues are increasing year on year as more connections are made, a sizeable business rates bill amounting to c. £125,000 per annum was unafordable.

FG Burnett was able to provide specialist advice through a combination of negotiations with the Grampian Assessor which resulted in a substantial reduction in the level of rateable value proposed, and a successful application lodged with Aberdeenshire Council in respect of Renewable Energy Producers Relief, one of many forms of relief available, depending on the individual circumstances of the individual rate payer, we were able to reduce the client's business rates bill to nil - a total saving on this occasion of c. £500,000 over a period of 4 years. Hopefully, this will help to contribute to the long term success of a pioneering scheme, which aims to provide affordable heat by sustainable means and give support to the local rural economy.

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Message from our MD...

At the beginning of 2014 the price of Brent Crude was $110 a barrel on the international markets. At home there was great anticipation in Scotland for the impending Commonwealth Games in July, which fired the starter's pistol on a summer of sporting brilliance. Away from field and track, golf featured –the Scottish Open was hosted at my home course of Royal Aberdeen, and anticipation of the Ryder Cup at Gleneagles in September was palpable. But there is no doubt, the greatest focus was on another tense encounter, the imminent independence Referendum, which, following a two year build-up, culminated in a nail-biting climax on 18 September.

The Commonwealth Games proved to be an outstanding success by anyone's standards, leaving a lasting legacy. Meanwhile, Rory McIlroy used Balgownie Links to hone his game for his first Open Championship win, and the European team celebrated an epic victory over the US at Gleneagles. Fast forward to December and the outcome of the Referendum is settled, while the downward spiral of Brent Crude at $52 barrel (at the time of writing) is favouring motorists at the fuel pumps but has spooked the markets somewhat.

So, what does this mean going forward for the Scottish business community? A closer contest than had been anticipated resulted in Holyrood securing a number of pre-polling day promises from the Westminster parties, which may not have been achievable had the gulf between the two campaigns been wider in the days leading up to the vote. It will be interesting to see what new powers transpire once the London parliament has had its say and what effect this will have on markets.

Whilst all this was going on, 2014 also saw the publication of Sir Ian Wood's report in to the UK oil and gas industry and, in particular, his vision for what is required to maximise opportunities in the North Sea. Sir Ian's report is direct, unambiguous and its findings are acknowledged by the majority of industry experts to reflect where we are, where we need to go, and what Government, operators and stakeholders need to do to ensure this massively important natural resource is prolonged to everyone's benefit.

As a business which is fortunate to have many energy sector clients, FG Burnett is keeping a weather eye on unfolding events. There is no doubt there is a direct correlation between oil price and activity in the property sector. The shock of a single digit oil price in the 1980s caused the industry to conduct a life-saving review of activities, and my recollection of the aftermath is of major service companies evolving on the back of outsourcing by the production companies.

Notwithstanding all of the political and sporting events of the past year, Aberdeen has continued to see new offices and sheds being built, let and sold apace with solid commitments to new build going forward. In that much of the recently constructed accommodation which now commands our skyline was pre-let, having a stock of oven-ready product may not be such a bad thing. Although some commentators see the amount of space coming through as being of concern, surely it is important to have top quality space available in order that we can both attract new operators and retain major occupiers in the region.

The energy sector appears to be at a crossroads. Hopefully, embracing a more collaborative approach to the use of assets, infrastructure, logistics and data, as recommended in the Wood Report, will be the bedrock on which the oil and gas industry continues to be successful for many years to come. That success will bring trickle-down benefits for those of us in the commercial property world and many other allied professions, services and industries based in the north east.

To round off, we're very pleased with the level of activity being generated within out Glasgow which is acting on belhalf of a wide range of high profile clients. their energies are being rewarded as we see continued improvement in the market and long may it continue!

Angus MacCuish

The Private Rented Sector

The next big thing in investment?

UK Institutions are beginning to look seriously at a major move into the UK's residential private rented sector.

Historically, they have been big players in the market however Government rent controls in the 1950's and 1960's led to their withdrawal from the market. The structural imbalance in the UK housing market is well documented – we seem to try and control the housing market by fiscal drivers rather than addressing the real issue of a chronic undersupply of homes, which is a planning issue. We are simply not building enough homes at a time when the UK's population is forecast to grow substantially. When you factor in the growing problem of affordability for owner occupiers, there is often no choice for many people but to rent on a long term basis.

The UK's huge buy-to-let market has satisfied some of the rental demand however the UK model is not replicated in North America or Europe, where institutions are major players in the residential rental market.

I think we can expect UK institutions to significantly increase their exposure to this market – by offering large scale, high quality, purpose built, well managed rental property. Their economies of scale in terms of operation, maintenance and energy use should create an attractive product for tenants – and happy tenants will stay for longer.

The target tenant for institutional investors will be young professionals and they will be looking at areas where there is a high level of social and recreational activity, major employment opportunities and good public transport. Clearly, London will be their focus however it is a model that should work well in the 3 main Scottish cities.

Aberdeen's international, affluent and mobile workforce would seem the ideal market for institutional investors – albeit we have to be honest and accept that we do fall short on public transport and that "big city" feel that Glasgow and Edinburgh provide.

Ultimately, the long term investment returns in the residential market will be the key driver for investors and historically, residential has been very attractive relative to other mainstream asset classes. It will be interesting to see whether the regions can attract the institutions or whether they will focus their investment in London and the South- East.

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Investment

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Land and Buildings Transaction Tax

Land and Buildings Transaction Tax (LBTT) replaces Stamp Duty Land Tax (SDLT) in Scotland from 1 April 2015, affecting both commercial and residential property.

Although LBTT will operate in a similar way to SDLT, it will be calculated differently. Gone is the "slab tax" basis of SDLT, where the highest applicable rate of tax is charged on all of the price, and in comes a more "progressive tax" approach, with different rates applying over value bands of the property's price.

A comparison between the old and new system is highlighted in the table below:

LBTT on Commercial Property	**SDLT on Commercial Property**
Up to £150,000 = 0.00% Over £150,000 to £350,000 = 3.00% Over £350,000 = 4.50%	Up to £150,000 = 0.00% Over £150,000 to £250,000 = 1.00% Over £250,000 to £500,000 = 3.00% Over £500,000 = 4.00%
LBTT on Commercial Leases	**SDLT on Commercial Leases**
NPV up to £150,000 = 0.00% Over £150,000 = 1.00% of the NPV that exceeds £150,000	NPV up to £150,000 = 0.00% Over £150,000 = 1.00% of the NPV that exceeds £150,000

What Does This Mean?

For commercial property purchases, the tipping point at which the amount of LBTT payable exceeds the outgoing SDLT is around the £2 million mark.

For SMEs undertaking a purchase for owner occupation this is likely to be advantageous, but from the perspective of investors, given the average lot size of commercial property transactions in Scotland over the last 24 months was £11,768,625[1], then clearly there will be considerable additional outlay.

In a competitive UK real estate market where large volumes of equity requires to 'find a home', stepping out of sync with the rest of the UK market clearly puts Scottish real estate at a commercial disadvantage and has the potential to create a new hurdle where one frankly isn't sought, particularly as we continue to recover from the effects of both the past recession, and more recently from the investment stale mate caused by the uncertainty surrounding the independence referendum that affected so much of 2014.

Quite how this manifests itself remains to be seen. In my view, whilst this clearly puts Scottish commercial real estate at a commercial disadvantage with the rest of the UK, I do not foresee this having a materially negative impact on transactional volumes. At least I hope not! It is more likely, in my view, to affect the prices paid. I believe that the market will continue to remain yield driven, hence the purchase price will drop to reflect the additional tax payment, as opposed to yields softening. What will be interesting to see is whether Westminster follows suit in pursuit of higher tax revenues and in so doing return the UK to parity on this issue.

[1] *Source: Property Data*

Office Market

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So how will the office market perform in 2015? As it is inextricably linked to the price of a barrel of oil, there is no doubt that the market will be more challenging than it has been over the past 4 years or so. However, In the slightly amended words of Mark Twain 'The reports of the demise of the office market in Aberdeen are greatly exaggerated'. The recent austerity being witnessed in the Energy sector, coupled with a falling oil price will have an impact on demand. Coupled with this there is a healthier supply of good quality modern offices than there has been in 4 – 5 years or so. Those companies who are in a position to expand and invest, with a view to an elevated oil price in the coming months/years, now have options and are not restricted to having to settle for sub-standard accommodation. At one point in late 2013, there was approx 1M sq.ft of demand and approx 10,000 sq.ft of supply in what could be roughly classed as Grade A accommodation. That is not a good demand / supply equation. Just as a dearth of demand has issues, so does a dearth of supply. This equation is now more balanced, the see saw is tipping in favour of supply and this is perhaps nearer normal market conditions; conditions that have been witnessed nationwide over the past 5 years or so and conditions prevalent in Aberdeen prior to this time. It is clear that Aberdeen has seen an exceptional level of demand and office take up in the last 5 years and a return to a more balanced market would appear to be the order of the day.

The graph for office take up over the last 10 years or so has mirrored the oil price graph, albeit with a slight lag. What we know is that the Energy sector activity is highly cyclical, as is the office market. Over the last 2 years Aberdeen has seen in excess of 1m sq.ft of take up per annum, the highest outside central London. This year, take up in London is set to top 14m sq.ft, the highest on record. Bearing in mind Aberdeen has a population of 225,000 approximately 3% of London's population of 8m, it is clear that Aberdeen has been punching above its weight in terms of take up over the last few years.

Despite the falling oil price, office transactions totalling in excess of 200,000 sq.ft concluded in Q4 2014. This is almost a quarter of the previous annual office take up figures. When the oil price last dipped significantly, in 2008, falling from $147 to $35, deals were pulled, transactions stopped and a bunker mentality prevailed. Whilst there have been some incidences of this, it is not as widespread as witnessed previously. However, it is an indicator of the belief in the market and the cyclical nature of the Energy sector that all of the above transactions continued through to completion, when it would have been an easier decision to sit tight and wait for a price bounce before committing long term.

There is also a new focus to the office market, the city centre now delivering up options for occupiers. The past 4 years has seen the peripheral areas of the city, particularly Westhill and Kingswells, being the focus of most development, both speculative and on the basis of pre-lets. Four major speculative developments proposed for the city centre will provide unprecedented suppy in this location. The Silver Fin Building, The Capitol, The Point and Marsichal Square, totalling approx 400,000 sq.ft are all due to be delivered within 12 months of each other, and all will provide office accommodation which will raise the bar in terms of quality and buildings which would not look out of place in any other regional CBD. It is clear that all sectors of office occupiers are seeking to enhance the quality of the working environment in order to attract and retain staff, especially in the Energy sector where, despite recent reports of redundancies, the supply of quality staff remains hugely important. There will be competition for tenants, but this reflects normal market conditions.

The Range

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The Range is the newest edition to Aberdeen's retail landscape, after opening its doors on Friday 28th November at Queens Links Leisure Park, and achieving a long held ambition for the homewares retailer. By combining units 8 and 9 Queens Links, the new store is over 60,000 sq ft and with a long term commitment to the site, will be a central feature of the area for many years.

Acting on behalf of the Landlord, Land Securities, FG Burnett Director Richard Noble comments: "Securing The Range for this amount of space in Aberdeen is a real coup for Queens Link. This retailer has been keen for representation in Aberdeen for some time and this location is ideal, offering modern retail warehouse space with excellent public transport links and on site car parking".

FG Burnett's Building Consultancy Department also acted as project monitor managing the tenant's contractor, who undertook a programme of all refurbishment and fit-out works. FG Burnett were instrumental in agreeing the works which were the responsibility of the landlord and negotiating with the tenants contractor allowing continuity during the site works. The landlord and tenant agreed a shared payment structure for the works; streamlining and expediting the process to ensure the store opened its doors as soon as possible. FG Burnett also made sure by way of regular site inspections that all works were carried out to a high standard and were able to agree stage payments during the site works.

Some of the key works which were undertaken included joining the two separate buildings together to form the new 60,000sq.ft store, renewing the esplanade pavement, glazing the previously steel sheeted canopies, opening the area up to the beachfront and creating a welcoming appearance.

Through extensive negotiations we were able to significantly reduce the initial quotation, whilst still ensuring that the works were finished on programme to a high quality finish. Jim Johnstone, FG Burnett's Head of Building Consultancy states: "As a result of our persistence and local market knowledge we were able to successfully negotiate a scope of works to cover the agreed landlords works at a cost to our client which in many cases was below the budget cost.

The tenants contractors programme had been accelerated to focus on the opening of the store. By attending site regularly and maintaining dialogue with the client, tenant and contractor, we ensured that a good quality result was produced, whilst still enabling the premises to open as targeted."

Industrial

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A surprising result...

July and August's Commonwealth Games, September's Independence Referendum and October's mid-term schools break - a hat-trick of obstacles that Scotland's property market has faced since our Summer Edition.

One could therefore be forgiven for reporting a slower period of property trading since that time. However, despite these considerable distractions, our Glasgow Industrial Agency Team is pleased to report a noticeable upturn in transactional activity which has seen them achieve a 35% increase this year in sales, letting and lease renewal transactions. These have included lettings of 1,000 sq ft to a more sizeable acquisition for Quiz Clothing of 145,000 sq ft.

Our upturn in activity is a result of a general increase in property requirements causing more frequent take-up. In more prime positions there is evidence of improved rents and reduced rent free incentives, although there does continue to be sticky locations and properties across Scotland's central belt and this may always remain the case.

The consequence of this positive upturn in activity has been met head on with an extreme shortage of speculative development which has prevailed over the last five years in particular. This has therefore resulted in the availability of good quality, second hand industrial space reaching a worrying low - particularly for units between 10,000 and 15,000 sq ft.

In turn the shortage in supply is causing a vast number of industrial requirements to remain unsatisfied for a considerable period of time. A more reactive approach is now present amongst occupiers as they are more aware of what is available having trawled the market for some time and they now patiently await the emergence of new opportunities. Accordingly, when a good quality well located industrial unit enters the market it is often acquired within a relatively quick timescale. Therefore, where industrial property owners have the ability to adopt a good asset management strategy and implement refurbishment for vacant units, a high percentage of success should prevail.

Going forward we envisage a continued mismatch between demand and supply as development viability remains an issue. The dilemma we face is that occupiers still often search for the perfect premises to optimise business performance and perhaps often harbour a slightly historic view on lease length flexibility, rental level and incentives. On the other hand, a developer can't and won't develop if the scheme isn't viable and they therefore require confidence in the market in terms of growth in rental, longer leases and reduced rent free incentives.

Perhaps our comments suggest for a moment that design and build transactions will increase and aid viability, but design and build development doesn't increase supply. It is also the case that most occupiers for the sub 15,000 sq ft market are very much like the retail consumer and they often wish to "touch and feel" the product they desire.

Thankfully there are small glimpses of the market trying to correct itself after such a difficult period. It will be a very slow recovery, but here's hoping it continues along the path it seems to be travelling.

From an Aberdeen perspective the signs are that the industrial market is now heading back to an era, however short or long where value and flexibility are key to occupational success.

Rather than take the difficult decision to commit long term to a new facility, occupiers appear to have changed their focus to value driven second hand buildings available on short to medium term leases by way of five or ten years maximum. In some cases even shorter term leases are sought suggesting there is an element of make do!

That is not to say that enquiries for both development land and new facilities have dried up, far from it, it's just that unpalatable and to an extent UK centric long term leases may make head office commitments more difficult to come by.

The mature diagnosis is that we've seen this all before and no doubt once a stage of equilibrium has been reached and encouragement for future activity is evident, through further Government intervention, confidence in the energy sector will return and new facilities will be sought.

There is no doubt that the vast sways of industrial stock in Aberdeen is now forty to fifty years old. This means these buildings are fast approaching functional obsolescence and without significant investment are likely to be unfit for purpose in the short to medium term. It is interesting, is it not, to compare and contrast this with the economic, and more particularly, energy sector global drivers.

Legionella - danger in the water…

FG Burnett's Property Management Department recently undertook refresher training in the awareness and control of Legionella.

As part of its duties, The Property Management Department has to manage and oversee a comprehensive range of health and safety requirements across its managed portfolio and it is essential that the department members keep up to date and refreshed with current legislation and best practice.

The training coincided with the recent issue of the Health & Safety Executive's latest guidance on this topic, and also gave the department an opportunity to review best practice.

Legionella Pnemophialia, to give it its correct name, is a waterborne bacteria that is found naturally in all water supplies. It causes between 200-250 cases of legionella disease in the UK each year. About 12% of these cases can be fatal and so it is essential that property owners have a water hygiene regime in place to manage this risk.

This means that a buildings occupiers must have control measures in place to deal with the bacteria to protect not only occupiers and visitors to the property but also people in the wider population surroundings who could be affected by a spread of the bacteria.

The danger arises where the waterborne bacteria are taken into the body in a breathable form. Cooling towers, evaporative condensers and shower heads are the areas of greatest danger, as this could lead to a possible exposure to water in a very fine droplet or aerosol form. A building's water supply and storage must be subject to a management regime designed to ensure that the legionella bacteria has no chance of flourishing. These measures involve ensuring hot water for taps and showers is heated to the correct temperature, pipework and storage tanks are kept in a good condition, and that regular sampling and temperature checks are carried out.

By implementing a thorough water safety regime this will ensure that the legal responsibility of the employer – i.e that person who has a legal or managerial responsibility for the safety of the building's occupants - can demonstrate they have met all their obligations under the law and ensure the continued safe occupation of the premises.

The safe management of water supplies and storage in a building is one of several services that the Property Management Department can arrange for clients, together with assisting with the raft of other health and safety obligations for modern buildings that include fire safety, working at height, asbestos, emergency lighting and so on.

If you would like to learn more about Legionella specifically, or the management of health and safety in general in your property then please speak to either David Henderson, Simon Smith or Christopher Yannaghas and we would be delighted to assist.

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Contact David Henderson
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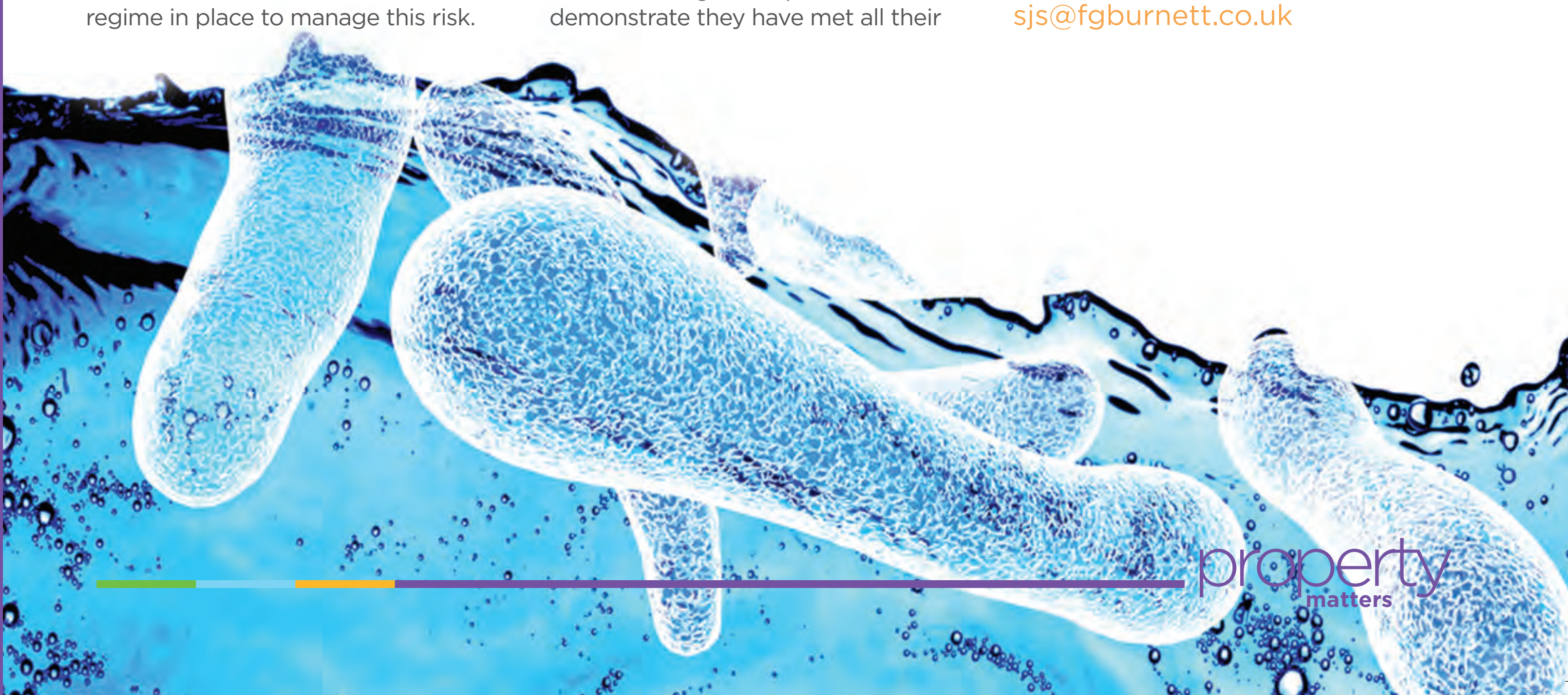

What implications could the two recent court decisions have for landlords and dilapidations?

Dilapidations can be defined as wants of repair / decoration / reinstatement, due as a result of a breach of obligations under common law or a commercial lease. Until recently tenants in Scottish commercial property were expected by landlords to meet any dilapidation costs as part of their lease agreement. However, in light of the recent court decisions, it now appears to be the case that tenants will only have to pay the cost of repairs if the landlord can satisfy the court that it actually intends to carry them out.

Businesses with a tenancy of commercial property should make provision in their accounts for their anticipated dilapidations liability arising from their lease arrangements. During the lease, the landlord usually expects the tenant to carry out its obligations, however, once the lease ends, it is common for a schedule of dilapidations to be served upon the tenant should a dispute occur; the landlord would normally raise an action based on breach of contract, with loss being calculated on the basis of the cost of repairs.

At lease expiry the landlord has had various options (depending on the wording of the lease), including carrying out the repair work or recovering the cost of anticipated repair work.

These recent cases in Scotland however show that where the landlord prefers to first raise a court action for damages or payment, the situation may be changing to favour the tenant when calculating the landlord's loss for any breach of the tenant's obligations to carry out repairs.

In the recent case of Grove Investments Limited v Cape Building Products Limited (Cape being the tenant), the opinion of the Inner House of the Court of Session (the highest appeal court in Scotland) came down firmly on the side of the tenant. Following lease expiry, Grove raised an action against the tenant and tried to argue that the dilapidations liability could be recovered under a payment clause with the value of the claim being measured by the cost of works. They also argued that construing the provisions of the lease properly, the parties had contracted out of the common law so that the tenant was stuck with the cost of works, therefore ruling out any alternative measures of loss, including diminution in value.

The issue turned on the meaning of the words "value of the schedule of dilapidations", with the tenant arguing that value could be determined in a number of ways including diminution in value and the landlord saying that it should equate to the cost of works.

At the appeal before the Inner House,

a bench of three judges agreed with the tenant's interpretation of the lease, resulting in the tenant's ability to introduce alternative measures of loss including, diminution in value.

This approach to payment obligations in dilapidations was verified in the case of **@SIPP (Pension Trustees) Limited v Insight Travel Services Limited (Insight being the tenant).** In this instance, the court also agreed with the tenant that the correct interpretation of the clause in question was that it was not a payment obligation.

It seems therefore that Scottish Courts are increasingly likely to take a view that, where there is any ambiguity in the lease, the common law position should be preferred. This opens up alternative measures of loss for tenants. It will still also be open for tenants to take the landlord to task on whether or not they will be doing the works.

Perhaps the most likely example of where the tenant can say that the works will not be done and, therefore, there should be no liability for repairs is where the landlord's intention to demolish the building can be proved.

Landlords and tenants, when pursuing or defending a claim of this nature, need to be aware of the pitfalls that could exist for anyone not taking professional advice from their building surveyors or commercial property lawyers on this complex area law.

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