MARKETS

Scotland

Hydrocarbon slump takes toll on Aberdeen

The fall in oil prices has hit Aberdeen hard – but will the oil-rig decommissioning sector offer the Granite City a lifeline? **Andrew Stone** reports

Oil and gas woes: Cromarty Firth is filled with a series of mothballed rigs

BERNABE BLANCO/SHUTTESRSTOCK

Mothballed rigs, as tall as skyscrapers and crusted brown with rust, crowd the hazy skyline of the Cromarty Firth, their ghostly silhouettes the most visible sign of a decade-long oil-boom-turned-bust.

Further east, the many 'To Let' signs in Aberdeen are another, more prosaic, reminder of the hydrocarbon slump. They plaster the windows of the modern office blocks around the station and the granite walls of the West End above a harbour packed with laid-up ships.

With oil prices at a fraction of the levels Scotland's oil and gas industry had come to rely on, Aberdeen is hurting. The city has always been exposed to this cyclical business, but could the latest downturn be the sign of a more structural decline? And, in a strange twist of fate, could the blossoming oil-rig decommissioning sector offer Aberdeen's office market an unlikely lifeline?

Low for longer

With oil as low as $30 (£21) a barrel, few operators will be making a profit; $50 a barrel is seen as a minimum. Already one of the world's most expensive regions in which to drill, $27bn worth of prospecting business for new oil fields will be shelved in the North Sea if oil prices don't rally strongly soon. Investment this year could fall by 90% compared with 2015, according to industry group Oil & Gas UK. North Sea job losses could reach a total of 23,000, and Aberdeen is expected to suffer a disproportionate share of them.

The knock-on effect on the city has been stark. A long-standing dearth of office space has become a glut, with 1.83m sq ft available in 2015, according to figures from Knight Frank. "That's an unprecedented level of availability – four years' average take-up," says Simpson Buglass, head of Savills Aberdeen. "There won't be much pre-letting going on for a while; that's safe to say. No one has ever seen anything like this before."

The level of available grade-A space rose seven-fold to 526,000 sq ft last year. The take-up of office space fell 61%, and more than half of that was out-of-town pre-lets agreed before oil prices fell.

Available space has now reached 2.2m sq ft, according to Bruce Murdoch, partner at surveyor Graham + Sibbald. "And that's only part of the picture," he adds. "There's a general under-occupation of space. In the business parks, the headcount has been reduced. People are rattling around in buildings with too much space."

While headline prices per square foot have »

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Deep impact: the fall in oil prices has had a knock-on effect on Aberdeen city centre

been largely static at around £32, deals now come with substantial soft incentives including help with initial rent, capital and fit-out contributions - something almost unheard of in Aberdeen in prior years. "Whereas landlords would have done 10- to 15-year deals with no incentives in the past, that is now changing," says Buglass. "We've seen Aberdeen become more aligned with other cities in terms of incentives. The balance has swung in favour of the tenant."

Investment activity, unsurprisingly, has been thin on the ground. According to Knight Frank, Aberdeen office investment last year fell 82% on 2014 (a record year) and was 46% lower than the 10-year average. Only four transactions of more than £10m completed compared with 14 the previous year.

Under pressure

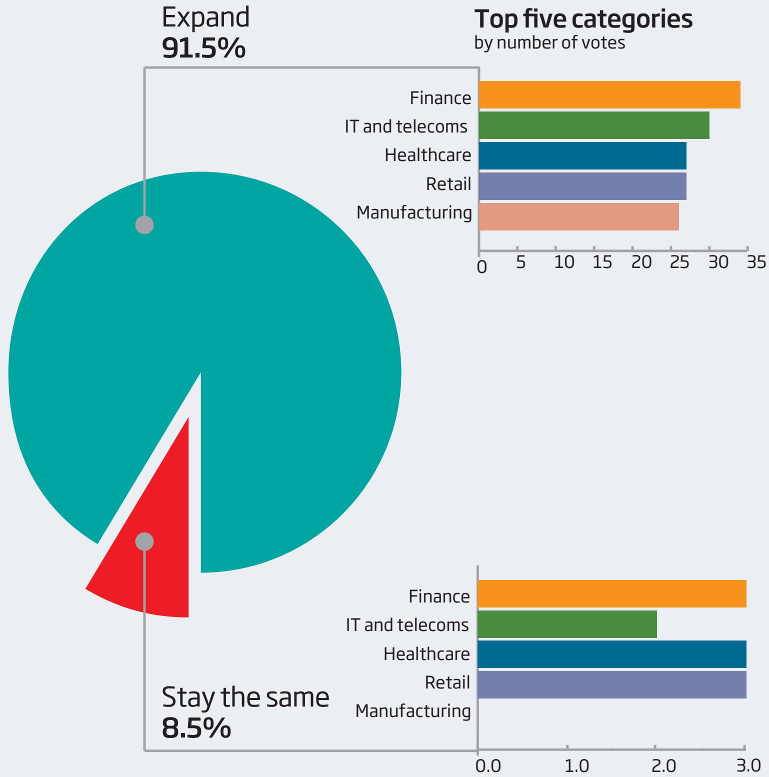
And more bad news is on the horizon. Oil prices may have bottomed out, but global gas prices are still falling and in March the first shale gas shipments from the US arrived in Europe - a reminder of the ongoing competitive pressures North Sea operators face.

A recent article in the *Financial Times* quoted gloomy oil executives off the record as fearing this slump could be the "beginning of the end" for the North Sea industry.

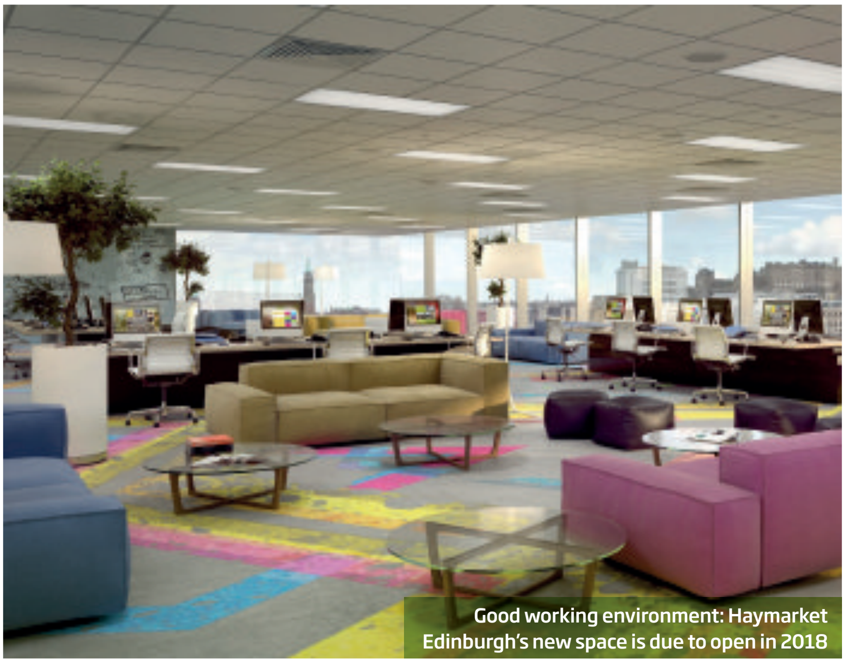
It's not a mood reflected among Aberdeen's property players, however. At worst, the attitude is one of resignation that a long boom is over. At best, there is a feeling of relief that things are a bit less busy for a change and that opportunity is in the air for those with the right investment horizons.

Aberdeen and the North Sea have been written off before and have bounced back. The same will happen again, says David Stewart, partner at law firm Morton Fraser. "Outside London, Aberdeen is the most volatile market in the country, but if you're able to take a longer-term perspective, it offers an interesting market. Closed-ended funds that need an exit in the next three to five years may suffer, but those prepared to buy and hold beyond this."

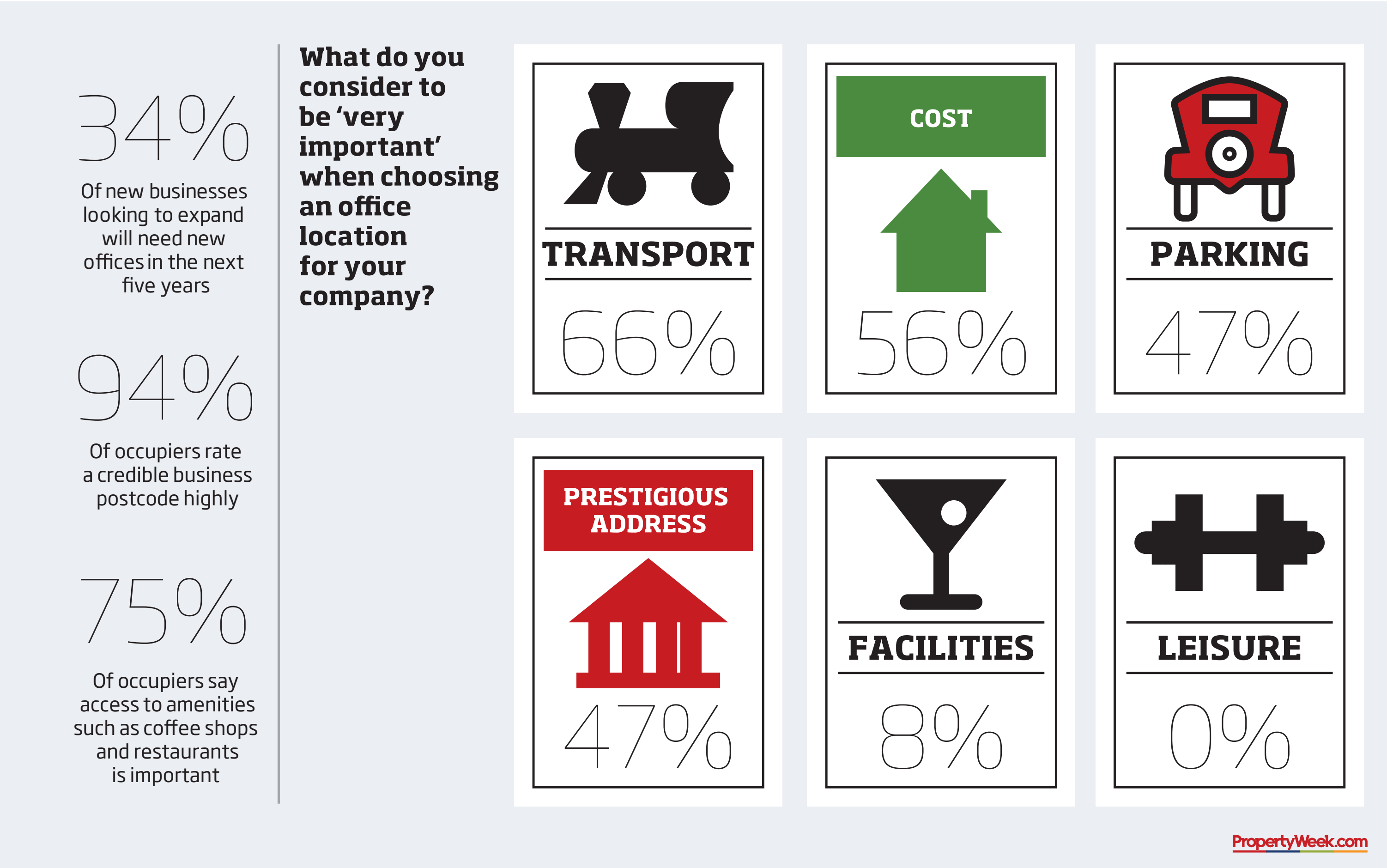
Expansion plans: is your company looking to expand in size or remain the same over the next five years?



Source: Haymarket Edinburgh



Good working environment: Haymarket Edinburgh's new space is due to open in 2018



Most Scottish firms plan to expand over the next five years

A recent survey shows clear demand for decent office space, particularly in Edinburgh

More than 90% of Scottish businesses are looking to expand over the next five years, according to a survey of 200 top Scottish executives.

Of those looking to expand, a third of businesses (34%) said they would require new office premises within the next five years. The sectors leading demand for more space were manufacturers, utilities, IT, telecoms and finance.

The survey paints a positive picture for Scotland, with less than one in 10 businesses believing they will stay the same or downsize in the coming years.

David Westwater, development director at Haymarket Edinburgh, which commissioned the research, says the survey shows a clear demand for quality office accommodation, particularly in the Scottish capital.

"What struck me most was the expectation of businesses to expand," says Westwater. "It is even better for us on the Haymarket development. Edinburgh is a really strong regional city. It's got a strong base in tourism, financial services, education and university technology spin-offs."

Surprising results

The survey offers up some surprises. For example, respondents valued proximity to public transport ahead of price, which was the second most important factor when deciding on new office locations. A credible business postcode was third in the list of 'must-haves', with 94% rating this as an important determining factor, particularly in the case of professional services (100%) and finance (97%).

"What also emerged was how important location is for businesses," adds Westwater. "Staff retention is very high on their agenda and the environment they want to be based in is important. To increase the profile of the business, you need to be visible and location matters. They want a nice place to work and a nice place for their people."

The study also found that some businesses increasingly see value in sharing office locations with similarly ambitious and successful organisations.

Access to amenities such as good coffee shops and restaurants scored highly, with three-quarters (75%) of respondents believing it was important or very important in their decision-making. Parking was lower down on the list, with less than half (47%) scoring it highly.

The findings bolster many of the decisions Haymarket Edinburgh made to make its own 340,000 sq ft office development in Haymarket - due to open in 2018 - fit with evolving tenant expectations, says Westwater.

"We wanted it to be a permeable development that did not throw up any barriers and that allowed people to flow through the development, to bring it to life and to make it a good environment in which to work and spend money."

With businesses keen to expand into attractive new office spaces, other developers may well follow suit. ■