

---

# Aberdeen Residential Strategy

---

---

## Work stream 2: Opportunities and Constraints

---

## Contents

<b>Introduction</b>	<b>2</b>
1.1. Purpose .....	2
1.2. Approach .....	2
1.3. Next Steps .....	2
<b>Executive Summary</b>	<b>3</b>
<b>1. Aberdeen Commercial Property Market Overview</b>	<b>8</b>
1.1. Market Overview .....	9
1.2. Office Market .....	10
1.3. Aberdeen Industrial Market.....	13
1.4. Vacant Office and Industrial Space.....	15
1.5. Retail Market .....	17
1.6. Leisure Market.....	21
1.7. Vacant Retail and Leisure Units .....	23
<b>2. Policy Framework</b>	<b>24</b>
2.1. Planning Policy .....	25
2.2. Planning and City Centre Development.....	26
2.3. Building Regulations .....	28
<b>3. Opportunities for Conversion</b>	<b>30</b>
3.1. Upper Floor of Union Street.....	32
3.2. West End Townhouse Conversion.....	35
3.3. Large Conversion Opportunity .....	38
3.4. Prime Development Opportunities.....	41
3.5. Woolmanhill Hospital .....	44
<b>4. SMART Recommendations</b>	<b>45</b>
4.1. Recommendation 1 - Be 'Open for Business' .....	46
4.2. Recommendation 2 - Act as a Catalyst For Development & Investment .....	47
4.3. Recommendation 3 - Plug the gap .....	48
<b>Important Note</b>	<b>49</b>

## Introduction

### 1.1. Purpose

This report is the second in a four part research programme. Its purpose is to consider trends within the commercial property market and how these are interacting, and potentially creating opportunities for residential development in the city centre.

### 1.2. Approach

We will comment on the local commercial property market, both historic and current. In doing so, we will consider occupier trends, and ultimately identify vacant properties and development opportunities within this context.

We will then consider these opportunities in respect of the policy framework in which they operate; planning and building regulations.

This will help form the basis of our site analysis and appraisals. We intend to take a number of existing or potential development opportunities across the city and run appraisals on these opportunities to assess their viability. This will help us understand where the market is on these products.

Finally, we will provide key recommendations for consideration by Aberdeen City Council.

### 1.3. Next Steps

There are two further reports to come forward as part of this instruction. The next report will consider how comparable cities have grown their populations and encouraged city centre development. This will encompass analysis of demographics and policies. The final workstream will provide our considered recommendations for the Council to take forward.

Economic circumstances are changing the city's development dynamics and creating a considerable number of development opportunities. These include converting upper floors and finding new uses for buildings which are no longer in demand for their current use.

However, many of these development opportunities are very challenging and our analysis of example appraisals shows that some are also unviable or unprofitable, which will make them access development finance for.

Therefore we recommend that Aberdeen City Council consider our recommendations to support, and actively encourage, the development of these opportunities to support the city centre strategy. Failing to do so might risk these buildings remaining vacant and falling into disrepair. Meanwhile supporting development will create a more vibrant city centre and the bonus of additional council tax receipts.

## Executive Summary

---

### Commercial Market and Oil and Gas

---

The performance of the Aberdeen commercial property market is inextricably linked to activity in the North Sea Oil and Gas Exploration and Production Sector, and there is a clear correlation between demand for commercial property and the price per barrel of Brent Crude Oil.

As is much publicised, the cost of Brent Crude Oil declined significantly from its peak at \$120 in Summer 2014, bottoming out at \$30 per barrel in January 2016. It has stabilised recently at between \$50 and \$55.

---

### Office Market

---

***The drop in oil price has created a correlated drop in demand from energy sector occupiers. This has been met by a significant increase in supply as occupiers introduce excess accommodation to the market at a time when speculative office developments are nearing completion. As a result, the market is witnessing an over supply of accommodation.***

Recently, the availability of new Grade A stock in the city centre combined with increased vacancies elsewhere is bringing about a 'flight to quality'. The demand for high quality accommodation is reducing the attractiveness of some of the city's older stock, creating potential redevelopment opportunities.

---

### Industrial Market

---

The industrial market has not suffered to the same extent as the office market in Aberdeen, largely due to a lack of industrial development over the past ten years. As a result, headline rental values have remained relatively stable following the oil price crash, however demand has undoubtedly fallen.

# Aberdeen Residential Strategy

## Work stream 2: Opportunities and Constraints



*While office development halts, industrial development is considered more attractive and profitable. Indeed, we have seen a number of key deals struck in the City which renews focus on industrial development.*

---

### Retail Market

*Whilst there are few vacancies within the shopping centres there are a high number of vacancies or occupiers on short term leases or licenses on Union Street, particularly to the east and west most areas of the street.*

Additionally, many of the occupiers are not of the quality you would expect for a city's major shopping parade and therefore the street is facing a number of challenges with the retail core consolidating to a north south axis.

---

### Leisure

The economic performance in Aberdeen has led to a decline in discretionary spend within the city. As a result a number of restaurants and bars have closed. Further, historically high levels of corporate demand has led to a considerable amount of hotel development catering to this market. Recently, hotels have started to diversify to attract tourist and conference visitors.

*There have been some new leisure openings, primarily in the shopping centres and the west end of Union Street. The shopping centre focus is forecast to continue with the extension of Bon Accord shopping centre to include a cinema and restaurants. .*

---

### Planning Policy

The Aberdeen City Centre Masterplan was adopted in June 2015 and identifies 7 intervention areas and 49 projects to define the masterplan's focus. The masterplan is embedded in the recently adopted Local Development Plan as the Council's agreed vision for the regeneration of the city centre. The Council is commencing development briefs and regeneration frameworks for the regeneration of each the intervention areas.

One such focus is the re-establishing Union Street as the heart of the city which includes stronger north/south linkages, creating a destination and refurbishing and remodelling buildings on Union Street. This provides a positive basis for redevelopment of the vacant space above shops on Union Street.

---

### Building Regulations

Although the City Council is looking to actively encourage city centre development and redevelopment, there are a number of challenges when it comes to older stock. These include structural viability issues, fire regulations, heat loss, and accessibility and viability challenges.

The best means to maintaining the city's built heritage is for the buildings to have a viable, sustainable and practical re-use and a close working relationships between developers, planners, building control, building standard officers and conservation officers can help everyone come to a positive way forward for the building.

---

### Opportunities for Conversion and Development

---

Our analysis showed that for many of the developments, the residential development value was less than the perceived current value of the asset. This creates little incentive to redevelop, particularly if the building is listed and therefore does not incur vacant rates. Listed buildings can also require higher levels of expenditure to convert or offer sub-optimal reconfiguration options.

---

### Recommendations

---

#### 1.4. Recommendation 1 - Be 'Open for Business'

Make life easy for developers and investors to do business by streamlining legislation and reducing the financial obligations which impact the viability of development projects.

This would be measured by market activity. The number of conversions and re-developments in the city centre and the number of developers actively seeking opportunities.

In order to achieve this goal, we would recommend the following initiatives:

1. Work with developers to identify solutions to deal with complicated Building and Listed Building Regulations.
2. Consider exercising statutory powers and CPO's to assemble land.
3. Introduce a Development Manager or regeneration team within the Council who can deal directly with the applicant/ private sector. Must be someone who understands the viability of development projects and the impact changes to consents and construction programmes can have on profitability (i.e be commercially minded). While the Council can subsidise this in the first instance, developers would be willing to pay for this service if it is successful.

We have been advised by a wide range of developers traversing the whole market that the existing planning and building control capacity, particularly in relation to Listed Buildings, make developments and conversions difficult and expensive. Most acknowledged that streamlining the system and having the Council as a support, rather than a barrier, to development would encourage them to actively develop. This will be demonstrated by making information clearly accessible so that developers can clearly understand what is expected of them.

The initiatives will be easy to implement relatively quickly and would be long standing initiatives. The introduction of CPO rights may take longer to implement and should be restricted to key projects only.

### 1.5. Recommendation 2 - Act as a Catalyst For Development & Investment

As discussed in detail throughout this report, market risk is a key issue impacting development and investment in Aberdeen centre as there is a lack of appetite from developers, institutional investors and lenders to fund and enable development in the city. In order to increase activity, Aberdeen City Council need to demonstrate their confidence in the market and act as a catalyst for investment.

This can be measured through activity in the market and the demand from developers / investors that follows.

In order to achieve this, we would advise the following initiatives:

1. Covenant Play –The Council’s covenant will attract funding and investment to allow projects to commence speculatively. Financial mechanisms was adopted with Muse for the development of Marischal Square.
2. ACC Development Company – Demonstrate confidence in the market by committing to the development of a key masterplan project, such as re-development of Queen’s Square.
3. ACC Land Trader – For large development sites, commit to carrying out site clearance and preparation work and introduce smaller, manageable areas of land to the market which would suit requirements. Such a framework, set up by the council, allows a wider mix of developers and increase rates of delivery.
4. Assist to fund a development through financial mechanisms.

This is a bold initiative and can have financial implications to the Council if not carefully considered. The initiatives must be subject to certain criteria, and likely restricted to larger scale projects.

This will not be a short term project and will require significant consideration and financial modelling in order to ensure the right projects are chosen.

### 1.6. Recommendation 3 - Plug the gap

Encourage investment and development by considering where the Council can intervene to assist with viability issue..

Can be achieved through the following initiatives:

1. Consider removing or reducing developer obligations and requirement for affordable housing within a blanket area of the city, particularly on brownfield land or conversion opportunities. During our stakeholder interviews, a number of developers and architects advised of a number of city centre projects in the pipeline which would commence imminently if there was no, or very little, requirement for developer obligations and affordable housing.
2. Introduction of grants / funds similar to Rural Housing Fund and Scottish Infrastructure Fund with similar timescale and value restrictions to assist with build costs, VAT requirements for conversions, site preparation work and feasibility testing.
3. A publically available and highly advertised website which allows potential developers to identify if they are a small, medium or large developer and submit a short business case confirming their debt requirement. Thereafter, the website can confirm the grants and funds available to them.

There is a wide range of grants available for the development of larger scale projects and affordable housing which have been introduced to meet Scottish Government targets for more housing throughout the Council. Altering these initiatives to make them suitable for brownfield land and adopting a multi-pronged approach where by the grants can assist at all levels of the market would help to address the price and land value gaps that have been described throughout our report.

The grants should be available for a restricted period of time in order to maximise their potential and encourage development.



---

# 1. Aberdeen Commercial Property Market Overview

---

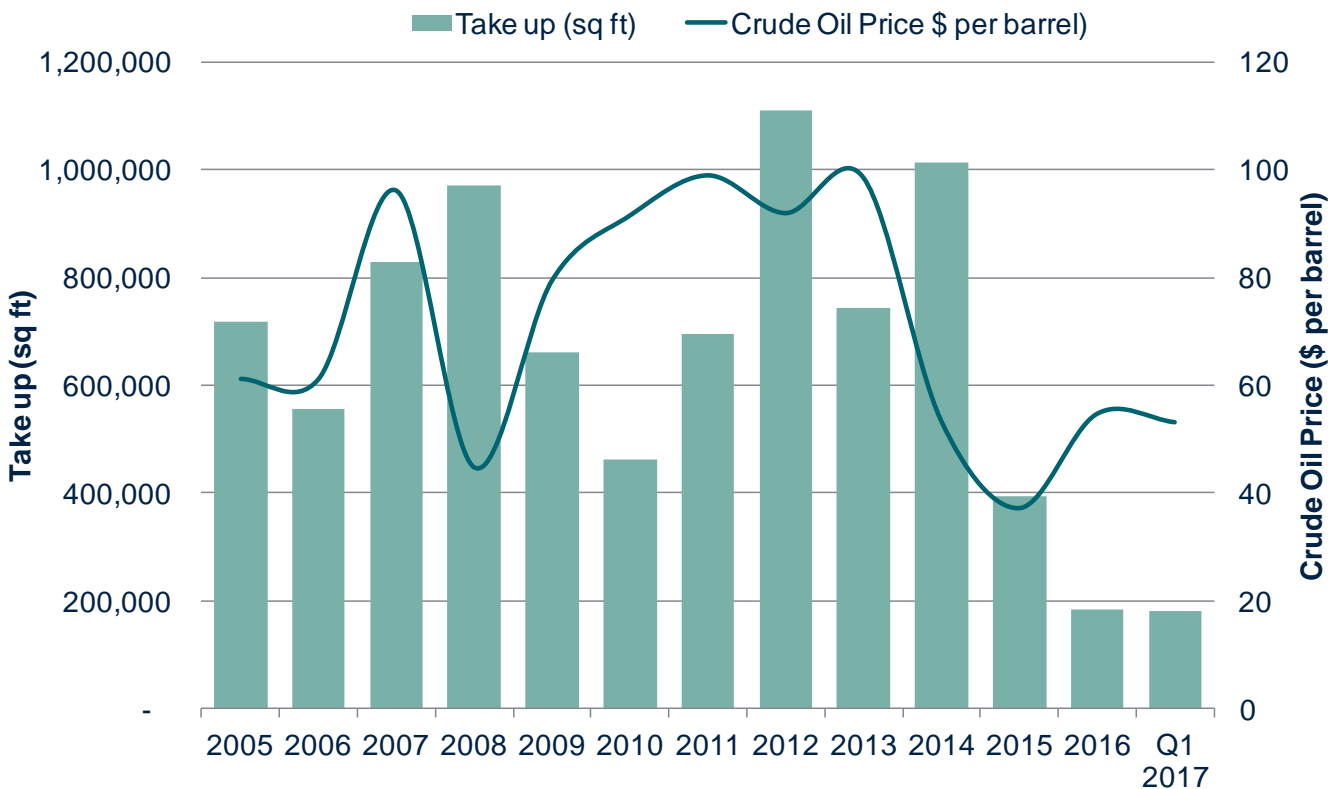


### 1.1. Market Overview

Demand for residential and commercial property in Aberdeen is inextricably linked to activity in the North Sea Oil and Gas Exploration and Production sector. The vast majority of occupiers in Aberdeen have a link, either direct or indirect, with the energy sector. As a consequence there is a correlation between the price per barrel of Brent Crude Oil, and demand for commercial property in the city and surrounding areas.

The price per barrel of Brent Crude Oil has seen significant decline from its peak at c. \$120 in late summer 2014 to its current level of around \$50. Oil price “bottomed out” at sub \$30 per barrel in January 2016, recovering slightly to \$50 - \$55 per barrel and has remained stable in this range over the last 12 months. General sentiment appears to suggest that global economic factors will ensure that the oil price will remain at, or around, the current level, at least in the short to medium term.

**Figure 1 – Aberdeen Office take up and crude oil price (\$per barrel)**



Source: Savills, Bloomberg

The drop in oil price has seen a significant tail off in activity from energy sector occupiers, with many companies in the sector having been through, or still going through, a staff rationalisation and redundancy process. This has had a significant and adverse effect on the demand for commercial property across the city. The supply and demand equation is now heavily weighted in favour of the occupier.



### 1.2. Office Market

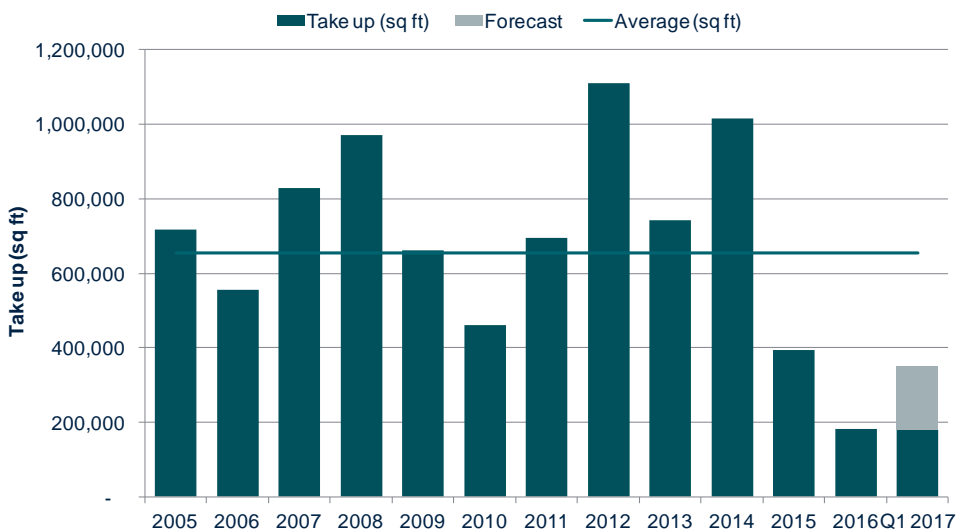
#### 1.2.1. Take Up and Supply

The office market in Aberdeen is currently characterised by huge oversupply, and very little in the way of noteworthy occupational demand.

In 2014, office take up in Aberdeen reached a high of 1.05 million Sqft, driven primarily by an extremely buoyant energy sector, huge pent up demand and a distinct lack of available stock. Office supply in the city at that time was at an unprecedented low, and many occupiers struggled to find suitable accommodation. At one point, it was well documented that there was less than 10,000 Sqft of available Grade A office space across the city.

This lack of availability led to occupiers committing to poorly specified space, often in undesirable locations, simply to satisfy their immediate operational requirements. This shortage of stock, coupled with significant levels of demand, landlord friendly lease terms, and substantial returns, led (somewhat inevitably) to a flurry of pre-let office transactions.

**Figure 2 – Office take up in Aberdeen 2005-2017**



Source: Savills, PMA, Trading Economics

Many of these pre-lets were in the periphery of the city, where the majority of the city’s development land was found. Much of this land was zoned for Classes 4, 5 & 6 (Office, Industrial and Storage Uses). Developers would often neglect lower value Industrial and Storage uses in favour of chasing the higher value office deals.

In 2014, investor confidence in Aberdeen was at an all-time high, and institutional funds recognised that far higher returns could be made in Aberdeen than other provincial markets. The weight of money coming into the city saw many new buildings built, and forward commitment to three large speculative city centre office developments, bringing some 380,000 Sqft to the city centre. The Capitol (c.80,000 Sqft) and The Silver Fin (c. 135,000 sqft) are now complete. Marischal Square (c.175,000 Sqft) is set to complete shortly.

The drop in oil price and fall in demand from the energy sector came at precisely the wrong time for Aberdeen. Just as unprecedented levels of supply were being delivered, office take up dropped over 50% to 403,000 Sqft in 2015, and reduced again to 230,000 Sqft last year. This is the lowest level of take up experienced for many years, and is significantly below the 10 year average of approximately 700,000 Sqft.

As a result of the fall in demand, office supply in the city has reached an unprecedented high. There is in excess of 2.5 million Sqft of available office space across the city, circa 4 years supply, based on 10 year average take-up. Much of this space is poor quality, effectively obsolete accommodation, which will require to go to alternative use.

The increase in supply of Grade A accommodation has resulted in a “migration to quality” with occupiers trading up the quality of their office space and taking advantage of rental incentives. Their former poor quality accommodation is lying vacant or being put to alternative use.

The growing recognition of the benefits derived from flexible open-plan accommodation may also lead to a re-examination of former period town houses in terms of change of use back to residential accommodation.

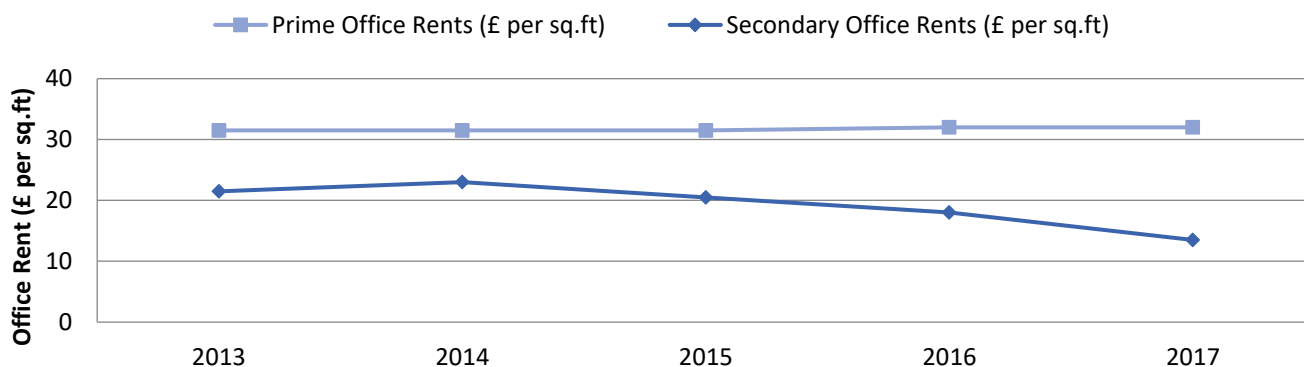
Notable office lettings in 2017 have been by Total with 108,000sqft at Westhill; Marathon Oil with 32,000sqft on Hill of Rubislaw and most recently Chrysaor who have taken 48,000sqft at the Capitol on Union Street leaving only c.10,000sqft remaining in this Grade A building. This last letting is perhaps also a portent of things to come as it is the first sizeable office letting in Aberdeen city centre for many years.

As more occupiers see the benefit of both Grade A accommodation and the benefits of a city centre location for their staff, there may be a requirement for additional Grade A stock in the city centre. The market will, of course, dictate.

### 1.2.2. Rents

In line with a high level of demand and distinct lack of stock, rents for prime Grade A stock in 2013/ 2014 hit an all time high for the city at £32 per sq ft. While the high rent reflected peak market conditions, it further reflected the quality of accommodation that had not been seen in Aberdeen for quite some time.

Figure 3 – Chart showing Office Rents (£per sq.ft) (2013 -2017)



Source: Savills

Since the drop in oil, and the subsequent fall in demand for office space, prime headline rents have remained stable, partly due to occupiers now demanding high specification, open plan, Grade A offices that they were unable to obtain at the latter stages of the bull market. However, the inclusion of rent free periods and premiums have increased significantly which has impacted net effective rents. Indeed, at the height of the market, an occupier was considered to have achieved a good deal if any rent free incentives was offered for 10 year lease agreements, where as 18 – 24 month incentives are now common place within the market.

Headline secondary rents have been impacted to a greater extent having decreased from their peak of £23 per sq ft in 2014 to a current value (Summer 2017) of less than £15 per sq ft as landlords seek to cut rents to avoid vacant rates and holding costs.

### 1.2.3. Yields

Prime office yields have remained relatively static over the last 12 years fluctuating within a window of 6.0% and 7.5%. There continues to be demand from investors for prime investments with long leases of 10 to 15 years, incorporating fixed rental increases, to strong covenants. For example, the 100,000 sq ft Grade A office let to Lloyd's Register for 15 years was sold earlier this year for £41.28m reflecting a net initial yield of 6.85%.

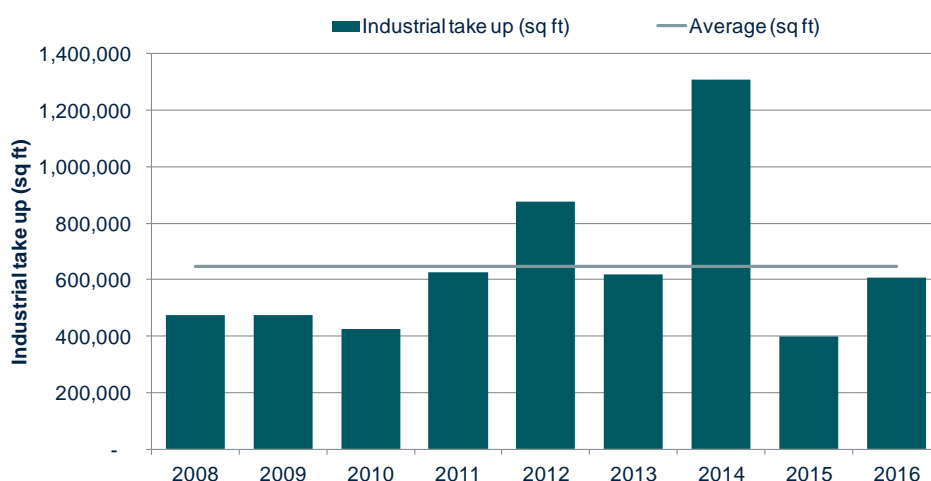
However, investments that fall short of this strict criteria attract very limited demand. In recent years, when demand for office investments was at its peak, there was a very small gap between prime and secondary yields. However, this gap has widened significantly as investors attitude towards Aberdeen has changed and there is generally less demand for secondary investments. 'Vulture' funds have emerged in the market who are taking advantage of vendors who need to sell in a weak economy and will accept offers at less than market value in order to secure a sale.

### 1.3. Aberdeen Industrial Market

#### 1.3.1. Take up and Supply

Take up in the industrial market has been less volatile than the office market, with take-up in the city at approximately 600,000 Sqft, very close to the 10 year average.

**Figure 4 – Industrial take up 2008-2016**



Source: Savills

Demand remains comparatively strong for new build high specification industrial stock and there are only a handful of high quality industrial buildings across the city which are available for immediate occupation – 7A International Avenue at ABZ Business Park, Core 3 at The Core Business Park, Pavilion 2 at Kingshill Commercial Park and H2 at Aberdeen Energy and Innovation Parks.

In addition to the above, we have witnessed a number of occupiers who do not require to be based within Aberdeen city, relocating to areas out with the city in order to benefit from the lower land prices and cheaper rents. Industrial estates in areas on the periphery of Aberdeen such as Inverurie, Kintore, and Blackburn have grown over the last few years as a consequence. This has left some older industrial buildings within the city’s industrial estates looking for occupiers and needing considerable reinvestment or redevelopment. Those which are economically and functionally redundant may require change of use.

Supply has increased over the course of the last 24 months, currently standing at c. 2m Sqft which is in excess of 3 years take up, based on a 10 year average. However, we have not seen the same number of surplus industrial facilities come to the market in comparison to the office market, as energy sector occupiers still need to retain industrial accommodation for operational and storage purposes, despite reducing headcount.

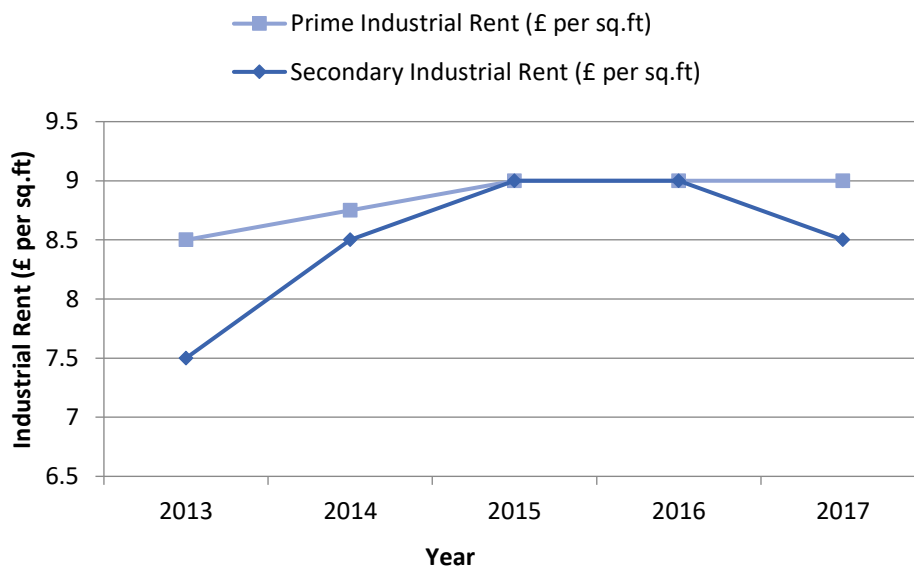
Of the supply in the market, approximately 600,000 Sqft (30%) is located in Dyce with the remainder on peripheral industrial estates. There is a very marginal market for industrial buildings within the city centre due to archaic constructions, layouts, absence of yards and congested access.

### 1.3.2. Rents

Headline rental values for prime industrial accommodation have also proved to be resilient despite current market conditions, with deals continuing to achieve headline rents in line with those experienced prior to the market downturn. Similar to offices, incentives have been introduced in order to attract longer lease terms however we have been involved in recent lettings at ABZ Business Park in Dyce and Kingshill Commercial Park in Westhill where, aside from incentives and in some cases lease length, the deals have mirrored those achieved pre oil price fall.

However, when the market was buoyant there was only a marginal difference in rents between second hand and prime/new build industrial accommodation, largely due to a low level of supply. We are now witnessing a gap between the two markets with second hand stock having to be appropriately priced in order to attract occupiers.

Figure 5 – Chart showing Industrial Rents (£persq.ft) (2013 to 2017)



Source: Savills

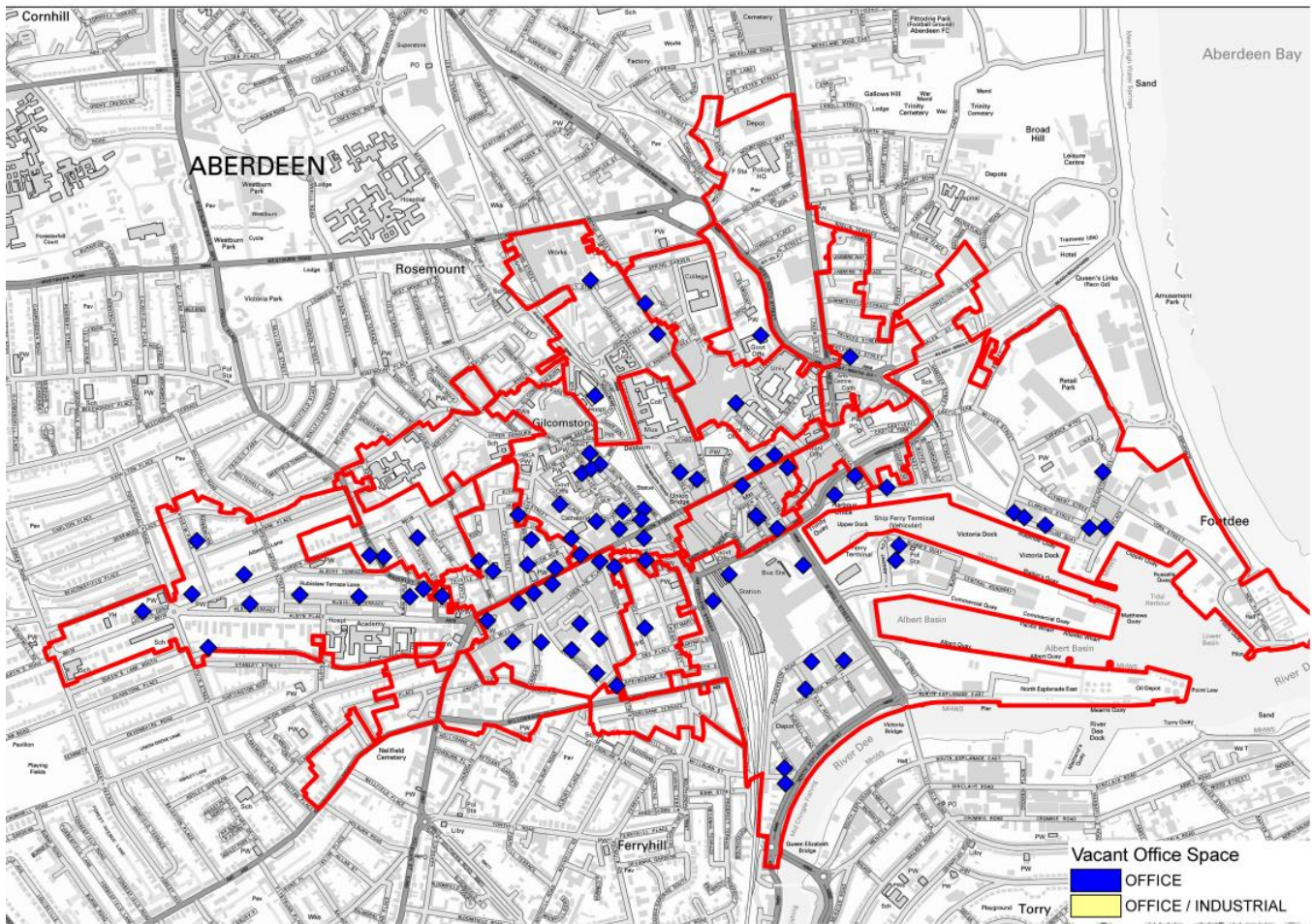
### 1.4. Vacant Office and Industrial Space

We analysed the number of vacant office and industrial units within the Aberdeen City Centre boundary. There were 295 vacant office spaces identified. Of these, 4 had become vacant between January and March 2017, 23 became vacant in 2016 of which 14 were units at 1 Thistle Street which is the Blue Sky Serviced Office Space. A further 19 units have been vacant since 2015 and a further 36 since 2014, the 17 of which were at Regent Road and Regent Quay.

Units around the Harbour have typically been vacant for longer. For example Regent Quay, Blackie's Quay and Poynerook Road account for a large number of the vacant space. Furthermore 92 vacant units are within AB11 5 postcode sector, the area covering the harbour.

There are 59 vacant office units on Union Street with many of them in clusters around key buildings. For example there are 18 vacant units at 210-14 Union Street and 6 units at 46a Union Street which covers the Union Chambers building.

Map 1 – Map showing vacant office space in Aberdeen City Centre



Source: Aberdeen City Council/ Savills Research/ OS



# Aberdeen Residential Strategy

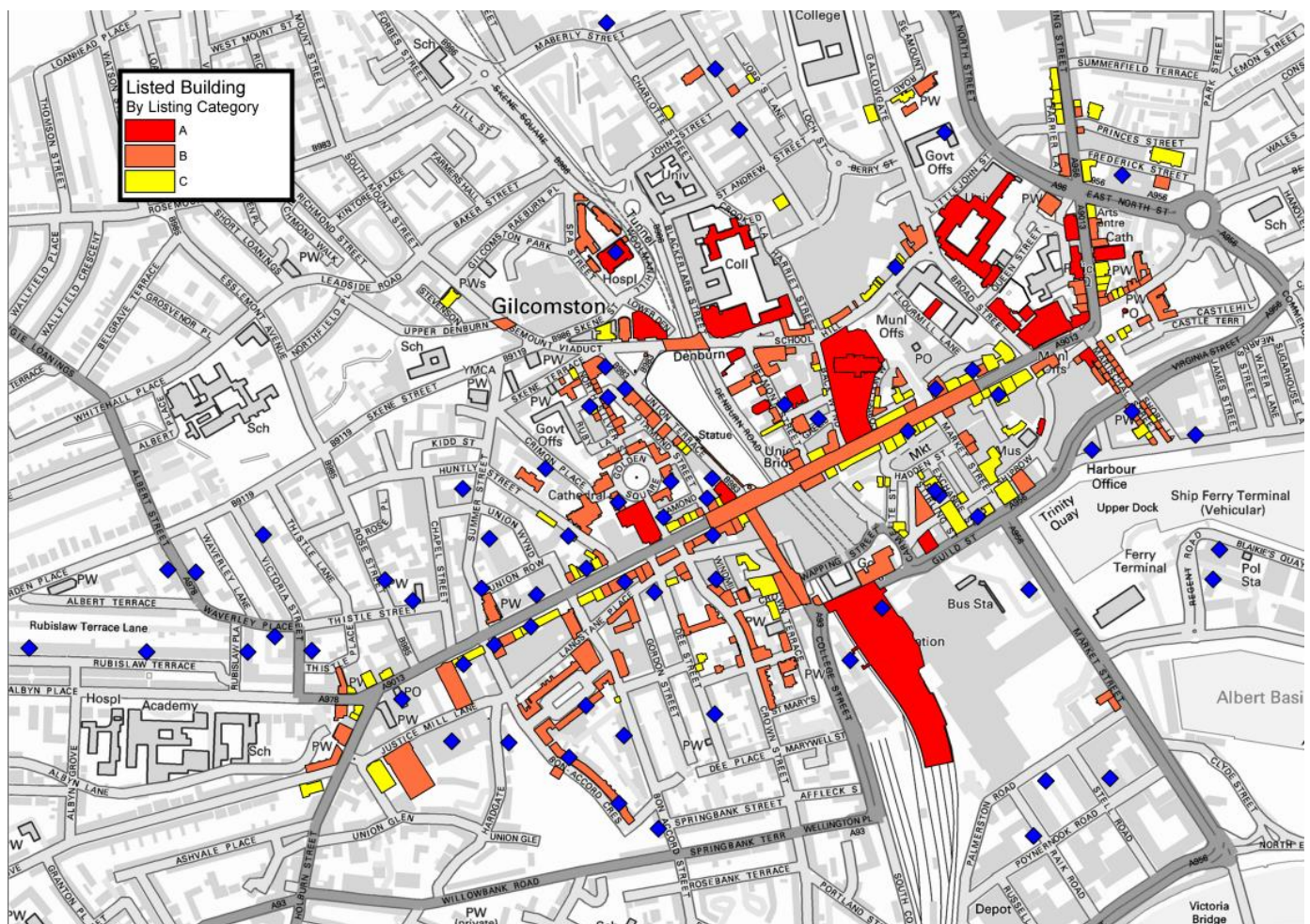
## Work stream 2: Opportunities and Constraints



When we consider the location of the vacant office stock in relation to listed buildings it becomes apparent that there is a degree of correlation between listed buildings and vacancy. This is particularly the case along Union Street and Union Terrace where the majority of stock, and therefore vacant stock, is located within B, and occasionally C listed buildings.

There are a handful of vacant units within A listed buildings including at Woolmanhill Hospital which is proposed for new hotel and residential development.

**Map 2 – Map showing vacant office space with listed building layer in Aberdeen City Centre**



Source: Aberdeen City Council/ Savills Research/ OS

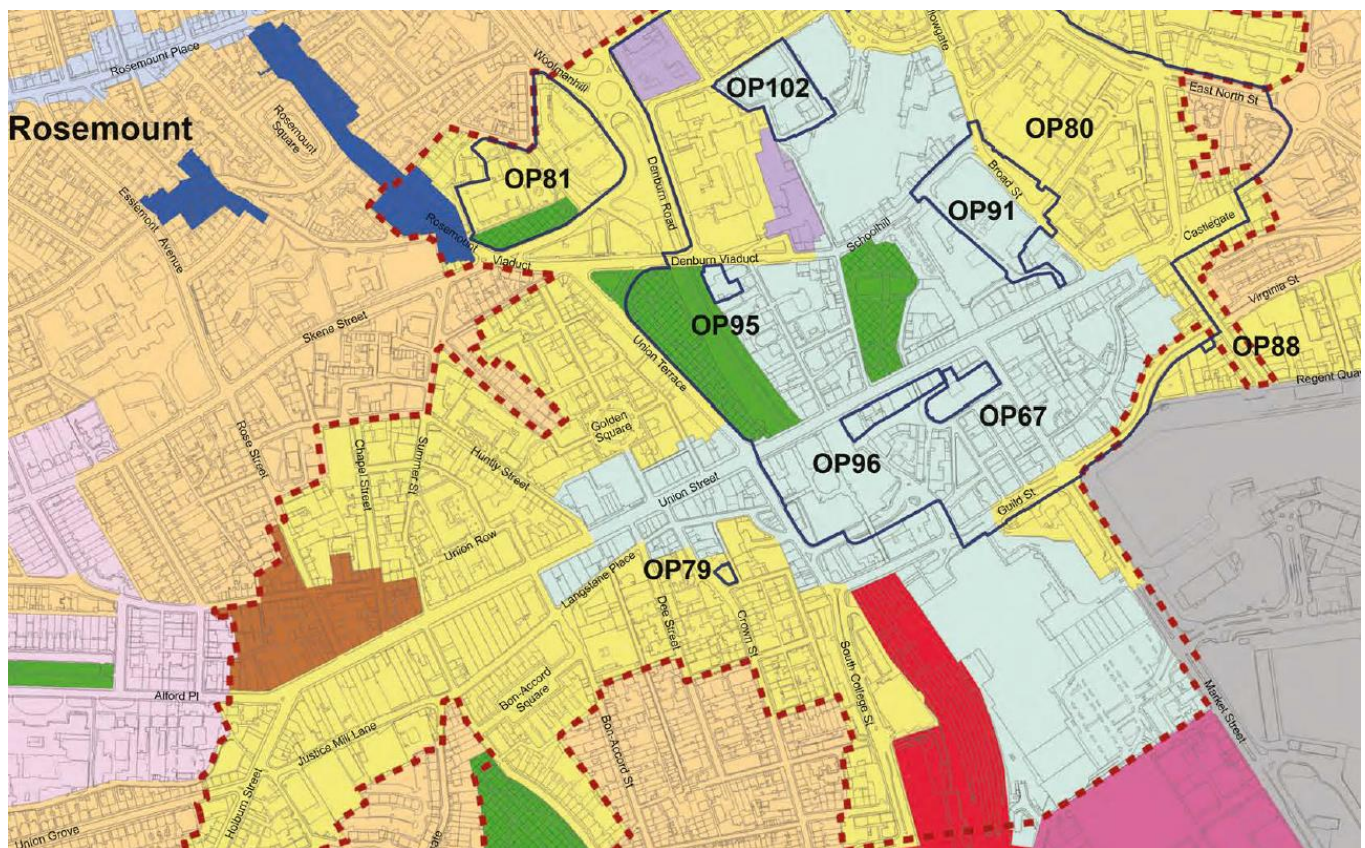
### 1.5. Retail Market

#### 1.5.1. City Centre Retail Provision

Total retail floor space in Aberdeen city centre is estimated at 2.21m Sqft. The core retail area in the city centre, as defined by PMA, includes part of the historic prime pitch of Union Street, which stretches east to west, and the city's four main shopping centres - Bon Accord Centre, St Nicholas Centre, Trinity Centre and, more recently, Union Square – all of which are situated in a linear formation north to south. In addition, there are two small specialist shopping centres, The Academy and The Galleria, with the latter occupied by local/independent retailers and bars.

This differs from the area identified as the retail core in the Local Development Plan, which identifies Union Street between its junctions with Bon Accord Street and Huntly Street in the west; and Broad Street and Shiprow in the east.

Map 3a – Map showing the *Retail Core (light blue)* defined in the Aberdeen Local Development Plan



Source: Aberdeen City Council

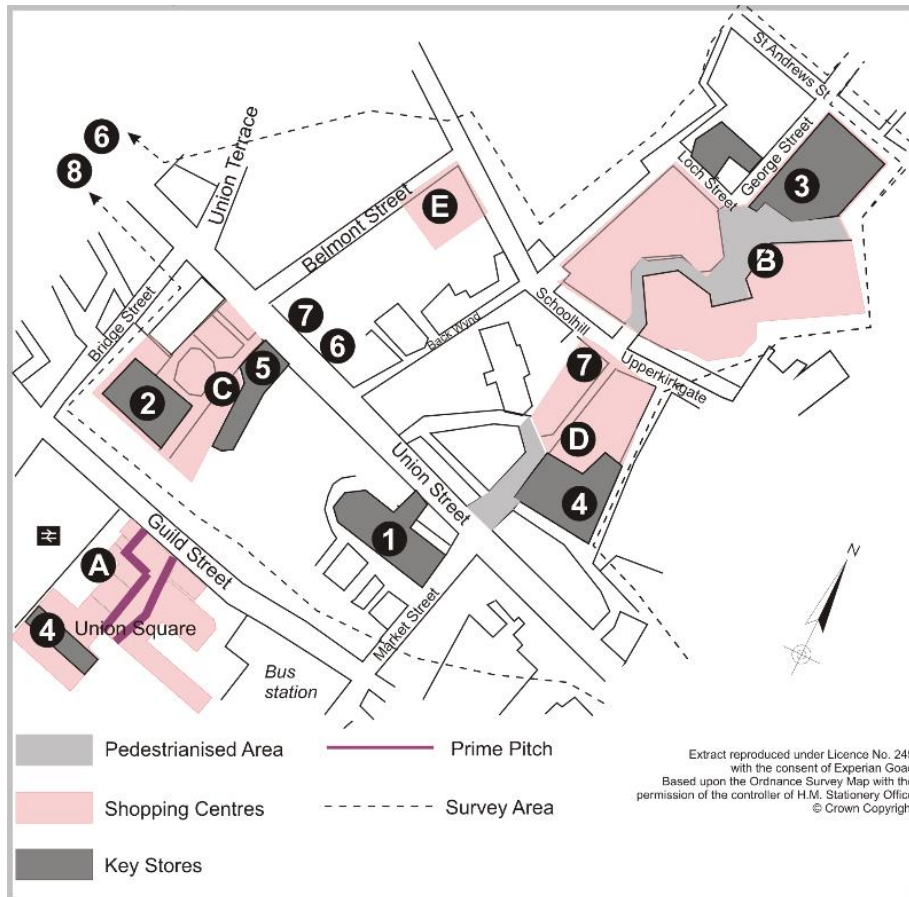
# Aberdeen Residential Strategy

## Work stream 2: Opportunities and Constraints



The plan below shows the layout of the city's prime retail offer as per PROMIS, the UK Property Marketing Information Service:

**Map 4b – Map showing the location of shopping centres in Aberdeen**



Source: PROMIS

A	Union Square	1	Former BHS (now closed) and Aberdeen Market
B	Bon Accord Centre	2	Debenhams
C	Trinity Shopping Centre	3	John Lewis
D	St Nicholas Centre	4	Marks & Spencer
E	The Academy Shopping Centre	5	Primark
		6-8	Convenience Stores

### 1.5.2. Aberdeen Retail Position

Aberdeen is a regionally dominant retail centre with few, if any, competing centres. The city undoubtedly serves the majority of the shopping needs of the population of north-east Scotland. The city's major competitors, Dundee and Inverness, are well over an hour's drive away. While the regional centres of Edinburgh and Glasgow both enjoy a superior retail offer to that of Aberdeen, they are around 2.5 to 3 hours distant and so are unlikely to attract any more than very occasional, special shopping trips.

As per PROMIS, Aberdeen ranks 15 on the basis of its PMA Retail Score and 15 on the PMA Fashion Score; the city ranks 17 on the PMA Anchor Score. Aberdeen has broadly the expected volume and quality of retail provision relative to the size and affluence of the shopping population.

### 1.5.3. Availability

In July 2017, PMA reported a vacancy rate in Aberdeen city centre of 8.7%, well below the Retail PROMIS average for the remainder of the UK.

The majority of vacant units are located on Union Street which has become less popular among retailers following the completion of Union Square and the change in the flow of pedestrian footfall. Many occupiers have relocated to either Bon Accord / St Nicholas or Union Square and we expect this trend to continue, to the detriment of retailing on Union Street.

There is a growing trend for the conversion of retail units at the West End of Union Street, where retail demand is low, to be redeveloped for leisure or office use. For example, the former Bruce Millers store has been demolished in part and is otherwise being converted to a Hotel with rooftop restaurant. Dr Noodles converted a former retail unit for use as a restaurant / takeaway and the former Waterstones on the corner of Union Street and Bon Accord Street is now occupied by Café Andaluz and local operator So... .

### 1.5.4. Retailer Demand

Aberdeen has a relatively high level of demand for a city of its size and status. The number of active requirements for Aberdeen has fallen slightly in recent years because pent-up demand was temporarily satisfied by the opening of Union Square but remains higher than the Retail PROMIS average.

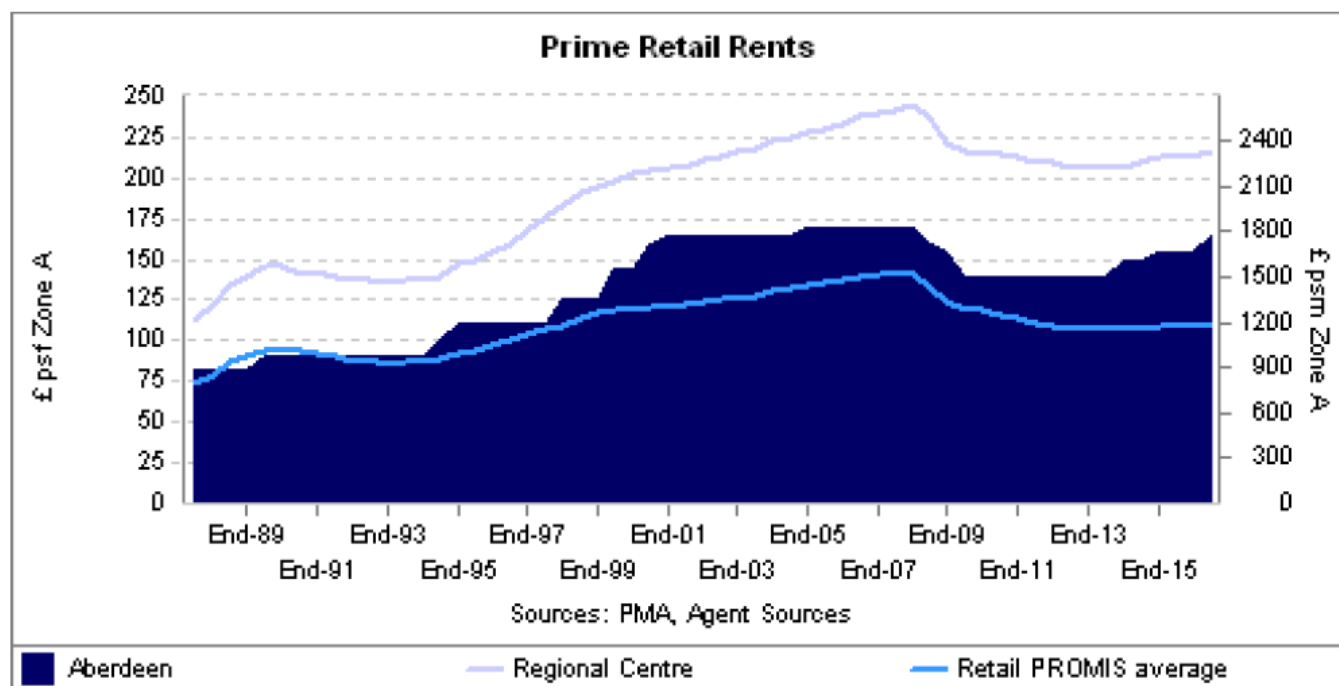
Demand for units in Bon Accord, St Nicholas or Union Square is likely to continue from existing retailers who are seeking to relocate from Union Street and retailers seeking to gain representation in the city when a suitable unit becomes available. Retailers, such as Whistles, Ted Baker, Timberland and Space.NK, are conspicuous by their absence in the city.

As discussed earlier, Aberdeen is a sufficiently strong retail centre for some of the larger fashion retailers to trade from more than one store in the city, although we would expect some retailers to be re-assessing their requirements for new stores in the city on account of the micro-economic conditions currently affecting the city.

### 1.5.5. Rental Levels

According to PROMIS, Prime Zone A rents in Aberdeen remained relatively stable at around £160 - £170 per Sqft Zone A during the 2000s before starting to decline in 2009 in-line with market trends and in response to the significant increase in supply following completion of Union Square, since then prime rents have recovered to around £165 per sq ft Zone A, as illustrated in the following chart:

Figure 6 – Chart showing rental levels in Aberdeen



Source: PROMIS

Prime rents in Aberdeen compare favourably to the Retail PROMIS 200 centres average of £110 per sq ft but falls behind Edinburgh (£250 per sq ft) and Glasgow (£315 per sq ft). The closest retail centres to Aberdeen are Dundee and Inverness which achieve £85 per sq ft and £70 per sq ft respectively.

Rents in Union Square command the highest levels at an estimated £165 psf Zone A. In comparison rents on the main ground floor mall of Bon Accord are at £140-£150 psf Zone A, with St Nicholas Centre slightly less at £110 psf Zone A, and Trinity Centre lesser still at £80 psf Zone A.

The best stretch of Union Street remains the eastern half near the intersection with St Nicholas Centre up to Trinity Centre, where footfall is at its highest. Rents within the most prime pitch have fallen to approximately £80 - £90 psf Zone A. Rents fall away sharply the further west and east along Union Street, dropping to around £30-45 psf Zone A.



### 1.6. Leisure Market

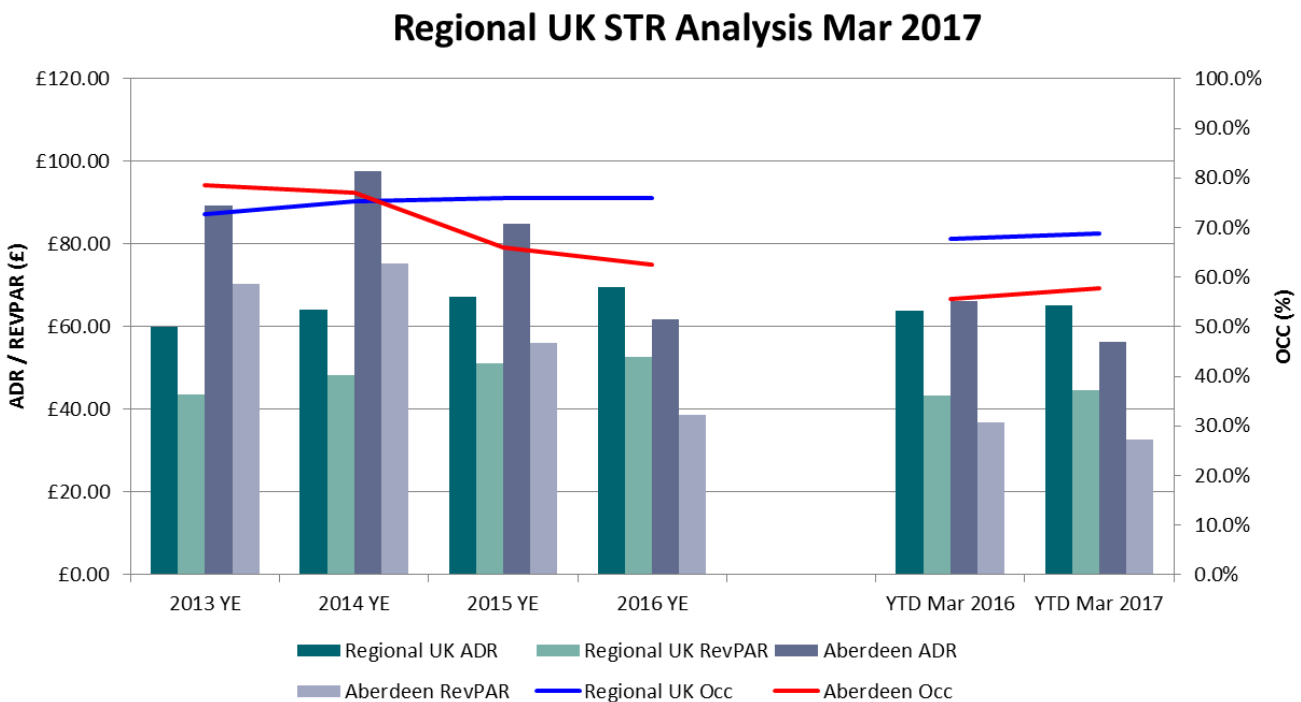
#### 1.6.1. Hotels

Aberdeen’s hotel sector has traditionally catered for the corporate market, receiving a steady stream of business from those working in the oil and gas industry. Recent development has primarily focused on out of town especially around the Airport in Dyce, in preference to the City Centre, in order to cater to this market. As result the performance of the city’s hotel sector is closely linked to the price of oil and as a result Aberdeen’s REvPAR growth has fallen back.

Since the shift in oil price Aberdeen has gained a reputation for an over-supply of hotel bed spaces and this is likely to continue for the medium term and with 366 bedrooms recently added in 2016/17 and 863 bedrooms in the active pipeline, the current imbalance between supply and demand in Aberdeen is likely to become further accentuated. This may improve in the long run as the North East aims to improve its tourist industry and current infrastructure improvements will allow the City to act as a gateway to the rest of the North East, however this will be measured in time.

The below graph shows the context of Aberdeen performance against regional UK:

**Figure 7 – Chart showing Aberdeen and Regional UK cities RevPAR and Occupancy**



However, there are a number of new trends emerging.

# Aberdeen Residential Strategy

## Work stream 2: Opportunities and Constraints



Firstly, conferencing facilities. In the past two years two hotels offering conference facilities have opened in the city and recently the Sandman Hotel Group, a Canadian private hotel chain will shortly complete the construction of a 217 bed hotel with three on-site restaurants, conference and business centres and associated leisure provision. The development of the Aberdeen Exhibition and Conference Centre will further contribute to the conference reputation of the city and will hopefully attract a new guest profile.

Secondly, increasing development of the tourist industry focusing on golf, outdoor sports, whisky distilleries and art tourism. With over 50 golf courses located in and around Aberdeen, the city is a popular venue for golf holidays and weekend breaks. Donald Trump opened the Trump International golf course in July 2012 bringing fresh awareness of the area's golfing heritage. In addition, Aberdeenshire is a popular location for outdoor sports and whisky distilleries and there is an opportunity to attract tourists to stay in the city, rather than the surrounding areas.

Despite efforts to broaden its offering, Aberdeen's performance is still heavily reliant on trends in the global oil market. The substantial issues highlighted above are not likely to be resolved in the short term and, as such, we expect hotel performance trends to decline further before recovering. Sandman Hotel Group's recent development is a notable and very welcome exception.

### 1.6.2. Restaurant

The local economic situation in Aberdeen has seen a reduction in discretionary spend with consequential impacts on bars and restaurants in particular. In Union Street and the surrounding area we have seen the closure of a number of restaurants (Jamie Oliver and Cue BBQ) to add to the closure of a number of standard retailers such as Office, Shuropolody, Santander and British Home Stores.

Restaurateurs who do not wish to be located in the shopping centres are focusing on the west end of Union Street, with Topolabamba and Bonobo recently opening. Local businesses such as Melt and Grain & Grape have opened stores in the West End and Food Story have shown commitment by extending their café to the first floor.

Fortunately the popularity of coffee outlets continues to appeal and the letting of major office buildings (The Capitol is now 85% let) will anchor daytime and early evening spend from office occupiers which will be strengthened when tenants are found for The Silver Fin, now completed, and Marischal Square office developments, nearing completion.

Extension of the Bon Accord Centre is at the planning stage and is to include some leisure elements, including hotel. There is demand from national bar / restaurant operators and chains but it tends to be for Union Square and The Academy (following change of use from retail for the majority of units). For example, Filling Station closed their restaurant on Union Street but opened a Coast to Coast restaurant, who are a sister company and of the same chain, in Union Square. As a result Union Square is now approaching 100% let for the first time, thanks to this move and those by others.

Gym operators have also been looking at the city with Pure Gym committed to take space within the building H1 office block on Hill of Rubislaw.

### 1.7. Vacant Retail and Leisure Units

There are 110 vacant retail and leisure units within the city centre. Recent vacant spaces have been within the Bon Accord and Union Square shopping centres. More historic vacant space is spread out across the city centre. There was a substantial increase in vacant properties in 2010 with 66 vacant spaces being vacant since then likely as a result of changes in rateable values.

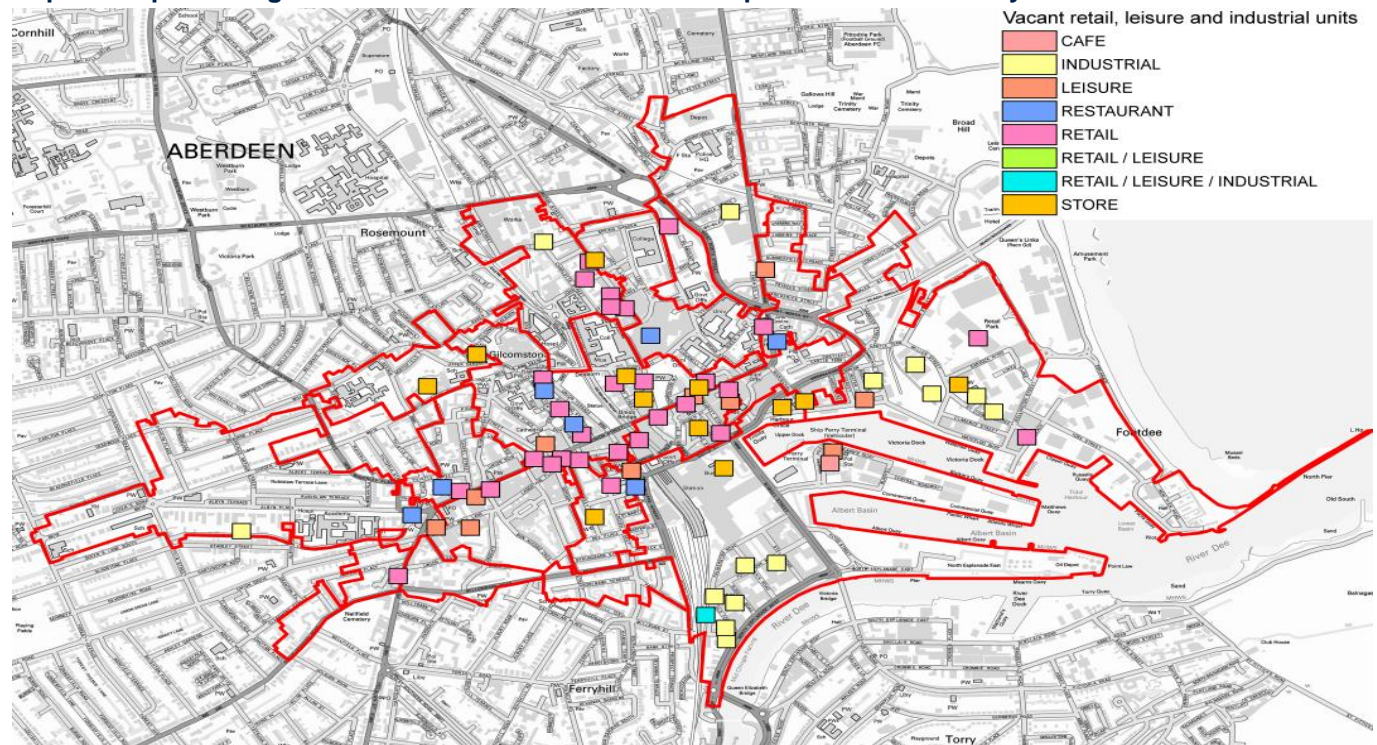
Once again the AB11 5 area around the Harbour accounts for a significant number of the vacant spaces with 36 vacant spaces in this area. The majority of these are at 7 Weighhouse Square, Aberdeen which is an industrial storage space saved in the harbour and others are arches retail and leisure units on Palmerston Road.

A further 19 units are vacant on Union Street and a number also vacant on Golden Square (2 units), Union Terrace (2 units) and Belmont Street (6units). The Bon Accord Shopping Centre was also recorded as having 10 vacant units.

The vacant units reflective of the shifting axis of retail trends within Aberdeen City Centre. The development of Union Square Shopping Centre has shifted the focus from an East/ West Axis to a North/ South axis and consequently retail and leisure premises out with this new route are more likely to be vacant. The area around the Harbour is particularly lacking focus and direction.

Within the retail core of the city centre, as identified by Aberdeen City Council, there are 42 vacant retail and leisure units. A number of these units have been vacant for a number of years and include units in the Trinity Centre and The Academy. There are also 47 vacant office spaces within this area, primarily on upper floors of Union Street.

**Map 5 – Map showing vacant retail/leisure and industrial space in Aberdeen City Centre**



Source: Aberdeen City Council/ Savills Research/ OS





---

## 2. Policy Framework

---

### 2.1. Planning Policy

#### 2.1.1. Local Development Plan

The Aberdeen Local Development Plan (LDP) was adopted in January 2017. It identifies distinct districts based on predominant land uses and a range of policies tailored to promote appropriate development in these areas. These include the City Centre Retail Core, West End Shops and Cafes, West End Office Area, and Mixed Use Areas and City Centre Development – Regional Centre.

Policy NC1 *City Centre Development – Regional Centre* requires all development to contribute towards the delivery of the *vision for the city centre as a major regional centre as expressed in the City Centre Masterplan and Delivery Programme*. Citing the city centre as the *preferred location for retail, office, hotel, commercial leisure, community, cultural and other significant footfall generating development serving a city-wide or regional market*. In this respect, proposals for new retail, office, hotel, commercial leisure, community, cultural and other significant footfall generating development on sites that are not specifically allocated for that use shall be located in accordance with a sequential approach.

#### 2.1.2. Aberdeen City Centre Masterplan

The Aberdeen City Centre Masterplan (CCMP) was approved in June 2015. It identifies 7 intervention areas and 49 projects (and growing) to define the Masterplan's focus, the Council have commenced preparation of development briefs and frameworks for the regeneration of each area.

The intervention areas are:

- 1 Denburn Valley  
Redevelopment of the Denburn Health Centre / car park and refurbishment of the historic Woolmanhill Hospital to provide a new mixed use neighbourhood, set within an attractive green setting, leading to a revitalised Union Terrace Gardens.
- 2 Heart of the City  
Reinstating the central role of Union Street in the life of the city, establishing stronger retail linkages north and south and creating a destination not just for shopping but for many city activities. Refurbishment and remodelling of buildings on Union Street. Negligible increase in overall accommodation but increased utilisation of existing floor space. Remodelling of the St Nicholas Centre, Mitherkirk and Aberdeen Indoor Market.
- 3 Queen's Square  
There is potential to redevelop the Town House extension and former Grampian Police headquarters along with other buildings and under used spaces within the Queen Street to create a new city centre neighbourhood with a strong urban character. This could include consolidation of public service provision in the eastern annexe of Maricshal College, presently vacant.
- 4 Union Street West  
A focus for the wider business sector, from new businesses with a Made in Aberdeen focus, to spin-outs from the energy sector. Union Street West emerges as a much stronger business address.

- |                                |   |
|--------------------------------|---|
| 5 Station Gateway              | The critical remodelling of the key gateway to the city centre, with new business and commercial developments, providing city centre users and visitors with a radically transformed arrival experience, leading seamlessly northwards to Union Street. |
| 6 Castlegate /Castlehill       | A focus for visitors and tourists, taking in the best of Aberdeen's townscape, including Castlegate, Union Street and links to the harbour to the south and the beach to the east.  |
| 7 North Dee / Torry Waterfront | New riverside quarters connected by a pedestrian bridge and a much improved riverside park and promenade. To the north, an urban business district; to the south, a residential neighbourhood that maximises its relationship to the river.             |

### 2.1.3. National planning changes/ Planning Consultation Paper

In September 2015, the Scottish Government appointed an independent panel to undertake a review of the planning system in Scotland, with the aim of achieving a quicker, more accessible and efficient planning process in order to build investor and community confidence in the system.

In January 2017, The Scottish Government published a consultation paper on potential reforms to the planning system entitled 'Places, People and Planning'. The document identified 20 potential reforms most notable among which are a drive to improve public consultation and participation in the planning process, lengthening the timescales for Local Development Plans from 5 years to 10 years, reducing the role of Supplementary Guidance and the potential for an infrastructure levy on development.

There were also proposals to strengthen the role of local communities through requiring development plans to take account of Community Planning Partnerships. This would further empower communities and seek to establish measures to ensure community interests are taken account of and to encourage wider public participation in the planning process. Proposed new fees (e.g. pre-app, appeals and fast track) present a real opportunity for delivering improved performance through providing much needed additional resources for planning departments.

It is unlikely that legislation will be brought forward until 2018, key issues for the regeneration of the City Centre will be how planning policy can remain flexible enough to adapt to changing requirements and allow for development frameworks and strategies to retain a statutory status so they are material considerations in the determination of planning applications and appeals.

## 2.2. Planning and City Centre Development

### 2.2.1. Planning constraints to city centre development

Aberdeen's city centre is the public transport hub for the north east, with bus and rail stations south of Union Street and most bus services running along this main artery. With the advent of the Aberdeen Western Peripheral Route (AWPR), the Council are formulating a strategy for revising access to the city centre by private car, potentially re-designating main roads, to provide arterial routes which direct traffic from the main AWPR junctions, avoiding and reducing unnecessary cross-centre journeys. In order to implement the majority of the traffic-related projects in the CCMP the Council aim to cut cross-city car journeys by 30%.

The opening of the AWPR will go a long way to achieving this goal. Nil car parking provision for new development is another Masterplan objective, which supports the conversion of upper floors along Union Street and its side streets to residential properties. The dense pattern of development in these areas has proved difficult in the past where spaces for private car parking was sought. Initiatives like the Car Club have allowed relaxation of this in recent years. Access and servicing of development by vehicles is also a key drawback to some new build developments.

Research of recent cases has confirmed that factors such as noise from licensed venues, extraction odour from restaurants and air quality can be successfully mitigated through means of glazing and sound proofing. The main constraint to conversion of historic properties to alternative, viable uses appears to be preservation of the historic aspects of the building itself; and a conflict between modern design and materials and defining the important characteristics of the building's fabric.

### 2.2.2. Variation between districts

The recently adopted Aberdeen LDP contains a policy for tall and bulky building developments named *Big Buildings*, to ensure that these are appropriately located - within the city centre or its immediate periphery; and provides guidelines to ensure that high standards of design and materials ensure that they provide a positive impact on the surrounding streetscape. Where buildings detract from their context or interfere with an established vista however, they will not be supported.

Examples are the Capitol and Silver Fin office developments on the west end of Union Street. Concentrating appropriate development within the city centre provides a clear long-term vision for growth and reinforces the role of the centre as a destination, well connected by public transport rather than sites outwith the city centre whose likely development impacts will displace and dilute the role of the city centre.

### 2.2.3. Infrastructure Delivery and Planning Obligations

The LDP identifies eight Masterplan Zones for strategic greenfield development; and through supplementary guidance and the LDP Action Programme it sets out infrastructure requirements for within these areas. Requirements for non-allocated and brownfield sites aren't discussed, but the Action Programme sets out key infrastructure, related to the city centre, this includes South College Street Rail and Road Improvements. Whilst the requirements for windfall sites, such as infill, conversion and redevelopment are not explicitly addressed, developments will require to address deficiencies in infrastructure provision where identified and as set out in supplementary guidance on planning obligations.

With regard to the city centre, contributions to community infrastructure such as schools, doctors' surgeries, leisure and community facilities are sought on the basis of the capacity of the existing facilities within the catchment area and may not always be necessary; however issues such as improvement of the urban realm would not currently meet the six tests for planning conditions, as evidenced by the recent ruling on the Strategic Transport Fund.

Should the Council take forward a comprehensive strategy to increase the city centre population the provision of new facilities will need to be considered.

### 2.3. Building Regulations

#### 2.3.1. The Adaptive Re-Use of Aberdeen's Historic Buildings



The key to retaining the city's built heritage is identifying a viable, sustainable and practical re-use, to preserve as much of the building fabric as possible, to conserve the sense of place that the property instils and creates within its setting. Preserving period buildings for future generations to enjoy is the central philosophy of conservation. This is supported by Historic Environment Scotland, their *Policy Statement* (June 2016) acknowledges that listed buildings will 'like other buildings, require alteration and adaptation from time to time if they are to remain in beneficial use, and will be at risk if such alteration and adaptation is unduly constrained' (para. 3.39). This is interpreted locally through policy D4 *Historic Environment* of the Local Development Plan which presumes 'in favour of (their) retention and reuse'.

Aberdeen has a plethora of architectural gems; quintessentially local in style and design that gives the city its identity and uniqueness. The influence of renowned Scottish architect Archibald Simpson (in addition to John Smith, Charles Abercrombie etc) has created the Granite City backdrop and detail in the streetscapes, all of which anchor Aberdeen's wonderful sense of place.

Balancing the dichotomy of current building regulation requirements with retaining as much of the property fabric is a difficult balance to manage successfully. Working with the local authorities and conservation officers during the initial feasibility and inception stage is vital in gaining support throughout the development process.

Assessing the property whether an old town house in a conservation area or listed public building, the challenges are similar. Whether converting into residential units or alternative commercial use, the areas of concern will be the same:

- Structural viability
- Fire regulations
- Heat loss
- Accessibility
- Viability/Cost
- Market Demand

# Aberdeen Residential Strategy

## Work stream 2: Opportunities and Constraints

---



A building survey will establish the condition of the structure and fabric and which elements need to be addressed, whether the specific re-use is yet to be identified or pre-determined through a Local Development Plan and/or City Master Plan.

Structural performance can be enhanced with the introduction of additional support, sensitively hidden within the existing structure or juxtaposed as a crisp modern addition, easily identified and removed in the future if the use changes.

Fire Regulations dictate travel distances, separation and protected areas, all of which can be managed through sensitive layout design, sub-division, material choice and/or the introduction of sprinkler systems.

Heat loss addressed by insulation must be specified to achieve the current standards without creating condensation or cold bridging, material choice and installation is crucial to the long term re-use. Original windows and glazing, essential in preserving a streetscape detail, can be enhanced by refurbishment and draught proofing with the introduction of secondary glazing if necessary.

Accessibility in conversion can be achieved through sub-division and vertical access where possible, identifying the least intrusive compromise through the initial stages of design in consultation with the local Conservation Officer and Building Standards.

Cost control and quality must be balanced to create a viable option for any developer. Aberdeen's built heritage will only survive if the re-use is carefully costed to address all of the design and regulatory restrictions, whilst retaining the character of the property. Conservation advice early in the project combined with cost analysis is a crucial factor in achieving a successful solution for both developer and the community in retaining their precious built history.

And proving demand in a non-functioning market might be the biggest challenge of all.

---

### 3. Opportunities for Conversion

---

We have chosen a number of potential development sites from across the city centre for review. Whilst we have not made their details public we hope in doing so we will bring to light the challenges facing the development market within the city. There are three main areas which we have identified which could be suitable for residential development:

### 1. Upper Floors of Union Street

The upper floors of Union Street present a wide range of opportunities for development due to the high volume of vacant accommodation, which does not meet the needs of occupier requirements and is therefore not suitable for commercial occupation.

While this space presents an excellent opportunity for creating a vibrant Union Street, increasing footfall and improving the atmosphere and vitality of the area, there are significant challenges associated with development of these floors relating to planning consent, cost and uncertainties surrounding the conversion of a Listed Building and the wider build costs to meet current building regulations. These are all covered in our case study of a recent development carried out on Union Street.

### 2. West End Townhouse Conversion

As occupier demand moves away from offices within West End townhouses towards modern, high quality and open plan accommodation, there is an opportunity to create prime residential accommodation in Aberdeen's most sought after location. Returning these properties to their original use should be relatively straight forward, yet there are a number of challenges associated with this type of development including satisfying building regulations and Listed Building requirements but, more importantly, dealing with viability issues. Many west end townhouses were valued for office use at the peak of the office market which has skewed vendors expectations on pricing. Developers and private individuals cannot meet these expectations in bringing forward residential conversion and properties are lying vacant as a result.

### 3. Large Conversion Opportunity

In order to consider the impact affordable housing requirements and planning gain contributions can have on the viability of a project, we have also sought to consider a larger scheme where there is an opportunity to convert a c. 19,000 sq ft office block to residential. The challenges facing a development of this nature largely relate to viability as a result of the build costs and developer's obligations, but also the significant cost and time that has to be incurred before any income, or profit, is made. Demand for these opportunities is at an all time low due to limited funding opportunities and market uncertainty.

**Please note any advice contained or attached in this pricing exercise is informal and given purely as guidance to highlight the challenges facing the development market in the city centre. Our views on price are not intended as a formal valuation and should not be relied upon as such.**

**No liability is given to any third party and the figures suggested are in accordance with Valuation Standard 6.1 and 6.2 of RICS Valuation Standards – Global and UK, effective from January 2014. Any advice attached is not a formal ("Red Book") valuation, and neither Savills nor the author can accept any responsibility to any third party who may seek to rely upon it, as a whole or any part as such.**



### 3.1. Upper Floor of Union Street



The upper floors of Union Street currently comprise a high volume of vacant commercial accommodation which no longer meets the requirements of modern occupiers. The majority of the stock is of poor quality and despite efforts from some landlords to refurbish the existing accommodation, occupiers are no longer seeking the cellular accommodation that is on offer. This presents a range of conversion opportunities to increase the volume of residential accommodation within the main thoroughfare of the city centre and, in turn, increasing activity and footfall on Union Street.

However, re-development or conversion of the upper floors of Union Street is very risky for a developer and there are a number of challenges facing them. Indeed, demand for these opportunities tends to be from small local developers as the national / mainstream house builders disregard conversion opportunities due to the uncertainty of cost.

We have been made aware of a recently completed conversion where the developer converted a former commercial property at the first and second floors of Union Street, to three residential apartments.

#### 3.1.1. Development Appraisal

Based on the information provided by the developer, we have carried out a development appraisal to investigate the viability and profitability of this project. Our appraisal is calculated as follows:

	AMOUNT
Projected Sales Income	£455,000
Build Cost including Professional Fees (inclusive of VAT)	-£294,000
Sales & Legal Fees	-£7,000
Planning and Building Warrant Fees	-£3,267
<b>Total</b>	<b><u>£150,733</u></b>
<b>Profit</b>	<b>Say £150,000</b>
<b>Profit % of GDV</b>	<b>33%</b>
<b>Profit % of Costs</b>	<b>51%</b>

# Aberdeen Residential Strategy

## Work stream 2: Opportunities and Constraints



While on simple terms, this would appear to be a reasonable profit, it should be noted that the developer owned the property prior to commencement of development and therefore incurred no additional cost at the outset for the purchase of the subjects. Had the developer been required to purchase the property we anticipate that they would have carried out a residual calculation as follows:

	AMOUNT	
Projected Sales Income	£455,000	
Build Costs Including Professional Fees (inclusive of VAT)	-£294,000	
Sales & Legal Fees	-£7,000	
Planning & Building Warrant Fees	-£3,267	
Finance / Interest @ 6%	-£10,662	
Total Costs	<u>£314,929</u>	
Projected Income less costs	£140,071	
Less Profit @ 20% of Projected Sales Income	<u>£91,000</u>	
Sub-Total	£49,071	
<b>Less Acquisition Costs</b>	<b>£3,000</b>	
<b>Total</b>	<b>£46,071</b>	
	<b>Say £45,000</b>	

Based on an estimated net internal area of the building at 2,102 sq ft, the equates to approximately £21 per sq ft. We anticipate that vendor's expectations would be significantly higher than this in the region of £100 per sq ft equating to approximately £200,000. In this case, if a purchaser / developer was to meet vendor's expectations, the development would have incurred a loss.

It should be noted that we have included finance / interest costs within our calculations, however the developer in this instance did not require external funding. Obtaining funding for projects of this nature would be extremely difficult and while we have sought to include a modest cost, we would caution that this will vary significantly depending on the lender involved. We have sought to consider development funding, and the challenges involved, in more detail later in this report.

### 3.1.2. SWOT

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Range of opportunities on Union Street for small and medium developers</li> <li>• Support of wider community to improve Union Street and, in particular, re-establish the upper floors for alternative uses.</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• High build costs to meet current building regulations, particularly for listed buildings</li> <li>• Timescale for planning consent</li> <li>• Feeling of discouragement for development by small developers from public bodies</li> <li>• Lack of collaborative approach to identifying solutions</li> <li>• Lack of funding opportunities</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Introduction of planning policy to permit development of the upper floors of Union Street and reduce timescale for developers</li> <li>• Offer of grants to assist with cost of conversion to meet Council expectations and make projects more viable</li> <li>• Introduce a 'Development Manager' as a Council Resource in order to assist developers through the process, particularly first time developers</li> <li>• Ease restrictions to Listed Buildings on Union Street to promote development</li> <li>• Provide a funding pot to support smaller developers and provide capital to cover the cost of feasibility and construction</li> <li>• Carry out land assembly's to create development opportunities for large scale development</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Rising build costs</li> <li>• Market uncertainty / risk</li> <li>• Ability of the planning team to work collaboratively/ be flexible to encourage development rather than deter</li> <li>• Lack of awareness in the Building Standards and Planning teams of commercial aspects of developments and the impact their comments and delay in the planning process can have on cost and development timescale</li> <li>• Lack of funding opportunities from mainstream lenders</li> </ul>

### 3.2. West End Townhouse Conversion



The West End of Aberdeen is considered to be the prime office location within the city. However, the townhouses located at Rubislaw Place, Rubislaw Terrace, Albyn Terrace etc. no longer meet the requirements of the majority of office occupiers who now seek open plan, modern accommodation. As a result, a number of townhouses are lying vacant following recent lease expiries.

This presents an opportunity for the townhouses to be converted to their former use. Conversion of the townhouses will meet the same challenges as those identified above in terms of planning, Listed Building/ Building Regulations and lack of consideration for the viability of projects. However, in this case, we have sought to consider the challenges a developer will face in purchasing a west end townhouse where vendor expectations on pricing become a wider issue.

In doing so, we have considered a townhouse which Savills are currently marketing for office use but which has great potential for conversion to residential.

#### 3.2.1. Existing Use

Assuming that the property is in good condition, with no major repair works required, we would estimate the value of the property to be calculated as follows:

Net Internal Area 1,990 sq ft @ £200 per sq ft	<b>£398,000</b>
Say	<b>£400,000</b>

This is significantly lower than pricing that was achieved at the height of the market in 2014, when West End properties were achieving approximately £350 – £450 per sq ft. We anticipate that vendors will expect to achieve pricing at this level at a minimum.

### 3.2.2. Conversion / Development

If the property was purchased for conversion back to residential, the achievable pricing would depend on the type of purchaser and intended conversion.

Firstly, if the property was converted to a single townhouse, purchasers are likely to be owner occupiers who would be unlikely to seek a profit. We would anticipate that owner occupiers would consider the value of the property as follows:

		AMOUNT	
Projected Sales Income		£600,000	
Estimated Conversion Costs GIA 255.32 sq m @ £1,000 per sq m	£255,320	£275,400	
Contingency @ 3%	£7,660		
Professional Fees @ 5%	£12,766		
Interest/finance @ 6.0%			£1,943
Total Costs		<u>£277,343</u>	
Projected Sales Income Less Costs		£322,657	
<b>Residual Land Value</b>		<b>Say £325,000</b>	

We anticipate that an owner occupier would purchase the property 'subject to change of use' so that, when it is purchased, it is done so as a residential property and therefore the vendor can remove VAT from the sale price and instead pay Land Building Transaction Tax (LBTT).

If the property was converted to two residential apartments, purchasers would likely be developers who would seek a profit margin in the region of 20% of projected sales income. We would anticipate developers would consider the value of the property as follows:

		AMOUNT	
Projected Sales Income		£690,000	
Estimated Conversion Costs GIA 255.32 sq m @ £1,000 per sq m	£255,320	£275,400	
Contingency @ 3%	£7,660		
Professional Fees @ 5%	£12,766		
Interest/finance at 6.0%			£14,408
Marketing & Sales		£6,900	
Total Costs		<u>£297,038</u>	
Projected Sales Income Less Costs		£392,962	
Profit @ 20% of GDV		£138,000	
Acquisition Costs		£4,617	
<b>Residual Land Value</b>		<b>£250,345</b>	
		<b>Say £250,000</b>	

To summarise, vendor's expectations on pricing based on office use would be in the region of £400,000, however there will, due to reasons of configuration and oversupply, be reduced demand for its existing use as an office. The cost of converting properties of this nature, in order to meet current building regulations is high and, as a result, purchasers, even those who do not have a necessity to turn a profit, cannot bridge the gap between the cost of conversion and vendors expectations.

Until there is a reduction in build costs, or vendors begin to reduce their expectations on sale price, the number of empty properties will continue to rise. As the majority of buildings are Listed, there are no vacant rates to pay and therefore vendors have minimal holding costs until such time as the office market picks up and a price closer to their expectations can potentially be achieved.

### 3.2.3. SWOT

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Popular West End location</li> <li>• Car parking available at the majority of properties</li> <li>• Suitable for conversion to single townhouses or duplex, opportunities for mews development in gardens.</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• High conversion costs to meet building regulations</li> <li>• Surrounding area generally in office use at present</li> <li>• Former garden ground surfaced in tarmac for car parking</li> <li>• Vendor expectations</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Provide grants to existing owners seeking to convert empty properties for alternative uses</li> <li>• Identify 'approved list' of lenders who would consider small development opportunities of this nature</li> <li>• Attract families into the city centre</li> <li>• Owner occupiers do not require developers profit</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Local plan identifies area as West End Office District</li> <li>• Planning and Building Control require to be committed to conversion of offices that are no longer viable</li> <li>• High conversion costs deterring investors/developers</li> <li>• Funding gap</li> </ul>

### 3.3. Large Conversion Opportunity

The developments described above take into account small conversion opportunities where planning gain and affordable housing contributions would not be considered. There has been a lack of large conversions or re-developments in the City Centre in recent years with the majority of mainstream or larger developers quoting the uncertainty of cost as the main barrier to development.

Below we have considered the re-development of a former office on King Street. The building was sold to a developer who intends to convert the property to residential. We have been advised that the project is currently on hold until such time as there is more clarity regarding development in the surrounding area. Our appraisal below highlights the challenges.

# Aberdeen Residential Strategy

## Work stream 2: Opportunities and Constraints



### 3.3.1. Development Appraisal

We have been provided with a proposed scheme of development which includes six 1 bedroom flats, eight 2 bedrooms flats and a large 2 bedroom duplex, in addition to retaining the two retail units at ground / lower ground floor which extend to 797 sq ft and 4,618 sq ft respectively.

Aberdeen City Council require 25% of the development to be 'affordable units' which, in this case, would equate to 3.75 units. In this case, we have assumed that the affordable housing would be dealt with by means of a commuted sum, reflecting £38,000 per unit (in accordance with Aberdeen City Council guidelines). In reality, there are a number of ways a developer can deal with affordable housing, however all impacts the profitability and viability of a scheme.

Based on the above scheme, we have prepared our own development appraisal however we have adopted build costs obtained by the developer.

		AMOUNT	
Estimated Projected Sales Income - Residential		£2,260,000	
Estimated Projected Sales Income - Commercial		£170,000	
<b>Total GDV</b>		<b>£2,430,000</b>	
<i>Conversion Costs</i>			
Residential 950 sq m @ £1,300 per sq m	£1,227,120	£1,746,714	
Retail	£216,600		
<b>Total</b>	<b>£1,443,720</b>		
Contingency @ 3%	£43,311		
Planning Gain @ £3,000 per unit	£45,000		
Affordable Housing @ £38,000 per unit	£142,500		
Professional Fees @ 5%	£72,183		
Interest/finance @ 6.0%		£71,452	
<b>Total Costs</b>		<b>£1,818,166</b>	
Projected Sales Income Less Costs		£611,834	
Sales, Legal & Agency Fees - Commercial		£6,975	
Marketing & Cost of Sales Residential (2.75% of Mainstream GDV)		£62,150	
Residential Sales Legal Fees		£11,250	
Profit @ 20% of GDV		£486,000	
<b>Sub-total</b>		<b>£45,459</b>	
<b>Less Purchasers Costs</b>		<b>£5,000</b>	
<b>Total</b>		<b>£40,459</b> <b>Say £40,000</b>	



# Aberdeen Residential Strategy

## Work stream 2: Opportunities and Constraints



Current market conditions are undoubtedly affecting our pricing exercise as developers are more risk averse and, therefore seeking higher returns, and a heavy over supply of flats within the residential market is affecting potential end values (GDV). However, the build cost that has been provided by the purchaser is very high and this reflects the cost to convert a building of this nature to meet building regulations and standards and complete a high quality product.

In addition, a developer would be required to pay in excess of £180,000 for planning gain/developers obligations and affordable housing. This adds an additional c. 12% to the conversion cost and impacts the viability and profitability of the scheme.

### 3.3.2. SWOT

<p><b>Strengths</b></p> <ul style="list-style-type: none"> <li>• Site identified as development opportunity by out-of-town investors</li> <li>• Located on edge of Castlegate which is intended to become Aberdeen’s main civic square</li> <li>• Proximity to Marischal Square and the proposed Queen’s Square</li> <li>• Public transport links</li> <li>• Zoned for Mixed Use within the ALDP</li> <li>• Suitable for a variety of uses including residential</li> </ul>	<p><b>Weaknesses</b></p> <ul style="list-style-type: none"> <li>• Cost to convert Listed Buildings makes projects unviable</li> <li>• Planning gain and affordable housing contributions increase viability challenges.</li> <li>• Bad perception of Castlegate and Union Street West from businesses and residents</li> <li>• Potential for building to lay vacant if profitable scheme can not be identified</li> </ul>
<p><b>Opportunities</b></p> <ul style="list-style-type: none"> <li>• Conversion to a range of uses including residential at upper floors and retail at ground floor</li> <li>• Enhance shop front to attract local businesses</li> <li>• Improve amenity of surrounding area</li> <li>• Encourage development in Castlegate area</li> <li>• Provide grants to developers seeking to convert empty and run down properties to alternative uses to bridge the value / cost gap</li> </ul>	<p><b>Threats</b></p> <ul style="list-style-type: none"> <li>• Planning and Building Control to be committed to assisting developers</li> <li>• High conversion costs deterring investors/developers</li> <li>• Market perception of Castlegate</li> <li>• Market uncertainty</li> <li>• Developer’s poor perception of city centre development</li> </ul>

### 3.4. Prime Development Opportunities

Prime development opportunities in Aberdeen are restricted by a lack of appetite from lenders, limited demand from major mixed-use developers and the unknown costs involved in brownfield development coupled with a period of weak market conditions and falling property prices.

Without the availability of proposed schemes it is impossible to prepare residual appraisals or financial models for large development projects and therefore we have not considered pricing for potential sites. However, we have outlined below the challenges facing this sector in Aberdeen and have discussed how they relate to two key Prime development opportunities in the city centre.

The main challenges are outlined in detail below:

#### 3.4.1. Funding appetite

Following the banking crisis in 2007/2008, high street banks have enforced very strict lending criteria to meet regulators requirements. Development projects are considered to be expensive and very high risk which significantly limits their facilities.

For commercial or mixed use projects, the High Street banks will only release funds if there is a secure pre-let agreement to a low risk, preferably institutional, tenant and the contractor is well known to them or has an excellent reputation. It is important that the customer has experience of successful developments as very few banks will consider lending to a new developer. This restricts lending to a small proportion of the market who are generally 'cash rich'.

The high street banks can ease their lending criteria if a deal involves additional equity from grants or private investors or institutions to whom they have experience with in the past. The second tier lenders may be softer in their approach to mixed use development and may take the risk of lending where the building is pre-let in part. However, they will still seek an experienced developer and will require the proposed tenant to offer a strong covenant.

Residential development is funded differently with some High Street banks only providing revolving credit facilities where by they lend against the developers balance sheet and there is no facility for single developments. Customers must meet a strict criteria based on the number of units per year, spread of location of sites and security of the balance sheet. Other High Street banks will offer development facilities but they are restricted to lending to experienced developers who have a good track record and whom have a range of sites across the country spreading the risk across a range of locations.

Restrictions to lending has impacted the volume of development across the country and is not a problem specific to Aberdeen. As a means of attracting debt and improving lending criteria, developers and institutions have considered a range of financial models and means of providing lenders with the security they require to satisfy their credit teams.

### 3.4.2. Site Clearance and Preparation Costs

The cost to demolish existing buildings and clear and prepare a brownfield site for development can significantly impact the viability and profitability of a project at any scale, particularly in an urban area / city centre where there is a higher density of development. Developers will seek to obtain as much information as possible prior to committing to purchase, however the true cost of demolition / enabling works will only be realised upon commencement of construction.

As a result, it is important that vendors seek to remove any barriers to development before introducing a site to the market and in order to generate the optimum value of the sites. There has been evidence of Greenfield sites adopting a Land Trader model, where by infrastructure and servicing works is carried out by the landowner which allows a developer to 'plug and play' and commence development on the day of purchase. This incurs up front costs to the land owner but generates an optimum end value.

A similar approach to city centre brownfield sites can be adopted to include demolition of existing buildings and site preparation in order to give the purchaser the certainty that the site is developable within known timescales and to enable smaller pockets of development land to generate higher land values.

Similar to the above, this is not an Aberdeen specific constraint and other city's have adopted land trader models and financial incentives in order to encourage development in brownfield land. This is considered in more detail in Workstream 3.

### 3.4.3. Market Risk

As a result of current local market conditions, and a sustained low oil price, major developers and institutional investors have a lack of confidence in Aberdeen and, therefore, have limited appetite to be involved in major projects in the city. This, coupled with a lack of appetite from banks and restricted lending criteria, is impacting the volume of development that can take place in the city. Larger projects require buy-in from institutional investors who are nervous of the city's reliance on the oil price and the uncertainty that is brought to the whole market, either directly or indirectly, by the volatility of the price of Brent Crude Oil.

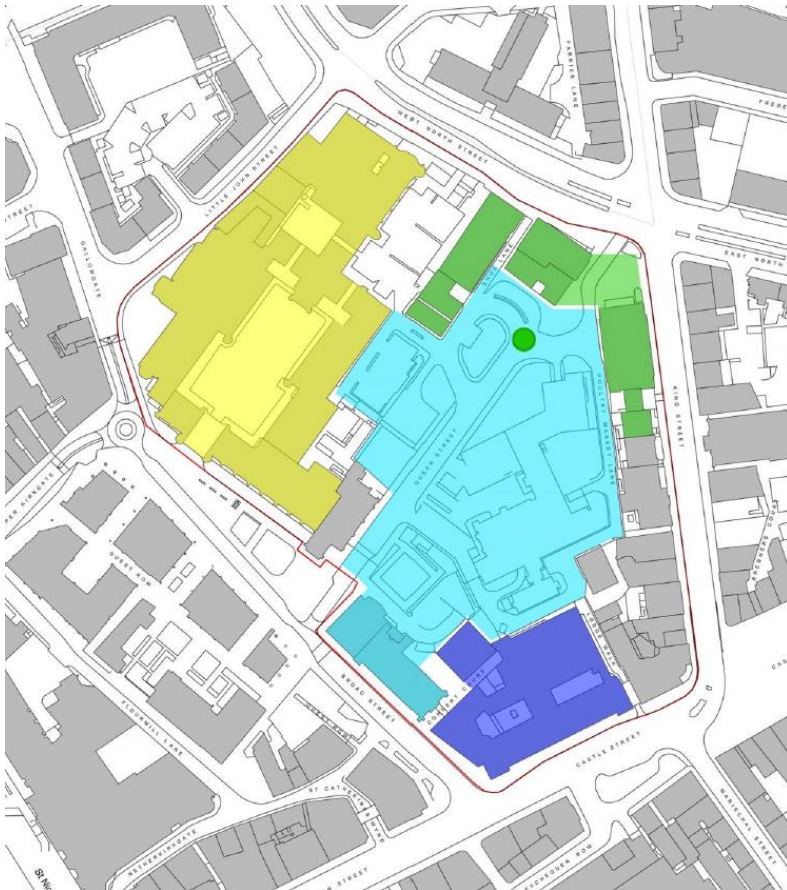
While this is impacting development in Aberdeen at the current time, we are aware of financial models that have been used in the past to provide investors and banks with the security and comfort required to fund a development. For example, we understand a model was agreed for the development of Marischal Square where by Aberdeen City Council guaranteed the rental income of the project upon completion if tenant's were not secured.

Introducing models of this nature would assist to provide developers, institutions and banks the security they need and encourage development.

In order to address how these challenges can be overcome we have sought to consider two prime development opportunities in Aberdeen city centre and a means to which the Council can encourage development.

### 3.4.4. Queen's Square

Queen's Square has been highlighted by Aberdeen City Council as a potential anchor site for the Aberdeen City Centre Master Plan. The identified site incorporates the buildings on Queen Street including the Courts, Police Scotland NE headquarters and University / Council owned buildings which are all under public ownership. The various buildings included within the proposed boundary are highlighted in blue and purple below:



In order to promote and encourage development of this site, we would propose the following strategy and mix:

- Agree a development brief / design guide with appointed architects to include a strategy for relocating Police Scotland and the Courts to occupy less accommodation and utilise the buildings in a more strategic manner.
- From the limited information available on the site, our initial thoughts would be to provide blocks of between 40-80 units and target house builders / developers to deliver a mix of high quality apartments. Careful consideration should be given to retaining and reusing the existing car parking on site and treatment of the ground floor / street level areas including pedestrian access and pathways through the site.
- The site would be suited to an element of build to rent and it would be appropriate for the architects to consider integration of a PRS scheme in part of the site, subject to identifying investor appetite
- In order to accommodate a range of developers and tenures, the layout should enable disposals of individual phases of land. Such a framework, set up by the council acting as 'Land Trader', allows a wider mix of housebuilders to participate and increases the rate of delivery.

Introducing parcels of land to the market which are based around a common development brief benefits all parties. This is a long term goal but delivers higher land values which justifies the higher initial investment. Public sector support allows more investment in placemaking as all parties can work together to deliver a common goal of creating better places and building more homes with a quicker rate of delivery.

Consideration must be given to the viability of this process to ensure the net land receipts after disposal sufficiently compensate the cost of delivering cleared sites to the required standard.

### 3.5. Woolmanhill Hospital



Woolmanhill Hospital is identified within the ACC Master plan as being a key development site within the Denburn Valley intervention area. The plan identifies the property as being suitable for Use Class 7 (Hotels and Hostels) or Use Class 9 (Houses) which is in line with the current planning application for 40 residential apartments, 52 bedroom boutique hotel and 27 hotel suites.

We anticipate that the costs to develop this site, in order to comply with current building and Listed Building regulations, coupled with weak demand for hotels and deteriorating market conditions since the site was originally marketed will make delivery challenging.

In order to promote and encourage development of this site, Aberdeen City Council can consider initiatives such as relaxing building / listed building regulations in order to reduce the build costs of conversion. In addition, consideration should be given to removing the requirement for affordable housing and developers obligations in order to ensure viability and encourage development, potentially with a greater emphasis on residential use. The Council should work in collaboration with the developer to help bring this key site forward.

---

## 4. SMART Recommendations

---

### 4.1. Recommendation 1 - Be 'Open for Business'

Make life easy for developers and investors to do business by streamlining legislation and reducing the financial obligations which impact the viability of development projects.

This would be measured by market activity. The number of conversions and re-developments in the city centre and the number of developers actively seeking opportunities.

In order to achieve this goal, we would recommend the following initiatives:

4. Work with developers to identify solutions to deal with complicated Building and Listed Building Regulations.
5. Consider exercising statutory powers and CPO's to assemble land.
6. Introduce a Development Manager or regeneration team within the Council who can deal directly with the applicant/ private sector. Must be someone who understands the viability of development projects and the impact changes to consents and construction programmes can have on profitability (i.e be commercially minded). While the Council can subsidise this in the first instance, developers would be willing to pay for this service if it is successful.

We have been advised by a wide range of developers traversing the whole market that the existing planning and building control capacity, particularly in relation to Listed Buildings, make developments and conversions difficult and expensive. Most acknowledged that streamlining the system and having the Council as a support, rather than a barrier, to development would encourage them to actively develop. This will be demonstrated by making information clearly accessible so that developers can clearly understand what is expected of them.

The initiatives will be easy to implement relatively quickly and would be long standing initiatives. The introduction of CPO rights may take longer to implement and should be restricted to key projects only.

### 4.2. Recommendation 2 - Act as a Catalyst For Development & Investment

As discussed in detail throughout this report, market risk is a key issue impacting development and investment in Aberdeen centre as there is a lack of appetite from developers, institutional investors and lenders to fund and enable development in the city. In order to increase activity, Aberdeen City Council need to demonstrate their confidence in the market and act as a catalyst for investment.

This can be measured through activity in the market and the demand from developers / investors that follows.

In order to achieve this, we would advise the following initiatives:

5. Covenant Play –The Council’s covenant will attract funding and investment to allow projects to commence speculatively. Financial mechanisms was adopted with Muse for the development of Marischal Square.
6. ACC Development Company – Demonstrate confidence in the market by committing to the development of a key masterplan project, such as re-development of Queen’s Square.
7. ACC Land Trader – For large development sites, commit to carrying out site clearance and preparation work and introduce smaller, manageable areas of land to the market which would suit requirements. Such a framework, set up by the council, allows a wider mix of developers and increase rates of delivery.
8. Assist to fund a development through financial mechanisms.

This is a bold initiative and can have financial implications to the Council if not carefully considered. The initiatives must be subject to certain criteria, and likely restricted to larger scale projects.

This will not be a short term project and will require significant consideration and financial modelling in order to ensure the right projects are chosen.



### 4.3. Recommendation 3 - Plug the gap

Encourage investment and development by considering where the Council can intervene to assist with viability issue..

Can be achieved through the following initiatives:

4. Consider removing or reducing developer obligations and requirement for affordable housing within a blanket area of the city, particularly on brownfield land or conversion opportunities. During our stakeholder interviews, a number of developers and architects advised of a number of city centre projects in the pipeline which would commence imminently if there was no, or very little, requirement for developer obligations and affordable housing.
5. Introduction of grants / funds similar to Rural Housing Fund and Scottish Infrastructure Fund with similar timescale and value restrictions to assist with build costs, VAT requirements for conversions, site preparation work and feasibility testing.
6. A publically available and highly advertised website which allows potential developers to identify if they are a small, medium or large developer and submit a short business case confirming their debt requirement. Thereafter, the website can confirm the grants and funds available to them.

There is a wide range of grants available for the development of larger scale projects and affordable housing which have been introduced to meet Scottish Government targets for more housing throughout the Council. Altering these initiatives to make them suitable for brownfield land and adopting a multi-pronged approach where by the grants can assist at all levels of the market would help to address the price and land value gaps that have been described throughout our report.

The grants should be available for a restricted period of time in order to maximise their potential and encourage development.

## Important Note

Finally, in accordance with our normal practice, we would state that this report is for general informative purposes only and does not constitute a formal valuation, appraisal or recommendation. It is only for the use of the persons to whom it is addressed and no responsibility can be accepted to any third party for the whole or any part of its contents. It may not be published, reproduced or quoted in part or in whole, nor may it be used as a basis for any contract, prospectus, agreement or other document without prior consent, which will not be unreasonably withheld.

Our findings are based on the assumptions given. As is customary with market studies, our findings should be regarded as valid for a limited period of time and should be subject to examination at regular intervals.

Whilst every effort has been made to ensure that the data contained in it is correct, no responsibility can be taken for omissions or erroneous data provided by a third party or due to information being unavailable or inaccessible during the research period. The estimates and conclusions contained in this report have been conscientiously prepared in the light of our experience in the property market and information that we were able to collect, but their accuracy is in no way guaranteed.