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# Does the oil price hold real estate over a barrel?

Collaboration, cost-savings, betterment, efficiencies… these are just some of the key terms being used to reflect the objectives of the energy industry in a time where challenges are faced and the focus is firmly on future strategy. As the UK energy sector is looking more closely at re-shaping their operating models in a more sustainable and cost-effective way, this will inevitably involve a re-assessment of current and future real estate requirements.

As a consequence of a high level of activity in the energy sector over the past few years, the property market has experienced sustained high-level activity, particularly in cities such as Aberdeen where there is a close association with the energy industry. The success in attracting occupiers and expanding businesses has put strain on the local office markets and an under-supply has inflated capital and rental values. This has naturally favoured developers with occupiers having limited negotiating strength. As a result of the adjustment in the oil prices, however, an element of balance has manifested itself and now is therefore the time for businesses to take the opportunity to review their space requirements.

With the recent surge of speculative developments and an increase in second-hand real estate as a result of many businesses down-sizing, we are already seeing an increase in incentives such as rent free periods, stepped rentals and landlord's contributions towards fit-out works. For businesses that are committed to expansion and growth this offers an ideal opportunity to secure additional space on terms that may have previously been unachievable. Rents for new properties on the market are likely to stabilise and, if moving to second hand stock where the market has been over-rented for some time, there may be opportunities to secure these properties at a lower rental level than the prime rents that landlords have been able to extort for so long.

Although this creates a wealth of opportunities for growth and expansion, it is appreciated that many businesses may be looking at streamlining their operations and so may be facing a need to down-size in the current market. Indeed, with recent redundancies and an increased focus on shared services and pulling of resources, many businesses are now finding that they are faced with leasehold commitments for properties that are now surplus to requirements. Many of these leases were entered into at the height of the market when the negotiating power was firmly in the landlord's court. It is inevitable that they will be on an upwards only rent review basis and so, even as the market stabilises and rents for second hand stock may decline, this will not have an impact on the already premium level of rents currently being paid.

Although challenging, that does not mean to say that there are no options available. A comprehensive review of any existing leasehold commitments will establish whether there are any up-coming break options that may be exercised. In the absence of any break options, there may still be opportunities to assign or, where there is surplus floor space in existing premises, to partially sub-let allowing the burden of the rent and outgoings to be shared. Lease terms should, however, be fully reviewed to establish any restrictions on sharing of occupation. It is likely to be the case that assignation or sub-letting requires landlord's consent and it may often be subject to conditions such as restrictions on the number of sub-leases that can be granted. It should also be borne in mind that there are often restrictions on sub-letting at less than the higher of either the passing rent under the lease or the open market rent which creates its own challenges in a market where there is an increase in available real estate. That being said, although the market is shifting, the general consensus is that it is simply stabilising after many years of record activity levels. In Aberdeen particularly, its position globally has changed and the sector has benefitted from the diversification that has emerged.  Accordingly, although take up may slow down, there is still investment and commitment within the city and the opportunity to share space may therefore be attractive to companies seeking to expand or establish in the local area.

This is the latest Foresight article in our Transformation series looking at the future of North Sea Oil and Gas. Discussing various issues from technology to employment and disputes, our sector experts offer their commercial opinions on the future of the industry. Please feel free to forward this Foresight to a colleague or to subscribe to our mailing list here CMSEmployment.Team@cms-cmck.com.

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