In this new report, we reflect on the commercial investment landscape in London and share six key themes defining the investment market

Knight Frank

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6 TRENDS SHAPING LONDON'S OFFICE INVESTMENT MARKET

Total office investment turnover in London fell to £1.69 billion during Q2, with 40 properties transacting, compared to £5 billion during Q1 and £5.2 billion in Q2 2018. Whilst this slowdown is symptomatic of Brexit uncertainty, the lack of stock is also playing a significant role in the fall in activity. As always, however, there are multiple factors at play. We take a look at six of the key trends shaping London's office investment landscape.

01

LACK OF QUALITY STOCK

The slowdown in investment activity has in part been fuelled by a lack of assets for sale. Indeed, long-income assets on the market are few and far between. Furthermore, there are no desperate vendors – in fact many are seeking premiums due to the dearth of quality stock. And so while some investors continue to seek Brexit linked discounts, the mismatch between the expectations of sellers and buyers is likely to persist. Although investment turnover has declined this year, the ratio of stock under offer to availability has increased by a third over the last 12 months, highlighting the depth of demand.

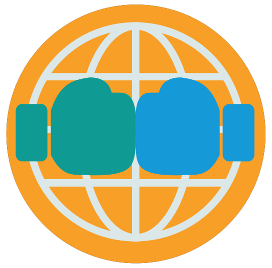
Interestingly, the depth of demand in the occupier market and its overall strength is fuelling greater interest in value add schemes amongst investors. This is in turn driving an emerging trend of the reinvention of assets, which we investigate in our 2019 Active Capital report.

02

YIELD MOVEMENT

During Q1 2019, we raised our prime office yields for London by 25 bps to 3.75% for the West End and 4.50% for the City. This was the first upward adjustment since the Brexit referendum. Given the strength and resilience in the occupier market, prime headline rents have edged up to record levels in most submarkets we monitor, supported by a lack of supply. A lack of quality stock and some assets taking a little longer to trade than anticipated drove our decision. Our experience shows that the volume of capital waiting in the wings is growing and we are likely to move our yields back in as soon as some of this capital begins to be deployed.

Despite this, prime headline yields in London are expected to remain more attractive than many European centres, significantly above the likes of Paris (CBD) (3%), Berlin (2.75%) and Milan (3.4%). This, combined with the strength of the occupier market, in addition to a shortage of new supply, will help to underpin rental value growth. Indeed, some markets, such as Southbank, Canary Wharf and the City Core are expected to register cumulative rental value growth in excess of 17% over the next five years.



03

GEOPOLITICAL TENSIONS DRIVING INQUIRES

London and the UK have historically registered an upturn in investor appetite during periods of global geopolitical tensions. Recent weeks have reaffirmed this trend, with a notable pick up in interest from overseas investors. However, as is the case with the UK institutions, whilst this capital is keen to find a home, its deployment remains subject to uncertainties around factors ranging from Brexit, the fallout of the US-China trade tariff battle and indeed other localised bouts of political insecurity. Nonetheless, although London remains as an investment safe haven, the shortage of quality commercial stock to soak up this growing pool of funds may hinder a return to 'normal' investment activity.

04

PRIVATE INVESTORS

There is evidence to suggest that HNWI (high net worth individuals) are still very active across Europe and especially UK. While the larger institutional money may have pared back activity due to uncertainty surrounding Brexit, individual investors are still being drawn in by the safety and security of an asset in London. The difference between individuals and institutions however are the lot sizes, with the former seeking assets in the £40-80 million bracket. The weakness of sterling is still a major attraction to international investors.

As it stands, US dollar buyers are looking at a discount of 16.9% and 7.9% for West End and City office assets, when compared to pre-referendum pricing.

05

UK INSTITUTIONS CIRCLING LONDON

International investors routinely account for 70-80%+ of total office investment activity in London. However, with some overseas investors scaling back activity for now, we have noted an upturn in interest from UK institutions in the London office market. Some perhaps sense an opportunity to acquire assets in a less competitive field. In addition, the strength of the occupier market and the potential for further rental growth may also be making London look increasingly favourable. Signs of a wider global economic slowdown may also be boosting the relative attractiveness of London.

06

LONDON'S ECONOMIC GROWTH SET TO IMPROVE

According to the Greater London Authority (GLA), employment in London is forecast to grow by an annual average rate of 0.71% between now and 2050. This will take the total number of people employed to almost 7.2 million, which translates into approximately 42,000 new jobs each year. The strongest and fastest growth is expected to come from the professional, real estate, scientific and technical sectors, which is expected to add an extra 1.2 million jobs to London's economy by 2050.

By this stage, these sectors are together expected to account for over a fifth of all employment in London. Indeed it is these services that have been the driving force behind office space requirements across London and currently account for 50% of all office space demand. This, combined with the fundamental attractiveness of the market, i.e., liquidity, transparency and governance, mean London is likely to continue outperforming its EU peers and indeed most other global gateway cities when it comes to its share of global commercial property investment.

LONDON INVESTOR DASHBOARD

H1 2019

PRIME OFFICE YIELDS

City: **4.50%**
West End: **3.75%**
Docklands: **4.75%**

PRIME CAPITAL VALUES

City: **£1,611 per sq ft**
West End: **£2,853 per sq ft**
Docklands: **£1,042 per sq ft**

PRIME HEADLINE RENTS

City: **£72.50 per sq ft**
West End: **£107 per sq ft**
Docklands: **£49.50 per sq ft**

TOP BUYERS

1. USA: **£1.9 billion**
2. UK: **£1.6 billion**
3. Malaysia: **£1.6 billion**

BIGGEST INVESTMENT PURCHASES

1. Waterside House,Paddington: **£220.5 million (NIY: 4.82%)**
2. 8 Salisbury Square, City Core: **£213.3 million (NIY: 4.60%)**
3. Alder Castle, City Core: **£103.5 million (NIY: 3.53%)**

BIGGEST LEASING TRANSACTIONS

1. The European Bank for Reconstruction and Development (EBRD), Canary Wharf: **360,000 sq ft**
2. Facebook, Euston: **141,000 sq ft**
3. Sony Music, King's Cross: **124,620 sq ft**

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