Knight Frank

RE LONDON

THE LONDON REPORT 2020 HIGHLIGHTS

RE

LONDON

THE LONDON REPORT 2020 HIGHLIGHTS

2020. A new year. A new decade. And indeed a new British government intent on “getting Brexit done”.

Despite new and emergent global headwinds, the UK is closer to the economic and political stability that decision-makers have hankered after ever since the EU referendum in 2016. After a year of resilience in 2019, 2020 is likely to go down as a year of stronger activity on many fronts.

However, no global city can afford complacency. We see four distinct aspects in which London will need to evolve, if it is to maintain its leading position over the next 10 years as a magnet for people, businesses and investment.

We draw confidence from the city’s history of evolution and rebirth. We have used the term ‘reLondon’ to encapsulate this process of constant reinvention; something we expect will be a defining feature for London in the ’20s. And real estate, of course, plays a crucial role in this strategy.

This document is a brief summary of our insight on these subjects. Greater breadth, more detail, case studies, and further analysis can be found on our Intelligence Lab – the home of our full 2020 London Report.

We draw confidence from the city’s history of evolution and rebirth. We have used the term ‘reLondon’ to encapsulate this process of constant reinvention.

This report is a summary of themes from the full 2020 London Report. More insight and analysis is available on the Knight Frank Intelligence Lab. Visit knightfrank.com/londonreport

FOUR THEMES THAT WILL DEFINE THE NEXT DECADE

RE PRIORITISING CUSTOMERS

Authentic customer partnerships will underpin value.
Tenants are no longer simply occupiers, but customers. What do they desire from their space, and how can landlords respond? Our surveys, case studies, and analyses highlight best practice, and demonstrate the investment value of the right approach.

RE AFFIRMING INFLUENCE

Education and innovation are now as important as finance and politics.
How will London will fare on the global stage as the UK leave's the EU? We examine the impact and extent of London's soft power, and draw on lessons learnt from other global cities across our network. We also investigate the importance of housing in unlocking London's competitive lifestyle offering.

RE ENERGISING DEMAND

London will restore its place as the world's most liquid and international market.
Domestic and global investors continue to raise more capital for real estate. How much will be directed towards London this year, and what are the major sources? Our research looks at the ways in which some of this demand might be satisfied.

RE IMAGINING SPACE

Corporate purpose will redefine the real estate agenda.
How will environmental considerations affect buildings and their users, and what will be the impact on saleability and letability of assets? Our analysis also covers the importance of digital connectivity and its links to workplace wellbeing.

THREE LESSONS FOR THE OFFICE MARKET

Customers are now willing to pay for value-added amenities. This is exemplified by the commercial success of Here East and White City, two developments that we explore in detail through case studies online. Developments such as these highlight three valuable lessons for the wider London office market as we enter the '20s.

Lesson one: the importance of creating a sense of place and community.
The days of the office being a self-contained space, impervious to outside influence are numbered. The future is about creating destinations – both physical and virtual – that generate positive, dynamic and uplifting workplace experiences and that support occupiers in attracting and retaining talent. The best offices of the future are talent magnets – whether they are in mixed-use schemes on the urban fringe, or within revitalised city cores.

Lesson two: customer experience is fundamental to success.
Property has somewhat belatedly recognised the customer. Best-in-class landlords are now investing time in understanding and responding to them. This requires a different mindset and philosophy. It demands regular engagement with the occupier. It demands empathy with them and a commitment to create solutions to the business problems they face. Moreover, it requires an acceptance that the role of the landlord now transcends a simple concern with bricks and mortar to encompass the provision, curation and maintenance of soft services as part of the customer experience. Expect an even greater influence for hospitality skill-sets in the office sector during the '20s.

Lesson three: the value of partnership.
The adversarial nature of the occupational markets is under increasing attack. Best-in-class landlords will enter into partnership with customers as the rules of the game shift, in an age of flexibility and shorter fixed commitments. Landlords will also need to partner with specialist providers to deliver the services, flexibility and experiences the customer increasingly requires. More crucially, this partnership between landlords and customers will also be essential if the big challenge of the next decade – that of more sustainable approaches to real estate – is to be adequately addressed.

QUALITIES NOT QUANTITIES

Recent metrics indicate a robust occupational market, with annual take-up averaging 13.8 m sq ft between 2016 and 2019, nearly 7% ahead of the 15-year average. Yet it is the qualities, rather than quantities, of demand that will have greater bearing on the future direction of the London office market. There are three key qualitative elements characterising recent demand, namely:

1

A clear mobility of occupiers towards the very best quality product that provides solutions to strategic business challenges, such as the attraction and retention of talent.

2

A push for increased flexibility in both product and lease in order to align real estate to modern business realities such as shorter CEO tenures, agile business models and digital transformation.

3

A desire for greater service and amenity in order to create positive workplace experiences that support staff retention and deliver greater collaboration.

These three elements are conditioning landlord responses, as they seek to tune into changing customer requirements and expectations.

LONDON LANDLORD & INVESTOR SURVEY

The results of our London Landlord and Investor Survey show that understanding customer expectations and priorities is their number one concern. What are occupiers' biggest concerns? What are the most important amenities/services and why are they in high demand?

visit knightfrank.com/londonreport

THE CASE FOR SUPER PRIME OFFICES

A shortage of office supply, the war for talent and the desire by businesses to base themselves in locations that are perceived to be prestigious is driving demand for a strata of space that can only be described as super prime. What does this mean for landlords and developers, and what kind of rental premia can such buildings command?

visit knightfrank.com/londonreport

QUANTIFYING LONDON'S SUPPLY SHORTAGE

Tenant demand for office space is significantly outstripping supply. How did we get to this position, and what impact is it having on businesses in London?

visit knightfrank.com/londonreport

LONDON – A TRUE ALPHA CITY

Cities are becoming ever more economically dominant, and top-tier cities are arguably more influential than the countries they sit within. London's success rests not only in the agglomeration benefits it offers businesses, but also its hard-to-rival culture, diversity, inclusion and innovation factors, which help to attract and retain the top global talent.

More than a financial powerhouse

The Globalization and World Cities Research Network categorises cities by the strength of their business service connections to other cities. Only two cities obtain the highest 'Alpha++' status – London and New York.

London not only remains a leading global hub but is still growing its influence in multiple areas. Take foreign exchange trading: London is recognised as the world's dominant global centre for currency trading, not just by the City of London Corporation but also by the European office of the People's Bank of China which names the city as the largest offshore Renminbi trading hub. London is also leading the way for the growing fintech sector. A 2019 report released by London & Partners and Innovate Finance, put London in the top spot for the number of venture capital investments in fintech businesses (114), ahead of New York's 101.

London is a centre for innovation

Innovation and education are key drivers of economic growth, while also fundamental to attracting and retaining talent and wealth. The quality of education on offer in London has global appeal, with international students accounting for 53% of those attending London's top 200 universities. This pool of talent means businesses are drawn to the city to harness the skills and innovation that London is able to generate.

Demographic trends provide a solid footing for demand projections. The forecast growth in 20-29 year olds, for example, will see London

HOUSING PROVISION IS KEY TO LONDON'S SUCCESS

London is jostling with other global gateway cities to attract and retain the world's best people. How important is the city's ability to offer a range of residential accommodation to house its growing talent pool?

visit knightfrank.com/londonreport

have one of the highest concentrations of this age group in Europe. This younger population is a function of London's higher education offer, as well as its ability to retain and attract graduates. In 2019, for example, 70% of final-year students in London said they intended to stay in the city after graduation, according to the Knight Frank/UCAS Student Accommodation Survey.

As an example of the capital's strength in innovation, London has four universities which sit in the top 75 (of 343) universities ranked globally*: UCL (rank 11), Imperial College London (rank 25), King's College London (rank 51) and Queen Mary University of London (rank 75). Their high ranking is reflective of their ability to produce commercially applicable research, generate patents, create spin-offs and collaborate with industry.

London has therefore positioned itself at the centre of the global tech explosion.

To illustrate the type of activity universities such as these are helping generate, according to the Centre for Entrepreneurs, there were over 221,000 new business formed in London over 2019, approximately one third of all new businesses across the UK. 17,400 of these businesses were in technology, and a number of these are linked to London's world leading universities.

Indeed, the capital's growing population and number of STEM roles (science, technology, engineering and maths roles) are supporting the continued growth of innovation and knowledge clusters around the city. These include Kings Cross and Euston as an established centre, with a range of innovation generators ranging from UCL and The Wellcome Trust, to Google and Facebook. Other knowledge clusters are emerging from White City in the west, to Here East, adjacent to the 2012 London Olympics Games site.

A global centre for tech

London has therefore positioned itself at the centre of the global tech explosion, emerging as the world's fastest growing tech scale up cluster, while the UK has spawned 35% of Europe and Israel's 169 Unicorn tech businesses (Technation, 2019). And the birth of these businesses in London and the flocking of others to the capital is largely down to one critical differentiator: a highly educated workforce and diverse pool of top talent.

In fact London has been positioned in second place, behind New York, in the World Economic Forum's 2020 Global Talent Competitiveness Index for cities, a measure of a city's ability to grow, attract and retain talent.

Ultimately, it is this combination of finance, innovation, education, and people, that underpins our expectation of sustained demand for commercial real estate from both occupiers and investors during the next decade.

**Times Higher Education ranking based on the UN's Sustainable Development Goal 9 of industry, innovation and infrastructure*

RE

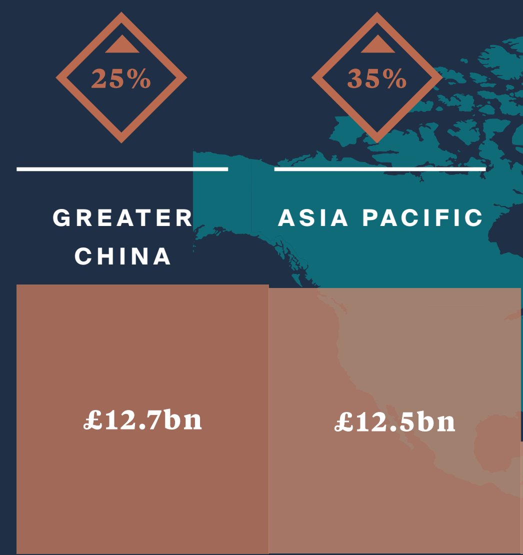
ENERGISING DEMAND

INVESTMENT: REASONS TO REBOUND

London's real estate is benefiting from 'extra time': an extension to the global economic cycle, and a renewed hunt for yield. Our 2020 Global Capital Tracker shows that £48.4bn has amassed globally, waiting to be deployed in London's office market, a 21% jump on the figure for 2019.

2020 GLOBAL CAPITAL TRACKER

There is currently £48.4 billion of capital targeting Lon



Expect a rise in investor demand

Compared with other global cities, London's office market now offers comparatively high yields and significant rental growth prospects. For overseas buyers, the lack of a strong Sterling bounce has further anchored pricing at attractive levels, albeit some currency volatility can be expected this year as the UK works to carve out a new trading relationship with the EU.

Those holding assets will have little reason to exit London's office market, not least because other secure, high yielding options remain limited.

As demonstrated by our Global Capital Tracker, a macro reweighting towards real estate generally, combined with this current mix of London-specific advantages, is fostering a rebound in demand for London commercial assets. The implications for pricing are clear: renewed downward pressure on yields, which should, in part, alleviate the current shortage of available investment opportunities.

Seeking return in a low growth world

But what of the longer term rationale for investment? Policymakers may have succeeded in sustaining economic expansion, but the pace of that growth in coming years is forecast to be low.

Against this backdrop, we expect real estate investors to be strategising accordingly: by focusing heavily on understanding London's local and micro-market dynamics, with a keen eye to the liquidity of acquisitions, and in many cases, favouring development, or repositioning angles. The latter will be especially important for those looking to bolster absolute returns.

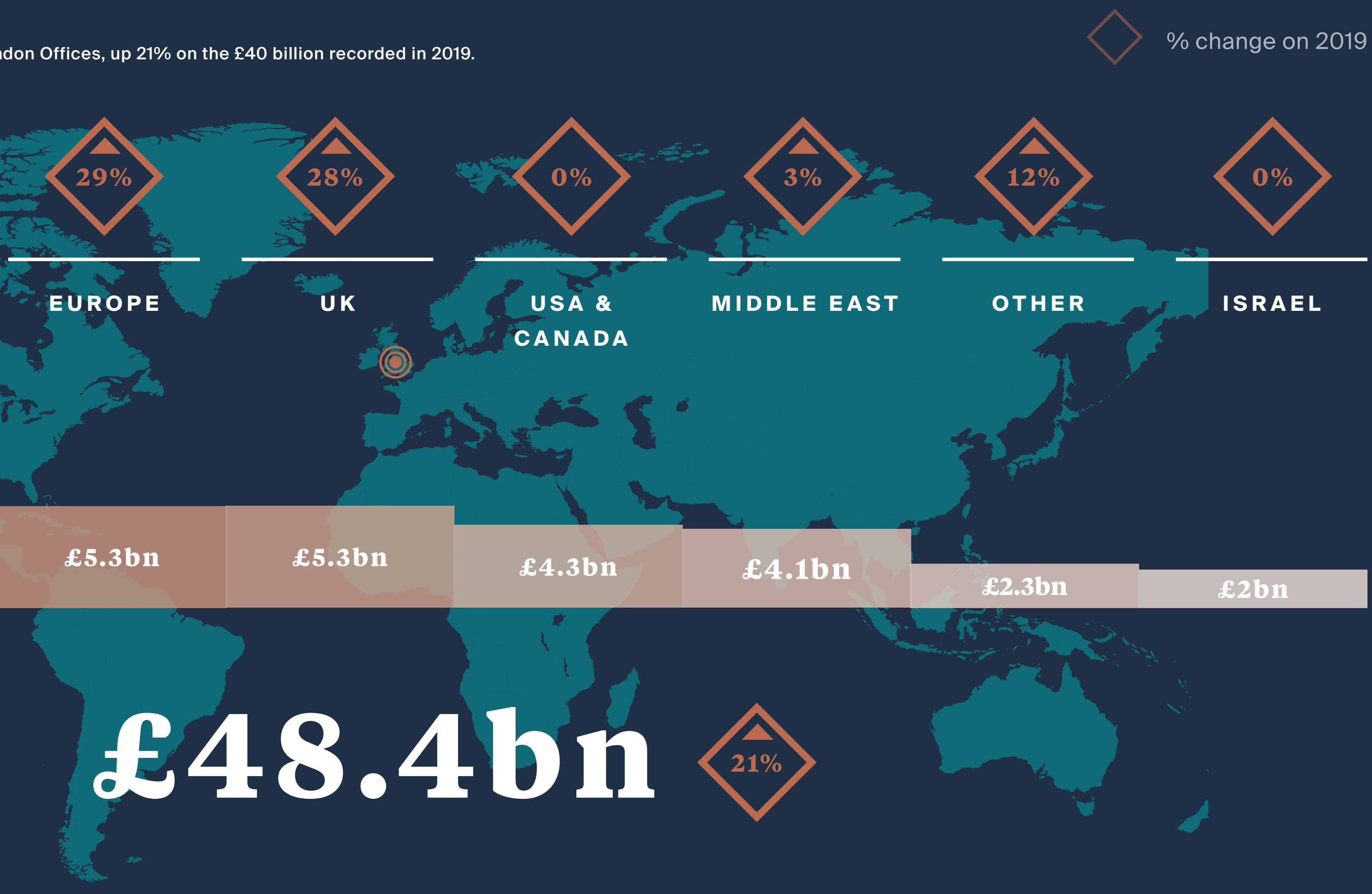
Underlying these factors will be a growing need to consider how the environmental sustainability of assets will increasingly impact both near-term investment performance and long-term liquidity. In short, despite a reprieve from recessionary scenarios, we still expect investors to act relatively defensively, albeit an increasingly customer-centric approach to asset management will remain at the core of decision making.

How to be proactive: educate and innovate

Finally, it may be argued that authorities have typically ridden to the rescue of markets over the past decade, by lowering interest rates, enacting quantitative easing, and via governments, spending more. These options, while not yet exhausted, have certainly been depleted in scope for the foreseeable future.

Can investors place as much reliance on such support in future? One proactive approach is to focus on the other tools by which cities and countries can support expansion: education and innovation.

Locations that score highly on their ability to monetise high-quality education and innovation are less reliant on the good fortunes of market trends, or the generosity of financial institutions. Our analysis, which ranks European cities by over 100 variables ndon Offices, up 21% on the £40 billion recorded in 2019.



related to these factors, shows that London stands far above any other city in Europe.

While we are glad to share growing optimism over London's economic outlook, we believe these fundamentals should give even the most cautious commentators a high degree of confidence in its prospects.

The challenge for investors, at least in the short term, will be the scarcity of stock. With the global economic uncertainty equation being further muddled by the inevitable fallout from the Coronavirus outbreak, investment safe havens such as London must brace for a demand influx.

Those holding assets will have little reason to exit London's office market, not least because other secure, high yielding options remain limited.

2020 KNIGHT FRANK GLOBAL CAPITAL TRACKER

Which investor groups are poised to splash out on London offices in 2020 and where is the stock likely to come from?

visit knightfrank.com/londonreport

STRONG OFFICE RENTAL VALUE GROWTH TO DRIVE INVESTOR DEMAND

With no relief expected from the dearth of office stock, prime headline rents are expected to come under upward pressure over the next five years, further inciting investor interest in the London market. Which submarkets are likely to experience the strongest rates of growth and why?

visit knightfrank.com/londonreport

RE
IMAGINING SPACE

GREEN IS THE NEW BLACK: HOW SUSTAINABLE BUILDINGS CAN SUPPORT RETURNS

London is a top-five market globally for commercial real estate investment and thus one of the most exposed to evolving developer, investor and occupier demands. As green investing moves up the agenda, the capital needs to respond.

The big picture

Not all investors are yet noticing the full extent of demand for green or sustainable investing. However, larger, international institutions are certainly seeing this shift. Globally, assets totalling USD 120tn, including commercial real estate, are now managed by financial firms signed up to voluntary climate change disclosures. This is driving some of the growth in green investor demand, especially as there is an expectation that these standards could become mandatory. With a significant amount of London's office stock now held in international ownership (c.80% in the City), the city's real estate needs to remain fit for purpose in this environment.

London is a leader for green infrastructure, but can do more

London is a leading city for infrastructure and green spaces. In 2019, the city became the world's first National Park City, with approximately eight million trees acting as a carbon sink and 17% of the wider city being covered by public green space. Good public transport helps too. The London Underground network is currently being extended and the new Elizabeth line will provide a fast link across London and extensions to the Northern and Bakerloo lines are either underway or in the pipeline.

This infrastructure means that there is a wide pool of commercial real estate offering sustainable credentials from the perspective of travel to and from the buildings. However, commercial real estate investors are often most interested in the green credentials of the buildings themselves. Our London Landlord and Investor Survey finds that improving the environmental qualities of buildings is one of the top three London-related challenges for the coming year.

Not all investors are yet noticing the full extent of demand for green or sustainable investing.

'Greenifying' buildings

London already enjoys a stock of over 3,000 BREEAM-rated buildings. However, for investors, being sustainable does not just mean investing in existing green buildings. With 64% of commercial buildings in London completed prior to the year 2000, there is opportunity to enhance value by innovatively greenifying these buildings, particularly if we see an increase in 'brown' building discounts, as the stock of green buildings continue to grow.

UNDERSTANDING THE ALPHABET SOUP THAT IS ESG

ESG is awash with acronyms, but what do they all mean?

visit knightfrank.com/londonreport

Occupiers thinking green to win the war for talent

Green rental premiums are largely driven by tenant demand for sustainable office space, and this links directly to the war for talent. Our London Landlord and Investor Survey finds that the top challenge for tenants in 2020 is the ability to attract and retain the right staff. London as a city helps tenants get part of the way there. In addition to agglomeration benefits, the capital offers hard-to-rival culture, diversity, inclusion and innovation factors, which help to attract and retain the top global talent.

However, London based companies also compete with each other. Offering a working environment which matches a wider sustainable ethos is a way of distinguishing themselves to an increasingly environmentally conscious workforce. While not all tenants will consider green buildings as a way of winning the war for talent, we do expect this to grow.

Green rental premiums are largely driven by tenant demand for sustainable office space, and this links directly to the war for talent.

The opportunity for london

It is important that in the real estate sphere, London's landlords, developers, advisors and future investors are also primed for this change if London is to remain a leading destination for capital through to 2050 and beyond.

For developers this could mean understanding investors' green requirements, or revisiting construction methods and materials. For occupiers, this might mean understanding how a green workplace can help attract and retain talent. For investors, this could mean understanding how best to invest in buildings which meet their current and future ESG targets and protect against risk of obsolescence in the face of strengthening legislation.

For all stakeholders it means cutting through the noise, asking the right questions and taking advice where necessary to understand what elements of ESG actually achieve their goals in the context of wider carbon-neutral targets.

DIGITAL WELLBEING – THE NEXT BIG THING?

We explore the links between digital connectivity and workplace wellbeing and investigate digital rental premia. How can landlords and investors in London respond to the need to be connected 24/7? Why does Wired Certification matter?

visit knightfrank.com/londonreport

DISCOVER MORE ON THE KNIGHT FRANK INTELLIGENCE LAB

EXPERT INSIGHT

IN-DEPTH ANALYSIS

CASE STUDIES

VIDEOS

FORECASTS

ALL AVAILABLE AT KNIGHT FRANK INTELLIGENCE LAB
KNIGHTFRANK.COM/LONDONREPORT

Stephen Clifton
Head of Commercial
+44 20 7861 1312
stephen.clifton@knightfrank.com

William Beardmore-Gray
Head of London Offices
+44 20 7861 1308
william.beardmore-gray@knightfrank.com

William Matthews
Head of Commercial Research
+44 20 3909 6842
william.matthews@knightfrank.com

Faisal Durrani
Head of London Commercial Research
+44 20 7861 1234
faisal.durrani@knightfrank.com

Knight Frank Research provides strategic advice, consultancy services and forecasting to a wide range of clients worldwide including developers, investors, funding organisations, corporate institutions and the public sector. All our clients recognise the need for expert independent advice customised to their specific needs.