Newmark Grubb Knight Frank

Knight Frank

THE LONDON REPORT

CONTENTS

14-15
London Investment In 2017

06-07
New Core Districts

18-19
Living In The City

03
Talking About a Revolution
In 2017 the Central London office market will surprise on the upside

04-05
Bigger Than Brexit
Much bigger trends than Brexit are shaping the future of the London economy

06-07
New Core Districts: Gaining Momentum
Discover the six new core districts that are extending Central London's CBD

08-09
A New Occupier Philosophy
Necessity is proving to be mother of invention for office occupiers in a fast changing world

10-11
Tomorrow's World
Find out which organisations will form the next wave of occupier demand

12-13
Meet the Decacorns
Who are the CEOs behind some of the digital world's biggest start-ups?

14-15
London Investment in 2017
Psychiatry offers some useful insights when examining the office investment market

16-17
All The World's a Stage
Find out where the £9.3 billion of foreign investment deployed in 2016 came from

18-19
Living In The City
Mixed-use is taking Central London back to its Dickensian days

LONDON: TALKING ABOUT A REVOLUTION

WRITTEN BY
Stephen Clifton,
Head of Central London Offices

This year's London Report is published at a time when the capital is in the midst of unprecedented change. As well as the tech revolution, and the emergence of new districts to expand London's CBD, we also have Brexit

These events are set to reshape both the economy and geography of London. James Roberts, Knight Frank's Chief Economist, argues in his article on pages 4 and 5, the tech revolution is perhaps of greater significance than Brexit. After all, leaving the EU is effectively a two year road bump for the London economy; whereas the coming revolution of AI (artificial intelligence), robotics, and fintech (financial technology), will reshape the very way we live. It has already created a new wave of office demand that remains active despite Brexit.

We see London's long-term growth story unchanged by the decision to leave the EU. In order to become a city of 10 million people, the capital will thus need to extend its crowded CBD, and on pages 6 and 7 we profile the six new core districts currently under development.

This coincides with enormous changes in how occupiers approach real estate as they adapt to the economic, social and tech disruption which is impacting their businesses. On pages 8 and 9, Richard Proctor, Head of Central London Tenant Representation, and Lee Elliott, Head of Commercial Research, examine how companies are evolving their office occupation to match the challenges of a fast changing workplace.

For office investment, 2016 was a year when the market feared the worst in June, but then quickly recovered. Anthony Barnard, Head of West End Investment, and Anthony Duggan, Head of Capital Markets Research, look at "the five stages of grief", and conclude that a wall of overseas money is migrating towards London in 2017. The main problem facing investors will be sourcing stock (see pages 14 and 15).

As more people want to live in a location where work, home, shops, and leisure are all in close proximity, mixed-use development is becoming the norm. Liam Bailey, Global Head of Research, argues on pages 18 and 19 that there is an element of 'Back to the Future' in all this, reminding us that this intermingling of property uses in a local setting is in fact a return to the London of Charles Dickens.

Overall, we enter 2017 with less certainty than many of us would like, or are used to. However, the fundamentals of the London office market are strong. In the leasing market, the tech firms have shrugged off Brexit and are taking space. In the investment market, overseas investors are showing a strong appetite for London offices. We view 2017 as a year that will surprise on the upside.

"IN THE LEASING MARKET, THE TECH FIRMS HAVE SHRUGGED OFF BREXIT AND ARE TAKING SPACE"

BIGGER THAN BREXIT

+

London is in a strong position to face the Brexit challenge, thanks to high productivity and rising new industries

WRITTEN BY
James Roberts,
Chief Economist

The resilience of the UK economy since the EU referendum last year has surprised many commentators. If one closely examines the underlying evidence, it becomes apparent that London accounts for a large share of the better than expected business news.

Since the referendum, Wells Fargo has bought a new European HQ in the UK, and Apple has pre-let 500,000 sq ft at Battersea Power Station. Facebook has announced plans to increase its London headcount by 50% in 2017 alone, while WeWork has acquired space for four new co-working centres. These major overseas corporations all want to do business in the UK after Brexit, and in particular they want to be in London.

That confidence in the London economy has held up so well is perhaps unsurprising. It is often said that the UK has low productivity, but that is not true of the capital. Productivity in London is 40% higher than in the rest of the UK, and thus compares well on an international level.

Moreover, London's success as a business location has in recent years owed ever more to its rise as a tech and creative industries hub, for whom the Brexit issue is of less concern than it is for the financial sector. Most tech and media firms are not faced by significant regulatory issues as a result of leaving the EU, so London remains an attractive place to do business.

Even for the fintech industry, Brexit presents fewer problems than it does for banks and brokers, as technically they are selling software not financial services. Indeed, the success of Tel Aviv as a fintech hub shows that a city neither needs to be in the EU or a major global financial centre to prosper in this area.

The TMT (technology, media and telecoms) sector overtook the financial sector on size of headcount in London back in 2013, and has been the largest source of office demand for the last six years. Further growth is expected, as there is plenty more road ahead for TMT as we stand on the brink of the coming revolutions of robotics, AI, and fintech.

Moreover, a future world of autonomous vehicles and drones will require a great many rules and regulations to be torn up, which is not something one associates with the EU. Arguably being outside the EU could make London a more attractive place for tech firms to develop these new lines of business.

This would also be true in scientific R&D. With the move towards computer simulation in scientific research, London has been gaining momentum in this area, particularly around King's Cross and Euston. This will increase the diversity of London's economy.

The diversity issue is important, as ten years ago London found itself dependent upon a financial sector that was moving into crisis. This is why the issue of financial passporting into the EU is less of a concern than it would have been in the past, although one cannot ignore it as a risk.

Certainly, if the TMT sector were to continue growing at its average rate over the next three years, this would be enough to counter balance a 15% fall in headcount for financial firms. However, it is doubtful that such a huge loss of jobs will occur in London's financial sector.

In reality, the EU needs the City of London's financial hub as the two year Article 50 timeline is not enough to replicate it on the continent. London accounts for 78% of the EU's foreign exchange turnover, and 74% of trades in over-the-counter derivatives. The risks to financial and economic stability in the EU from an abrupt end to trading with the City of London are high. We expect this area of the Brexit negotiations to end in a compromise, with the City broadly maintaining its position as Europe's financial capital.

Nevertheless, critical to the success of London is access to talented staff, which sometimes means recruiting overseas. The political pressure to cut immigration is high, and this is probably the main risk facing the London economy.

In part we expect the allocation of work visas post-Brexit to be heavily biased towards skilled workers, which should ease the impact on London's economy. Moreover, there has been discussion of a 'London visa'. This is inspired by similar schemes in Australia and Canada, where it is possible to grant immigration visas to live in a specific area of a country.

London is moving towards Brexit in better economic health than many expected back in June 2016, in the aftermath of the referendum. Its transition away from finance and towards technology and creative industries has proved well timed, although we expect the issue of financial markets access to the EU to end in a compromise. However, a working solution is needed to the problem of maintaining high skilled immigration if London is to continue to be a leading global city.

"PRODUCTIVITY IN LONDON IS 40% HIGHER THAN IN THE REST OF THE UK, AND THUS COMPARES WELL ON AN INTERNATIONAL LEVEL"

NEW CORE DISTRICTS: GAINING MOMENTUM

Last year Knight Frank identified six new mixed-use districts under development which are extending the boundaries of the central zone. One year on, we take a look at their progress and how they are shaping London's occupier dynamics

WRITTEN BY
Victoria Shreeves,
Associate – Research

STRATFORD

Stratford is now widely recognised as a key London business district, offering 1.9 million sq ft of retail, vast green spaces, sporting facilities and a cultural hub that will become Europe's largest arts district in the planning. Institutions already committed to the hub include the V&A, London College of Fashion, University College London, Sadler's Wells and the Smithsonian Institute. Last year saw Delancey's scheme, Here East complete, adding over 900,000 sq ft of new office, studio and innovation space to supply. However, only 300,000 sq ft remains after occupiers such as BT Sport, Infinity, the Bartlett School of Architecture, UCL and Loughborough University London committed to the scheme.

Central to the vision of Here East to create a truly innovative and collaborative cluster has been the acquisition of Entiq and the roll-out of Plexal, a new innovation centre led by Claire Cockerton, founder of Entiq and Level 39. Plexal offers a suite of services to the start-up community focussed on digital innovation. Here East was recently awarded the highest level of connectivity certification from WiredScore, the Wired Certified Platinum rating, for flexibility, diversity and power. Here East offers a mix of co-working to traditional office space, research campus, and academic institutes all based in surroundings that appeal to the millennial workforce.

NINE ELMS - BATTERSEA POWER STATION

Nine Elms received a major boost to its profile as a business district last year when Apple agreed to pre-let 500,000 sq ft of office space at the Battersea Power Station development. Over 1,400 Apple employees will take occupation in 2021, relocating from 13 offices around Central London. The 42-acre site has planning consent for 8.5 million sq ft of space, which includes both commercial and residential uses, in a landmark mixed-use development. Apple's new offices will be inside the historic Sir Giles Gilbert-Scott designed Power Station.

Nine Elms, Battersea Power Station

The evidence elsewhere in London is that large, fast moving tech occupiers grow quickly in situ, which makes clustering around them attractive to small-to-medium sized tech companies. This should drive the wider Nine Elms area as a TMT location, and encourage wider redevelopment of the local area. With potential to develop a further 750,000 sq ft of office space (or more), Battersea Power Station is one of the few new zone one riverfront sites where occupiers can design a building in partnership with the developer to meet bespoke requirements. The new Northern Line extension is underway and due to complete in 2020.

WATERLOO

The much anticipated redevelopment of Elizabeth House in Waterloo draws closer as JV partners Chelsfield and London & Regional explore options for an outright sale or a stake in the development. The proposed development has drawn a lot of interest from bidders, both foreign and domestic. The development, which was approved in 2014, involves the demolition of all existing buildings and the construction of two new buildings that comprise 750,000 sq ft of office and 250,000 sq ft of residential. Nearby, works are underway at Almacantar's two new office buildings, One and Two Southbank Place, which are expected to complete by September 2018 and form part of the wider Southbank Place mixed-use estate. One Southbank Place is fully pre-let to Shell.

WHITE CITY

White City Place and Television Centre is a new 1.5 million sq ft business district being developed by Stanhope, AIMCo, and Mitsui Fudosan. It covers 17- acres within the White City regeneration area and is positioned to become a major centre of creative thought. The MediaWorks building (231,500 sq ft) and Garden House (38,860 sq ft) both completed in Q4 2016 and are already home to an impressive list of tenants. The luxury online fashion retailer Net-a-Porter took 70,508 sq ft and Huckletree, the co-working providers, took 23,127 sq ft at MediaWorks, whilst Garden House has been let in its entirety to the Royal College of Art.

The WestWorks building (281,500 sq ft) is under construction and due to complete in Q2 2017. Along with MediaWorks was awarded the top mark Platinum by WiredScore. White City Place and Television Centre is part of the wider 112-acre White City regeneration that includes Imperial College London, Westfield London, and Berkeley St James.

CANARY WHARF – NEW DISTRICT

This significant mixed-use project, currently known as New District, Canary Wharf, represents one of Central London's largest privately owned developments. The New District will encompass 22- acres, including interconnected parks, piazzas, riverside walkways and garden squares. Formerly known as Wood Wharf, the site has been designed to provide a new residential led, mixed-use, waterside community. The scheme comprises around 2.0 million sq ft of new offices targeted towards creative and progressive businesses, with the first phase of buildings to be delivered in 2019. The offices are to be delivered in six office buildings typically ranging in size from 100,000 sq ft to 200,000 sq ft. The first phase includes two new office buildings; 15 Water Street (100,000 sq ft) and 20 Water Street (210,000 sq ft). Completion of the first phase follows the arrival of Crossrail in 2018, with the entire project potentially completing by 2023.

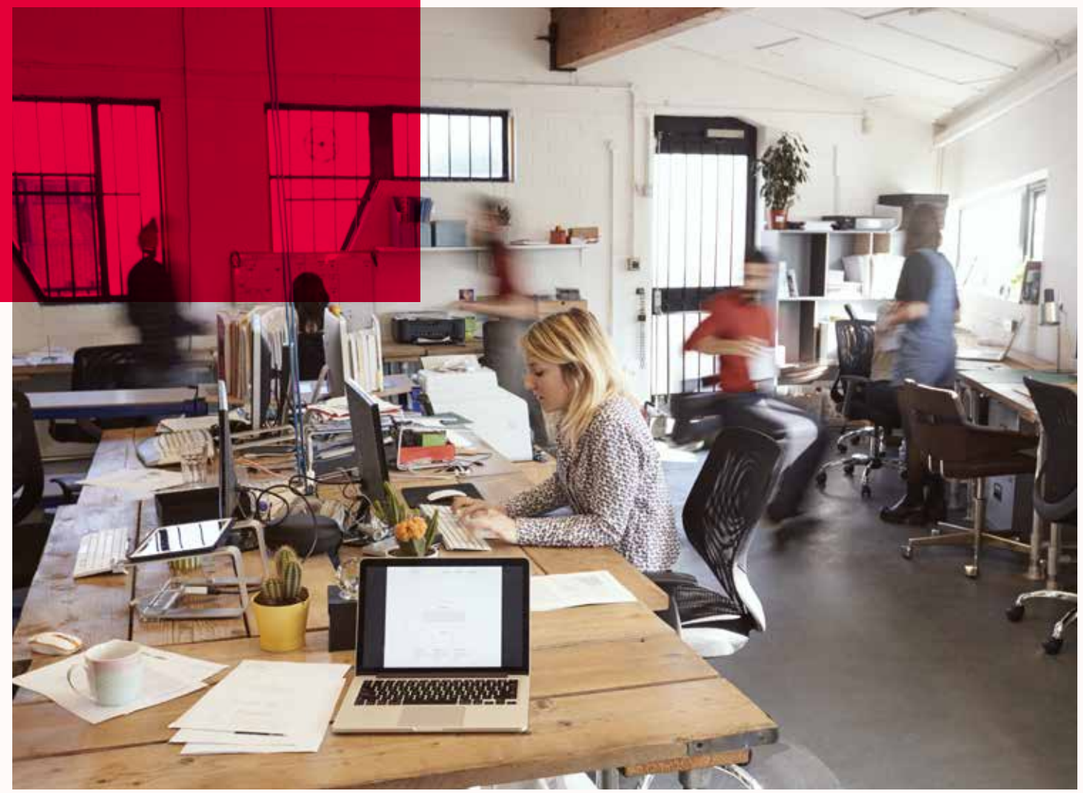
CANADA WATER

British Land is developing plans for a major new urban centre at Canada Water. The Canada Water Masterplan covers a 46-acre site incorporating the Surrey Quays Shopping Centre, the SE16 Printworks and Surrey Quays Leisure Park. It is expected to deliver around 2.0 million sq ft of offices around 1.0 million sq ft of retail, leisure, entertainment and community space, plus 3.4 million sq ft of residential, a leisure centre, and potentially a higher education campus. British Land also acquired the historic Grade II listed Dock Offices towards the end of 2016, which will now be integrated into the masterplan.

A planning application is expected to be submitted in 2017. In addition, Notting Hill Housing Group and Sellar Developments are developing the Decathlon site at Canada Water to provide a high-quality mixed use development. The first phase is currently under construction and will complete in 2018, delivering 234 new homes. Later phases will deliver further homes, along with additional retail, commercial space and new public areas across eight acres.

A NEW OCCUPIER PHILOSOPHY

After the most tumultuous twelve months since the global financial crisis, it is perhaps time to be philosophical about the prospects for the Central London office market



WRITTEN BY

Lee Elliott,
Head of Commercial Research

Richard Proctor,
Head of Central London Tenant Representation

It was Plato who declared that 'necessity is the mother of invention'. This is an apt descriptor of the key drivers of current and future occupational demand across Central London.

For amidst the uncertainty created by the results of the EU referendum and the US election, a simple truth has been neglected. Faced with on-going technological disruption, businesses of all sizes, drawn from every industry sector, have a pressing need to reinvent themselves. Business models are being re-set, new teams are being established to turbo-boost responses to a new operational reality, collaboration is being nurtured, and technology is being applied to drive transformation.

This has fuelled strong readings from post-referendum business surveys. UK PMI data is solidly in expansionary territory, hiring intentions have remained robust, and corporate investment has increased. This augurs well for occupational demand, which has also surprised on the upside. Central London take-up rallied in the final quarter of 2016 with 3.6 million sq ft transacted – some 14% above the long-term average. Firms such as Apple, Amazon, Wells Fargo, and WeWork all committed to London despite the uncertain backdrop. There is a depth of occupier demand to drive future activity. At the end of 2016 Knight Frank was tracking 8.6 million sq ft of active searches – higher than average and notably above the same point in 2015.

The characteristics of that demand are changing in four notable ways.

First, the dominant source of Central London office demand is shifting away from finance and towards tech and creative industries, driving with it the reinvention of the city itself as a global tech hub.

Second, occupier demand is becoming more flexible in terms of location and required lease structure. For example, retail banks, in response to the threat of the challenger banks and the growing digital expectations of their customers, are accommodating innovation and digital teams not in their grey space, but in new offices in London's tech villages. Great examples of this include HSBC taking 65,000 sq ft at Blue Fin on the Southbank or Barclays establishing an accelerator on Mile End Road. Non-financials are following suit, with Deloitte Digital's active, standalone requirement for approximately 90,000 sq ft.

Lease flexibility is also important and occupiers are acknowledging the 'premium' required to secure it – for many it is a price worth paying in a disruptive business environment. Before the global financial crisis, five year breaks on deals for new space of over 20,000 sq ft were few and far between. This is no longer the case.

Flexibility is also expressed by a corporate drive towards co-working. Our Tech and Flexible Office Solutions teams have just completed a 70 workstations deal for BrightTALK and are currently working on a range of co-working or serviced office requirements ranging from 30 to 70 desks. Gone are the days when once a company hits a headcount of 20 people it moves to conventional leased space. Amazon has over a thousand people in London based in such space.

Third, the advent of new technologies such as automation, robotics and Artificial Intelligence (AI) will, for a mature market such as London, shape demand via a simple questioning of just what is the purpose of the London office. Nowadays, for large international firms, the London office performs the role of a key global hub office. The focus of the office is geared towards visiting clients and employees; essential, client facing employees principally serving the London market. The best hubs are of course in one place, so with larger occupiers we continue to see consolidation and a drive towards a single roof strategy.

Finally, demand will focus heavily on amenity rich product, and places which act as talent magnets. The war for talent continues, and the role an office can play in attracting and retaining the best people has never received greater focus. The workplace and its surrounds, through the provision of retail, leisure and, increasingly healthcare and educational facilities, can drive improvement in staff attraction and retention and this will more than counter an uptick in property overheads arising from better accommodation and facilities for staff.

In ending, let us return to where we began – philosophy. While it is easy to form a gloomy outlook for occupational demand amidst an unpredictable macro environment, the reality is that businesses urgently need to restructure and future proof themselves. This will drive demand, for as Nietzsche once said "the future influences the present just as much as the past".

"GONE ARE THE DAYS WHEN ONCE A COMPANY HITS A HEADCOUNT OF 20 PEOPLE IT MOVES TO CONVENTIONAL LEASED SPACE. AMAZON HAS OVER A THOUSAND PEOPLE IN LONDON BASED IN SUCH SPACE"

TOMORROW'S WORLD: LONDON'S FUTURE BUSINESSES

Firms at the cutting edge of innovation will form the next wave of demand for London offices

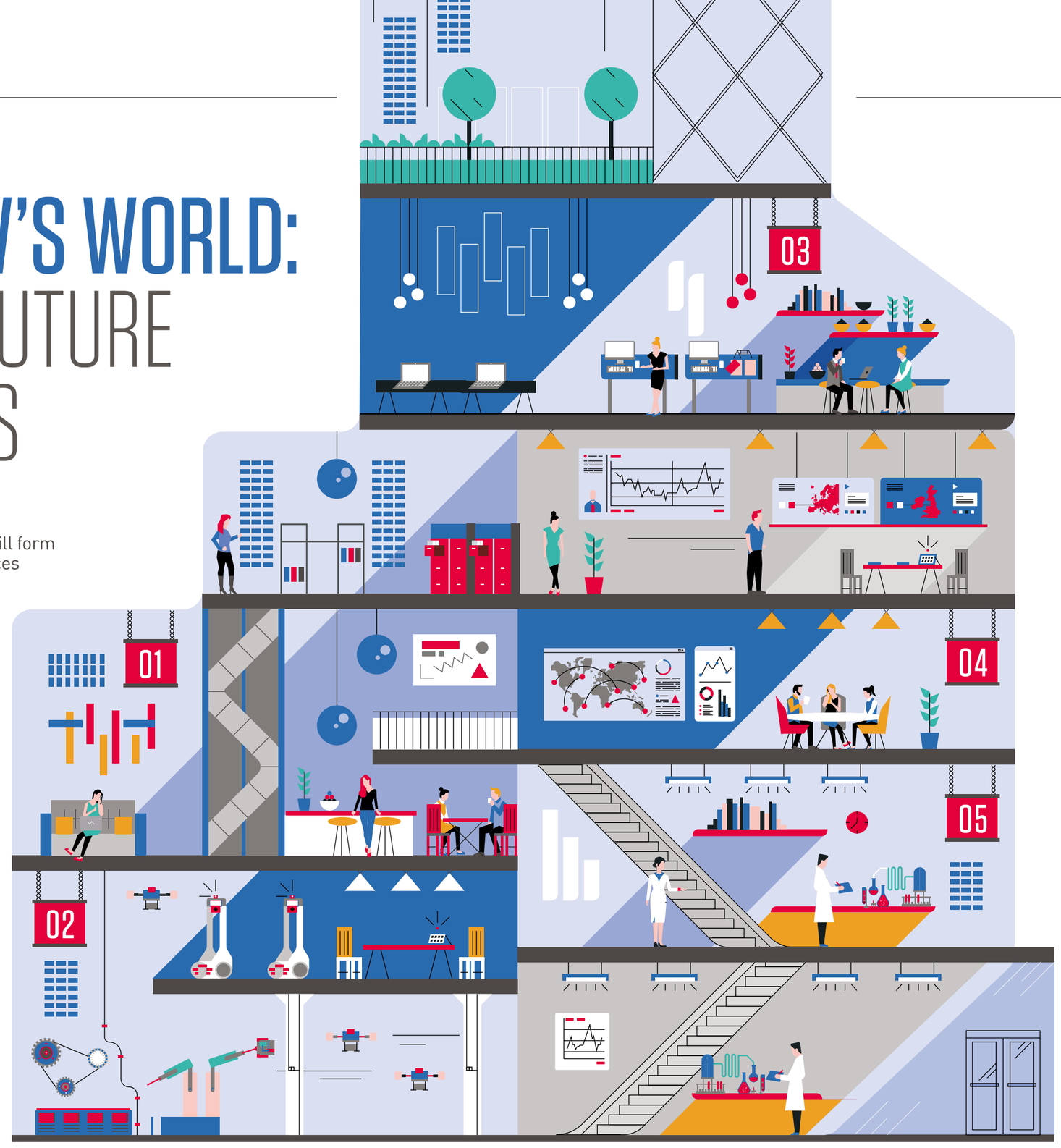
London has successfully positioned itself as a world-class innovation economy, with technology and creative clusters firmly established alongside the traditional financial, insurance and professional industry hubs. The capital has the vibrancy necessary to draw in all types of skilled workers, which in turn persuades new industries that they should locate in London.

The lesson of the last decade is that London must continuously attract firms and workers at the forefront of economic and technology change. Below are the firms and industries we see leading the next wave of innovation, generating future office demand.

01 | BORN-AGAIN START-UPS

A growing trend is established companies wanting to re-introduce the start-up culture into their existing operations. Moving offices to a more vibrant district is often seen as part of the solution, as demonstrated by GE relocating its HQ from Connecticut to Boston. In a low interest rate environment, we see large corporations coming under shareholder pressure to invest their cash reserves, and demonstrate that they are re-inventing themselves to meet the challenge of tech disruption.

Several mature tech and media firms in London have already adopted the 'born-again start-up' strategy. However, with the digital revolution invading all aspects of life, we believe firms in industries not typically associated with Central London, like airlines and car manufacturers, will open innovation centres in the capital to stay ahead of the disruptors.



02 | ROBOTICS AND ARTIFICIAL INTELLIGENCE (AI)

The next wave of the technology revolution is to be trail blazed by companies operating in robotics and AI, as testing continues on autonomous cars and commercial drones. With London already an established technology hub, we see robotics and AI start-ups favouring the capital, as computer simulation means more testing and development can occur in an office-type environment. Also, the regeneration of East London looks set to deliver affordable business space suited to these industries.

03 | RAINMAKER LAUNCH PADS

Some legal firms in London have long operated 'Mexican wave' systems whereby a partner in London wins work, that is emailed to a junior member of staff in a regional office who does the actual drafting of documents. This allows the firm to leverage the access to clients and high value rainmakers in the capital, but with the lower operating costs in the regions. The approach could be applied to other industries.

Under this model, the London office does not lose its significance, but it will change in nature. There will be a move away from accommodating staff and desks, and towards offering meeting rooms and conference facilities, supplemented by hot desks and break-out space, for an office where the human traffic ebbs and flows. Such offices will need to be in a central location for the rainmakers to minimise their journey times between meetings; and provide an exclusive address for the letterhead. This could create a market for high quality and well located C-suites.

04 | RE-CENTRALISING FINANCE

Fintech is leading the way in financial innovation. However, when acquiring new office space such firms are encountering higher rents in places like Shoreditch and Clerkenwell, as they compete against other tech industries for a diminishing pool of high quality space. Yet for fintech the long-term benefits of clustering with companies producing video games or phone apps is limited in scope, and there are potential benefits from being near to their finance sector customers.

This creates the logic of fintech forming its own cluster, with the City Core offering the advantage of bringing it into the finance world proper. Indeed we may see other tech sub-sectors breaking away to form new clusters nearer to client industries, e.g. media-focussed tech firms moving to Fitzrovia.

05 | SCIENCE IN THE CITY

Scientific R&D has typically been associated with out-of-town business parks, particularly around Cambridge and Abingdon. However, recent years have seen hi-tech firms (another out-of-town stalwart) moving into London, as companies relocated to where talented staff wanted to live. Scientific R&D is similarly a people business. There is also an established research cluster in Bloomsbury, which should benefit from the redevelopment of Euston and King's Cross as vibrant live/work locations. The Francis Crick Institute has opened a new life science laboratory in King's Cross, partly due to the rail link to Cambridge.

MEET THE DECACORNS

Unlisted tech firms who were valued at over a billion dollars, 'Unicorns', were viewed just a year ago as a new phenomenon. Such is the pace of growth we are now seeing the emergence of 'Decacorns' – with values above $10 billion. Who are the CEOs behind these companies?

WRITTEN BY
Raconteur

EVAN SPIEGEL, SNAPCHAT

"Let's just take a shot at restoring some context." That was Evan Spiegel's modest goal when he laid the foundations for the picture-messaging app in his Stanford University dorm room in April 2011. Like many tech entrepreneurs before him, he dropped out of college to pursue his idea. Now, at just 26, he runs a company valued at $16 billion.

Snapchat's young user base – predominantly people in their teens or twenties – seems to have endorsed Spiegel's central observation that pictures spontaneously taken and shared on smart phones should not necessarily live forever on a searchable database. The company now boasts 200 million active users.

As well as its headquarters in Venice, Los Angeles, the company has offices in Seattle, New York and London, and around 330 employees and counting, as it brings on new hires.

wework

ADAM NEUMANN, WEWORK

In February 2014, WeWork was valued at $1.5 billion. A little more than two years later, the company was valued $16 billion. In January 2017, WeWork operates across five of the world's continents. However, is Adam Neumann a tech entrepreneur or a real estate magnate?

While chiefly a provider of collaborative offices, WeWork's 6'5", leather jacket-wearing, Israeli-born CEO likens the firm to a smartphone's operating system. It brings buildings to life in the same way that Android or iOS makes a smart phone much more than the sum of its parts.

The seeds of WeWork were sown in 2008 when Neumann, a serial entrepreneur, partnered with his co-founder Miguel McKelvey to create an ecologically-minded co-working space, GreenDesk. Both Neumann and McKelvey had experienced communal living as children – Neumann on a Kibbutz and McKelvey in a collective of mothers and their children that was formed in Oregon. After GreenDesk morphed into WeWork, WeLive was not far behind. The company's first communal living space launched in New York in January 2016 and there are ambitious plans to have opened 68 more by 2018. At present, WeWork has a presence in 19 cities within the U.S. and 16 more globally. Having recently opened shop in Australia and Brazil, WeWork plans to launch in India.

Neumann says the company could also expand its range of products to include shipping, software, credit cards, travel, payroll, banking, and training. Eventually members might be able to sign up for these alone, without having to rent space in one of the company's buildings.

Palantir

ALEX KARP, PALANTIR

With the controversy surrounding government intelligence agencies, Wikileaks, Julian Assange and Edward Snowden still fresh in the memory, you could be forgiven for being a little suspicious of a man who runs a company that has been referred to as a "combination of big data and Big Brother", been backed by the venture arm of the CIA (In-Q-Tek), and also counts the NSA and FBI among its customers.

However, Alex Karp is at pains to argue that his business is not the malevolent Orwellian entity that some people imagine. "I didn't sign up for the government to know when I smoke a joint or have an affair," he once said. "We have to find places that we protect away from government so that we can all be the unique and interesting and, in my case, somewhat deviant people we'd like to be."

Karp is known as the company's 'conscience' and readily admits that his lack of technical qualifications makes him a slightly incongruous figurehead for such a complex operation. He has been called "sheer brilliant" by former head of the CIA, General David Petraeus, and he went to Stanford Law with the now legendary Silicon Valley investor, Peter Thiel. Thirteen years after the college buddies reunited to set up Palantir, the company operates in 15 cities around the world, including London, and is valued at $20 billion.

A DAY IN THE LIFE OF DIVYA NARENDRA

AS TOLD TO
Raconteur

More than a decade on from co-founding Facebook antecedent ConnectU with the Winkelvoss twins, Tech entrepreneur, Divya Narendra, is making waves with a social network for investment professionals, SumZero

I usually get up between 7am and 8am, when I open the Bloomberg News app on my cell and read the top articles. Then I'll walk over to my office in Soho to be at my desk between 9am and 9:30am. Although I hate to admit it, I usually skip breakfast and keep myself going until lunch with a banana or two.

My typical day at work is a mix of wading through emails, client calls, demos, book-keeping and team meetings. Functionally speaking, I probably spend the greatest proportion of my day focused on helping our sales team with leads and account management, but I also try to reserve time to think about the various initiatives we have to drive user engagement on SumZero. Greater engagement means more high quality, user-generated content that will in turn attract people to join our community. That's how we see SumZero becoming a must-have resource for investment professionals around the globe.

In terms of SumZero's potential for growth, the sky is the limit. We're aiming to provide value-adding services to investment professionals throughout the various stages of their careers and to connect members of the investment community, no matter where they are in the world – although, I do still think that there will always be those who value physical proximity and the benefit of living and working in large financial centres.

After a day in the office, I often head straight to the gym, which I find helps me keep my mind clear and recharge for the next day. My gym also has the advantage of being close to Wholefoods, so I can grab some produce before walking home and making dinner.

LONDON INVESTMENT IN 2017

2016 was undoubtedly a turbulent year and, looking back, there were distinct similarities between how the London real estate capital markets reacted and the work of Elisabeth Kübler-Ross on the "Five Stages of Grief"

WRITTEN BY

Anthony Duggan, Head of Capital Markets Research

Anthony Barnard, Head of West End Investment

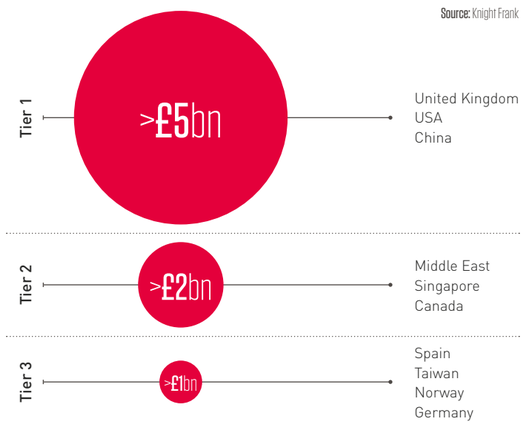
The five stages of grief according to psychiatrist, Elisabeth Kübler-Ross, are denial, anger, depression, bargaining, and acceptance. In 2016, Brexit brought all five to the Central London investment market.

In the six months before the referendum the market was in denial that there could be anything but a 'remain' vote, but just to be on the safe side decisions were deferred until after June. This resulted in a fall in capital turnover in the first half of the year of 27%.

Following the shock result, the market then progressed to the anger phase followed briefly by bargaining, and in some instances depression. These three stages were very short lived and this phase lasted a matter of months. The market found its floor, liquidity was maintained, and there was limited renegotiation with many where instances transactions completed at pre-referendum prices.

We then passed swiftly to the acceptance phase or, in other words, stabilisation. By the end of 2016 asset values had recovered and, in many instances, surpassed the pre-referendum levels. Indeed, in the weeks post-referendum we had more conference calls and meetings with Asian investors looking to make the most of potential market re-pricing than in the previous twelve months. Investors viewed volatility bought about by Brexit as an opportunity, and this was reflected in the Q4 transaction volume, which at £4.2 billion was the strongest quarter of the year.

TOP 10 PURCHASERS IN CENTRAL LONDON OFFICES BY VALUE OVER THE LAST 3 YEARS



As with recent years, overall transaction volumes in 2016 were driven by overseas investors. London remains a leading global marketplace for real estate; last year 73% of transactions involved an overseas buyer. This compares to 40% in New York City, 33% in Paris and 65% in Singapore.

Interestingly, the depth of purchaser nationalities buying London offices has continued to increase. Transaction volumes over the last three years show that the market has been dominated by purchasers from the UK, US and China, but with a deep pool of other countries who have spent more than £1.0 billion over this timeframe. Indeed, at the start of the millennium there were 11 nationalities active in the market; last year there were 20.

Turning to 2017, we expect all of these buyers to remain active. Key purchaser groups that will drive activity include investors from Europe, who are again looking to the UK as pricing now looks more attractive than in some of their domestic markets, given the weight of money that has been active recently plus the recent fall in sterling. Middle Eastern investors are also more active, drawn to London by the weakened pound.

A key theme for the market over the last few years has been the rise of the Chinese buyer. Their appetite has grown exponentially from almost nothing just eight years ago. However, this activity is now being questioned in the face of domestic capital controls put in place to control their exchange rate. This is a double edged sword for London real estate. On the one side, the reason for the controls, i.e. the renminbi is expected to continue to devalue, means that investors have continued to look overseas to protect their capital. Added to that, the threat of further capital controls also accelerates capital out of the country. On the other side, if capital controls do their job the money flowing out of the country will be restricted.

In our view, the period of capital control should be temporary. History shows us that they have been enacted before and lifted. Indeed, China's President Xi Jinping announced at Davos that his country would generate $750 billion of outbound capital investment over the next five years. Overall, the larger investors are telling us they are able to remain active; it may be the mid-sized private investors that find it more difficult. Importantly, the type of Chinese buyer has evolved significantly and is now much more diverse than five years ago.

Our view is that Chinese investment will not stop; but it may slow as overseas reserves are depleted and mechanisms of getting capital out of the country are restricted. Longer term, with an ever deepening pool of buyers looking to global real estate and a $1.6 trillion insurance industry that has yet to invest overseas in any meaningful way, there is plenty more in the China story to come.

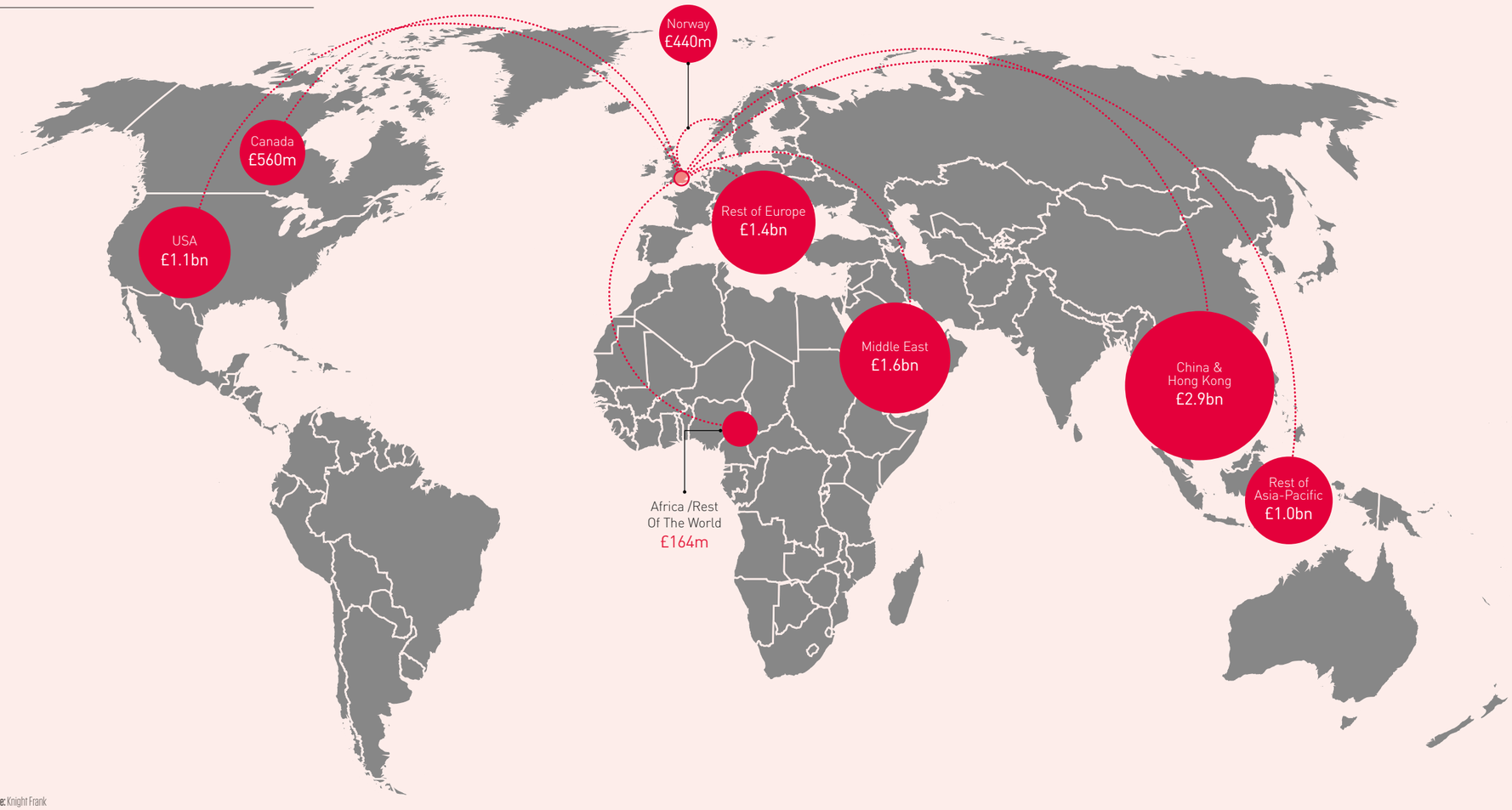
Overall, we expect a solid market this year and one that will benefit from the global geopolitical uncertainty that will undoubtedly echo around Europe and the world as the year progresses. This will be supercharged by the on-going weakness of the currency, which has seen values fall 17% in dollar terms over the last few months. Indeed, there is more likely to be a restricted supply of assets for sale over the course of the year rather than a let up in demand that will limit transaction volumes in 2017.

33 Central, London

In 2016, Central London remained a popular destination for overseas real estate investment, with the office market alone attracting over £9.3 billion of deals by foreign buyers. The money was truly global in origin, but with investors from China and Hong Kong accounting for the largest share. With the pound having fallen in the aftermath of the referendum, and another wave of Chinese capital searching for assets, we expect momentum to continue into 2017

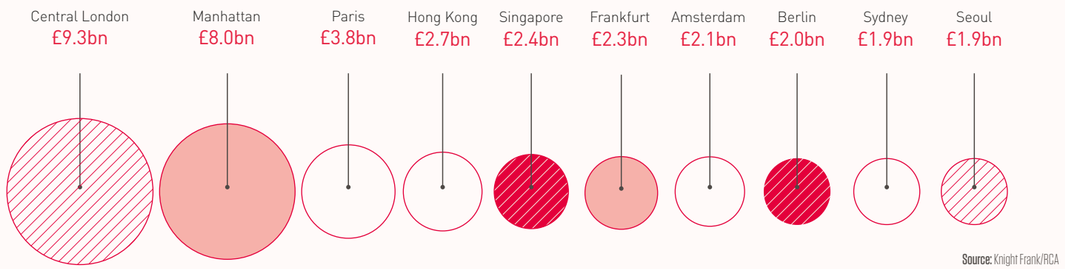
ALL THE WORLD'S A STAGE

OVERSEAS INVESTMENT INTO CENTRAL LONDON - 2016



Source: Knight Frank

THE TOP TEN OFFICE MARKETS FOR OVERSEAS INVESTORS - 2016



Source: Knight Frank/RCA

LIVING IN THE CITY

Cities are competing to regain their vibrancy, the ones which make true mixed-use work for them will win

Williamsburg, Brooklyn, U.S.

WRITTEN BY

Liam Bailey,
Global Head of Research

The main character in most of Charles Dickens' books is London; "wealth and beggary, vice and virtue, guilt and innocence…all treading on each other and crowding together" (Master Humphrey's Clock). For the great chronicler of the world's first global city the vitality, crime and poverty of what was then the largest city in the world, drew him in and became his obsession.

What made Dickens' London so interesting and surprising a place, as with most large cities of its time, was the dense mix of activities. Residential and commercial areas were one and the same, with housing, small-scale manufacturing, shops and offices creating a street life full of variety and energy.

The downside to this organic and chaotic mix was endemic poverty, disease and pollution. Spend an hour reading Friedrich Engle's descriptions of urban life at the time and the scale of the problem becomes clear. The response in London, and throughout the developed world, has been almost a century of planning rules with one overriding objective – zoning: the separation of the city's activities into more controllable spaces.

Old Street, London, UK

"WHERE ART OR MUSEUM QUARTERS LEAD, RETAIL AND RESTAURANT CULTURE FOLLOW"

The problem is that zoned cities are generally dull. So, for several decades, cities have been trying to untangle the restrictions they put in place. Mixed-use may be an overused term for developments, many of which often don't deserve the title, but it reflects a clear shift in priority from city authorities, developers, occupiers and residents.

This desire to make cities more interesting places has coincided with a number of related trends which are propelling true mixed-use to the forefront of development activity. The 'war for talent' has been a critical driver, with cities competing ever harder to nurture the right ecosystem to attract the best workers. Put bluntly, if you are the right side of 40, well educated, tech-savvy and have an interest in art and culture then you are in demand.

While not every city has an environment that immediately appeals to this group – somewhere in-between San Francisco, New York and east London - a number are finding that they can create it. Miami's focus on high-end residential development provided a catalyst for innovation in retail and design industries. Dubai's skill at urban repositioning focused initially on tourism following the financial crisis, but is now widening into the creative sectors.

The challenge for city authorities is balancing their top-down approach to regeneration without undermining the authenticity that talented workers appear to demand from their working and living environments. Put simply - how do you create creativity?

In some cases it is a simple process – the happy confluence of cheap space and accessibility were the twin drivers behind the transformation of Shoreditch in London and Brooklyn in New York. In other locations, especially those without the advantage of several million affluent workers on their doorstep, the top-down approach is a valid route forward.

Culture, as a means to broaden the appeal of a city is well established, and Miami's Art Basel event is only one high-profile example. Where art or museum quarters lead, retail and restaurant culture follow.

As The Wealth Report confirms, education is a key driver underpinning residential demand. Over 25% of all ultra-high net worth individuals considering changing their country of residence in 2016 name this as the key push factor. Universities in particular have a real ability to encourage commercial development, especially supporting research and development requirements - attracting high-skill employment. Student accommodation has a similar significant potential to add density and vitality to existing residential or commercial neighbourhoods.

With schools and universities creating new campuses in cities, this is an area of significant future growth. The on-going encouragement of innovation hubs and incubators for new industries is another source of change, with private sector sponsors increasingly acting alongside or in place of public sector champions.

Layering other uses into the urban mix is a key focus for cities in their bid to maximise their attractions to current and future residents and commercial occupiers. One of the biggest growth areas we see is health and fitness, an industry which has moved far beyond the obvious gym and swimming pool offer, with the intelligent use of the city as the enabler of fitness – most visibly through the encouragement of cycling.

At lunchtime in Shoreditch one can see suited City lawyers, who have walked up from their smart offices around Moorgate, buying lunch in street markets, rubbing elbows with bearded techies from the start-ups.This highlights a desire for local diversity, individuality and a more human scale within development – the move towards a more engaging and mixed urban environment is clear.

Dickens would approve.

CONTACTS

STEPHEN CLIFTON
PARTNER - HEAD OF CENTRAL LONDON OFFICES
+44 20 7861 1312
STEPHEN.CLIFTON@KNIGHTFRANK.COM

JAMES ROBERTS
PARTNER - CHIEF ECONOMIST
+44 20 7861 1239
JAMES.ROBERTS@KNIGHTFRANK.COM

TAMAHRA RISK
ASSOCIATE- SENIOR MARKETING MANAGER
+44 20 7861 5267
TAMAHRA.RISK@KNIGHTFRANK.COM

IMPORTANT NOTICE