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London: The world’s greatest city!

Constantly evolving, London adapts to change like no other city. Its robust performance in the face of the Brexit spectre bodes very positively for the acceleration we are set to feel as Euro-pean uncertainty subsides. 2018 will be both a pivotal and positive year. The Elizabeth line, a key accelerator to growth, will open and change how we move around the city. Add to that the world’s top talent pool, the emergence of new technology and bioscience occupiers in an increasingly supply constrained environment, and we have a recipe for performance.

As the marketplace continues to shift, The London Report provides further context and guidance for those operating within it.

These are the five key takeaways:

01. London’s economy has been particularly resilient in the face of Brexit. Any job losses over the next two years as a result of the UK’s exit from the EU will be off-set by new job creation.

02. The biotech sector has now joined technology, media & telecoms (TMT) in attracting unprecedented levels of investment, and will drive demand for office space in 2018.

03. Occupier decision-making has evolved. For occupiers, real estate has become a strategic device.

04. London’s investment market saw transaction volumes rise 30% in 2017. New market entrants, favourable global pricing and a rotation towards risk will drive investor appetite in 2018.

05. London Offices
Head of Central
Stephen Clifton

Overview

London’s economy: Resilient and global

The capital’s adaptable economy is successfully weathering the Brexit uncertainty, thanks to rising digital industries

1. London is not seeing large numbers of jobs leave as a result of the vote to leave the EU

Most major banks and insurers have announced plans to move a small number of jobs (usually in the low hundreds) to offices in the European Union in order to continue servicing EU-based clients post-Brexit. The number of jobs has been much lower than previously expected.

A survey by Reuters of over 120 UK and international banks and insurers suggested 10,000 jobs could relocate as a result of Brexit. The office space occupied by 10,000 workers is equivalent to 0.5% of total office stock in Central London – a manageable figure for the market to absorb. Expertise Economics is forecasting 49,000 jobs will be created in office-based industries in London over the next two years – more than enough to compensate for the job losses predicted.

2. London’s economy has not been led by finance for some time now

London’s investment market saw transaction volumes rise 30% in 2017. New market entrants, favourable global pricing and a rotation towards risk will drive investor appetite in 2018.

3. That interest rates in the UK are rising again is reason for confidence in the outlook

The Bank of England Monetary Policy Committee (MPC) in November 2017 raised the UK base rate because it has confidence the economy can cope with the increase. Unlike the Eurozone, which is still pursuing Quantitative Easing, the UK is now in a position to move away from emergency measures brought in during the global financial crisis. The MPC has indicated that going forwards rates will rise very gradually, which should limit the impact on debtors.

In particular, the Bank of England views the tight conditions in the employment market as proof that the UK economy is strong enough to handle higher rates. Our outlook is for London to remain a leading global business hub, but with TMT industries leading growth. Finance is adapting to new realities, but the job losses involved are manageable in number. London is the UK region best positioned to shrug off the Brexit uncertainty and benefit from the upturn currently underway in the global economy. This bodes well for demand for Central London offices in 2018.
Supply has peaked, the development pipeline is weak and tenant demand is strengthening. We are now in the next property cycle.

The Central London office market is cyclical. This adage has been the cornerstone of London office commentary and forecasts for more than thirty years, and it has been absolutely correct. Property cycles are fluctuations in activity measured by peaks and troughs in performance, and in Central London they have historically been triggered by major global economic events.

The 1990’s recession, the dot com crash, and the global financial crisis all sparked a fall in occupier demand, an increase in vacancy rates, and downward pressure on rents. However, the most recent increase in supply was not triggered by any particular economic event; it had already commenced before the EU referendum in mid-2016.

As the pipeline thins and employment remains high, London office supply will start to fall.

One of the key characteristics of the property cycles has been the relationship between peaks and troughs in office supply, and speculative construction activity. Speculative construction is counter-cyclical; as demand picks up, supply begins to fall, and developers commence schemes to fill the potential supply-demand gap due to their increased confidence.

Levels of supply of new and refurbished space began to fall rapidly in 2014, which prompted a reaction from developers. However, it was also the release of second-hand space to the market by occupiers moving into stock they had pre-let in the preceding years that contributed to supply’s fall.

Despite an abundance of development schemes across London, relatively few are commercial and fewer still are available to lease.

At the end of 2017 there was 7m sq ft under construction speculatively.

25% of schemes under construction speculatively will not be delivered until 2020.

CONTINUED...
WE NOW FIND OURSELVES IN THE NEXT PROPERTY CYCLE.

Although to an observer London may appear to be a sea of cranes, there is going on beneath the surface that ought to be understood by any appraisal of the market. There are 250 development schemes under construction in Central London, however 187 of these (or residential) only 72 can offer commercial space, and just two-thirds of these remain available to lease.

That being said, at the end of 2017 there was more than 6.9 m sq ft under construction in Central London, which is 20% above average levels. So what does this mean for the Central London office market?

In normal circumstances, the delivery of such a volume of stock to the market would be a cause for concern. However more than a quarter of all office space currently under construction is not due to be completed until 2020 at the earliest, leaving around 4.9 m sq ft of new stock to be delivered to the market in 2018 and 2019. The development pipeline for this period will only be able to satisfy little more than half of tenant demand, assuming average levels of take-up of 1.5 m sq ft per year.

An ongoing fall in supply will drive tenants to seek speculative space available to satisfy their requirements. As the pipeline thins and employment remains strong, tenants cannot afford to assume that there will be speculative space available to satisfy their requirements. Large tenants cannot afford to assume that there will be speculative space available to satisfy their requirements.

Who’s Building London?

London’s commercial pipeline has historically been controlled by UK developers and funded by domestic capital. While overseas investors have dominated the market for built investment stock, there has been less appetite for involvement in development. However, since the global financial crisis, bank funding for speculative development has been difficult to obtain, which has helped keep the pipeline under control. This has led to a significant shift in the type of money behind developments. Our analysis shows that the percentage of development over the next five years funded by UK money has fallen from more than 60% to around 32%, with a noticeable rise in the volume of space under the control of North American developers. This includes schemes yet to start on site. One of the side effects of this rise in overseas money has been the lowering of returns for development projects in London, as unsecured returns of circa 10% become normal. London has become more aligned with other global markets.

Despite both this and Brexit, London has remained a relatively safe and attractive market. One of the side effects of this rise in overseas money has been the lowering of returns for development projects in London, as unsecured returns of circa 10% become normal. London has become more aligned with other global markets.

In last November’s budget, however, the Chancellor announced that from April 2019, most foreign investors will be liable to pay capital gains tax on UK property. From April 2020 they will also be subject to the recently introduced distress relief restrictions and loan relief restrictions, meaning that heavily indebted structures will be exposed to more UK tax. Importantly, this could be most keenly felt where an investor has already purchased secondary stock with a view to scaling up with a new scheme.

The London Report 2018

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Historically, off-plan pre-lets are most prevalent at the extremes of the cycles

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<thead>
<tr>
<th>OFF-PLAN</th>
<th>DURING CONSTRUCTION</th>
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Source: Knight Frank Research

SOURCES OF CENTRAL LONDON DEVELOPMENT FUNDING

- UNITED KINGDOM
- NORTH AMERICA

2012 - 2016

- 61%

2017 - 2021

- 32%

- 19%

61%

Data for 2017-2021 shows completed schemes and schemes under construction.
American architect Frank Lloyd Wright believed that architecture was not just about buildings, but about nourishing the lives of those within them. This notion is more relevant to Central London now than ever before.

Historically, companies’ focus tended towards maximising profit through reducing capital expenditure; real estate was often a key area in which it was perceived margins could be increased. A drive for large, efficient floorplates with high occupational densities drove commercial real estate design during the 1980s, 1990s and 2000s.

However, attention has turned to potential gains in productivity and staff satisfaction, which has impacted building design. In addition, as technological advances made moving back office functions to cheaper locations a possibility, the focus turned to attracting and retaining talent in front office functions.

A study by the British Council for Offices found that around 55% of underlying business costs are staff-related, with just 15% being directly related to real estate. By this logic, it makes good business sense for a company to limit the costs involved with staff turnover by creating a desirable, rather than simply efficient, workplace.

"Investment related to real estate, should reduce spend related to staff"

Therefore, investment related to real estate, should reduce spend related to staff.

The following selection of schemes highlight where this new thinking has been incorporated not just in the design of buildings, but in the amenity and public realm, to create the next wave of London’s commercial real estate.
The International Quarter London forms part of the redevelopment of the Queen Elizabeth Olympic Park, Europe’s largest urban development.

The mixed-use scheme has the capacity to provide 4 m sq ft of workspace alongside residential, retail and leisure accommodation. Wellbeing forms a major part of the scheme’s design; staff can access the Park’s sporting facilities along with the open spaces, while the buildings themselves are adaptable and designed to accommodate more agile ways of working.

Connectivity will also be a major factor in the scheme’s future. The area is currently served by the High Speed 1 rail line, the Docklands Light Railway, Overground services, the Jubilee and Central Lines, and from 2019, the Elizabeth Line.

The regeneration of the iconic Grade II* listed building and surrounding area will provide a minimum of 1.25 m sq ft of offices along with extensive residential, retail, leisure and public spaces.

Once complete, the regeneration of the 42-acre site will include: a 2,000 capacity events venue within the Power Station itself; 40 cafés and restaurants; 250 shops and food and beverage outlets; 18 acres of public space; and a new zone one tube station. In addition, the site will provide 4,364 new homes.

Apple has already committed to 500,000 sq ft in the Power Station; its new London campus is expected to be operational in 2021 and will initially house around 1,400 Apple employees from existing offices around London, with space for future headcount growth.

The northern section of Phase 3 designed by Foster & Partners has been pre-let to The Art Hotel, which will provide 163 rooms with the benefit of a rooftop pool.
While recently researching for a project entitled ‘Future Gazing’, I was struck by the wisdom of a quote from Bill Gates. The Microsoft co-founder maintains that ‘we always overestimate the essential component – the occupier – was itself which that space is occupied have all been physical space developed within it; the tenant sometimes subtly, redefined over the remainder normal?’. The hopeful inference therein was crisis (GFC) and even greater trepidation in the that commenced with the global financial emergent tech giants - Microsoft, Google, Apple, Amazon and Facebook - who led this real estate became redefined. It is telling of the period that it was the businesses’ talent requirements, the role of a digital revolution which changed the route staff retention. It facilitates and drives new strategies, supporting headcount growth and a business. It contributes to talent management on the function, use, design and even location of productivity, open up new markets or create applying new technologies to drive efficiency, now entirely dependent upon adopting and of innovation hubs across a range of industry sought to support the growth and activities of occupiers in the next two years and maintain that “we always overestimate the change that will occur in the next ten.” This is present when assessing the recent evolution of the London office market.

WHAT A DIFFERENCE TEN YEARS MAKE

Just think back over the last ten years, a period that commenced with the global financial crisis (GFC) and even greater trepidation in the market. At the time, I was constantly fielding the question “when will the market return to normal?”. The hopeful inference therein was that huge market disruption emerging from the GFC would be short-lived. The answer, as it transpired, was that it would not be. What constituted ‘normal’ was steadily, and sometimes subtly, redefined over the remainder of the decade. The size and shape of the London market; the volume and nature of the physical space developed within it; the tenant mix occupying that space; and the terms on which space is occupied have all been fundamentally altered. Rather than returning to type, the market adapted. The market had to adapt because its most essential component – the occupier – was itself needing to respond to a range of pressures. As the post-GFC operating environment became characterised by lower economic growth, the transformational impact of technology, a digital revolution which would completely redefine the way to market forever, and an associated shift in businesses’ ‘talent’ requirements, the role of a real estate backbone became defined. It is telling of the period that it was the emergent tech giants – Microsoft, Google, Apple, Amazon and Facebook – who led this process of redefinition. In the spirit of the Gate quote, it was an incremental but significant change. The giants gravitated towards cities and particularly towards London: they utilised technology to change work styles and working practices; transformed the layout and fit-out of the workplace to support those work styles and raise workplace satisfaction; and, critically, in doing so, they have inspired and inspired the real estate strategies of occupiers drawn from across all other industry sectors.

THE FOUR KEY THEMES IN THE OCCUPATIONAL MARKET TODAY

This influence cannot be underestimated, as well as being the dominant source of occupational demand in London today, the new workplace introduced by tech occupiers has been actively mimicked by law firms, accountancy practices, media firms and banks – in fact by all businesses being reshaped by technological disruption. In this sense, London’s occupational market has four key themes running through it today.

1. Real estate underpins strategy

Real estate is now firmly viewed as a strategic device. Rather than a simple factor of production, the right office supports operational and cultural transformation within a business. It contributes to talent management strategies, supporting headcount growth and staff retention. If facilities and drives new working cultures. It increasingly embodies employee and promotes brand values. Yet this strategic role for real estate is not without problem. The inherent uncertainty, together with the sheer scale and speed of change within the operating environment, means that businesses planning horizons are becoming ever shorter. For many businesses, looking out two to three years from today is now impossible. This is problematic in a real estate market where, although reducing, average Central London lease lengths stand at over seven years. Little wonder therefore that occupiers today demand greater flexibility and optionality within leases. It is vital therefore that the premium placed on lease flexibility is not lost, the basis of occupier decision making will change forever. The key implication of this for occupiers and investors alike can be found in the next wave of that Gates’ quote. ‘Don’t be lulled into inaction’.

2. An innovation imperative

Business success, if modest business survival, is now entirely dependent upon adapting and applying new technologies to drive efficiency, productivity, open up new markets or create new product offerings. As a result, an innovation imperative is a work which is directly impacting on the function, use, design and even location of space. A key trend has been the emergence of innovation hubs across a range of industry sectors. These can be entire ring-fenced within an organisation but are increasingly open, collaborative environments that seek to generate fix-ups between corporate occupiers and innovative startups or suppliers. No longer is the office about housing row upon row of staff administering email. Instead, it is about creating and innovating in collaboration.

3. Occupier mobility continues

In seeking both strategic transformation and greater innovation, occupiers are showing increased levels of mobility across the London market. This is notable when assessing the last two years, but one that shows no sign of abating. There are a number of factors at work. Key is the need for occupiers to tap into talent pools that are capable of supporting business transformation. Unsurprisingly we have seen growing interest in locations that benefit from transport infrastructure improvements, and which therefore increase the catchment from which labour can be drawn – three of the five best-performing submarkets since 2007 are those surrounding Crossrail stations. Similarly, we now see occupiers proactively seeking locations that are supported by an innovative, academic infrastructure. While reduced new supply in the London market has influenced this mobility, the push for staff access is undoubtedly the principal driver.

4. Coworking expands and evolves

An undeniable trend is increased interest in new occupational models. The market has witnessed the astonishing growth of coworking and it is among the models that is evolving rapidly. Once the domain of small start-ups and companies, coworking has found a solution to the needs of larger occupiers, or, in popular parlance, enterprises. Yet even what is defined as assessments of the coworking phenomenon is what we believe is its most important attribute. Coworking has shifted the supply of real estate from being product to service based. Spaces as a service is now also a feature of the London market. More importantly, it taps entirely into the needs of the modern occupier to be housed within well serviced space that creates a positive experience and a sense of community, with a level of service and attention that is consistent irrespective of the amount of space occupied. Coworking operators recognise the occupier as the customer and serve them accordingly with high quality service.
The London Report 2018

flexible working in London

The success of coworking and its effect on the London market

Knight Frank

Victoria Shreeves
Associate, Central London Research

Amanda Lim
Associate, Office Solutions

London has experienced rapid change in the provision of flexible workspace and coworking in recent years. Since 2014, the average level of flexible office take-up in Central London has increased by more than 50% and is now more than double the ten-year average. We explore the drivers of this success, and what effect it will have on the Central London office market.

THE RISE OF FLEXIBLE SOLUTIONS

The unprecedented rise in demand for flexible working, serviced and coworking space is not attributable to a single factor. A number of influencing trends have taken shape in recent years, allowing a 30-year-old industry to essentially rethink and redesign itself as it aligns with a new digital age.

The key drivers are:

• London has seen a 41% increase in small and medium enterprises (SMEs) since 2010, much of which has been driven by a marked increase in funding from venture capital investments.
• The growth of the gig economy has led to an increase in freelancing and contract-based working.
• Volatile economic conditions have increased the appeal of avoiding long-term lease commitments.
• Working practices have evolved to include collaboration, sharing and a desire to be part of a community.

Technology enablement has provided a reliable and efficient platform to work in a manner that historically was not feasible. Cloud computing, super-fast broadband, wireless internet and 4G smartphone devices have made digital working the norm. Technology advancement sits at the forefront of the flexible and coworking success story.

TRADITIONAL VS FLEXIBLE

Flexible solutions relieve occupiers of the significant capital expenditure associated with setting up conventional leased offices, such as fit-out, meeting rooms, catering and IT services which normally are included in the package. This allows the flexibility to grow or contract space to suit requirements; a convenient solution for new businesses growing rapidly, working on short-term contracts or simply unsure what their headcount will be in 12 months’ time.

Furthermore, occupiers benefit from other businesses in their own workspace communities offering services like financial, legal and digital services. Almacantar’s chief executive Mike Hussey explains, ‘WeWork is an early mover and recognises that if it fees the cost of its property, it can develop superior returns through the services it offers to its growing community of users.’

WHAT IS THE EFFECT ON THE LONDON OFFICE MARKET?

The long-term effect of the growth of flexible offices on the traditional office sector remains to be seen. It has been suggested that traditional offices in the smaller size brackets are under threat due to direct competition with the flexible office market. There has been a fall in demand across Central London for sub-5,000 sq ft units on traditional leases over the last three years, which is attributable, at least in part, to the rapid growth in the number of flexible working centres.

However, a more detailed examination of the figures reveals that the West End sub-5,000 sq ft market has actually performed at above average levels for the past two years, in particular the 0-1,000 sq ft size band, which is currently at least five times the long-term average. The story in the City is the opposite, with sub-5,000 sq ft take-up below average since 2014.

The primary reason for this is that there have been fewer acquisitions by flexible workspace providers in the West End in comparison to the City – in 2017, there were 37 flexible offices transactions in the City, compared to just 16 in the West End.

A point to consider is that space being let to start-ups is not the same as traditional office space before moving, down from 37% in 2016. This suggests that increases in coworking do not have a direct, proportionate effect on traditional take-up.

According to the Global Coworking Survey 2017, 49% of people currently occupying coworking space were previously working from home before becoming a member, and 28% were in traditional office space before moving, down from 37% in 2016. This suggests that increases in coworking do not have a direct, proportionate effect on traditional take-up.

What will have a greater effect on the traditional take-up is the marketing of flexible space to corporate occupiers on a larger scale. SVA has already reportedly signed a deal for all of the desks in a 100,000 sq ft WeWork centre in New York City. In Central London, partnerships of this nature are likely to provide direct competition to space offered on a traditional lease.

THE FUTURE OF FLEXIBLE SOLUTIONS IN CENTRAL LONDON

Flexible workspace providers are acquiring new stock at an ever accelerating pace, and will remain a key feature of the London office market in the future. As working practices continue to evolve, many employers, contractors and freelancers alike will experience an increasing need for flexibility in their accommodation. In addition, technological disruption will create a growing need for short-term, flexible space, for corporates, flexible options will provide convenient solutions.

There will also continue to be many businesses for whom traditional office space will be the appropriate option. Occupiers with more stable and predictable growth projections may find considerable cost savings through opting for a traditional lease, despite the significant capital expenditure involved in a move. This is particularly true for larger occupiers.

Occupier requirements are evolving to incorporate increased levels of flexibility. Traditional landlords can adapt to provide this, so we believe flexible working solutions can flourish alongside, not at the expense of existing landlord.

The “surprise” emergence of the coworking providers and noise around their apparently explosive growth is only matched by the general lack of engagement from the established property owners to provide what the future occupiers need. The shock of WeWork’s success and speed of growth is only matched by the disappointment of others’ inability to see where the demand sits. Even at $20 million sq ft in London, WeWork are catering for less than 1% of the capital’s working population, or the size of two investment banks. There is scope for much more.

Mike Hussey
Chief Executive, Almacantar

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Source: Knight Frank Research

The story in the City is the opposite, with sub-5,000 sq ft take-up below average since 2014.

The rise in demand for flexible working, serviced and coworking space is not attributable to a single factor.
The future of demand

Despite Brexit uncertainty, there will be sector growth over the coming five years

Over the past few years, attention has been on the tech giants; the London real estate industry has been trying to second-guess the sector and identify the next Google or Facebook to commit to large-scale developments. However, office demand from TMT firms has not just been from the global firms; 70% of all transactions to TMT firms in the past five years (by number) have involved units smaller than 5,000 sq ft.

The reality is that the sector will be driven forward not just by the small companies making technological breakthroughs that are hastily reported outside the sector. Wireless innovation and the Internet of Things are set to become an even bigger part of our everyday lives, both in the workplace and at home, and provide myriad opportunities for new innovation from small firms. In fact, according to data from UCL, tech funding of London firms has accelerated since the referendum and shows no sign of slowing down.

We will also see growth from the larger occupiers as they continue to refine their products and services. Facebook recently announced its intention to double its staff working on security to 30,000. This will be a growing area of concern for all tech firms and will create growth as staff are hired to counter cyber threats.

In addition, we predict that new entrants from the biotech, Artificial Intelligence (AI) and life sciences fields will add to TMT demand in the next five years as they chase London-based talent and develop products via desks and computers rather than lab-based science.

In fact, there is also likely to be a considerable ongoing need for legal services as firms negotiate the post-Brexit environment. The same is true for accounting and management consultancy services, whose foresight and expertise will be in demand.

However, there are potential pinfalls for the sector. Brexit could make it harder for law firms to operate in the EU and, like financial firms, cause some to downsize their UK operations and relocate some lawyers to EU jurisdictions. Some British lawyers have been fast to pin the role of solicitors in Ireland to maintain their legal presence in EU cases, according to the Law Society of Ireland, around 1,250 UK solicitors have applied in the last two years. Prior to the referendum, applications would be expected to total between 50 and 100 per annum.

The future is less certain for the financial sector. Forecasts for the number of positions lost to the EU after Brexit vary wildly, the majority are headline-grabbing as they represent the unlikely worst-case scenario of shared Brexit with no transition period deal. We believe banks remain unlikely to relocate staff to the EU in significant numbers. In addition, they are actively exploring mechanisms such as back-to-back lending as loopholes to continue operating in the UK while a more permanent solution is found.

When considering the future of the financial sector, Brexit has undoubtedly overshadowed other opportunities such as Finlech; according to research by London & Partners, London is the leading centre for Finlech start-ups in Europe, despite fears that Brexit would harm the industry.

The future's bright?

As we move towards Brexit, speculation will continue over how London’s businesses will be affected. It is impossible to predict the future but we have clear sight of what is taking place now. Take-up of office space in Central London has performed well above expectations since the referendum and there is little sign of any major slowdown.

Short-term uncertainty is unlikely in any market, but London’s occupiers have taken the view that the capital is the place for their long-term future. The majority are here to stay.

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Since the EU referendum, demand for office space in Central London has remained surprisingly robust. Leasing activity in 2017 vastly outperformed the previous year, with 4.1 m sq ft acquired – 31% above average.

The growing economy and workforce will provide myriad opportunities for new innovation from small firms. In fact, according to data from UCL, tech funding of London firms has accelerated since the referendum and shows no sign of slowing down.

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The future's bright?

As we move towards Brexit, speculation will continue over how London’s businesses will be affected. It is impossible to predict the future but we have clear sight of what is taking place now. Take-up of office space in Central London has performed well above expectations since the referendum and there is little sign of any major slowdown.

Short-term uncertainty is unlikely in any market, but London’s occupiers have taken the view that the capital is the place for their long-term future. The majority are here to stay.

Since the EU referendum, demand for office space in Central London has remained surprisingly robust. Leasing activity in 2017 vastly outperformed the previous year, with 4.1 m sq ft acquired – 31% above average.

The growing economy and workforce will provide myriad opportunities for new innovation from small firms. In fact, according to data from UCL, tech funding of London firms has accelerated since the referendum and shows no sign of slowing down.

In addition, we predict that new entrants from the biotech, Artificial Intelligence (AI) and life sciences fields will add to TMT demand in the next five years as they chase London-based talent and develop products via desks and computers rather than lab-based science.

In fact, there is also likely to be a considerable ongoing need for legal services as firms negotiate the post-Brexit environment. The same is true for accounting and management consultancy services, whose foresight and expertise will be in demand.

However, there are potential pinfalls for the sector. Brexit could make it harder for law firms to operate in the EU and, like financial firms, cause some to downsize their UK operations and relocate some lawyers to EU jurisdictions. Some British lawyers have been fast to pin the role of solicitors in Ireland to maintain their legal presence in EU cases, according to the Law Society of Ireland, around 1,250 UK solicitors have applied in the last two years. Prior to the referendum, applications would be expected to total between 50 and 100 per annum.

The future is less certain for the financial sector. Forecasts for the number of positions lost to the EU after Brexit vary wildly, the majority are headline-grabbing as they represent the unlikely worst-case scenario of shared Brexit with no transition period deal. We believe banks remain unlikely to relocate staff to the EU in significant numbers. In addition, they are actively exploring mechanisms such as back-to-back lending as loopholes to continue operating in the UK while a more permanent solution is found.

When considering the future of the financial sector, Brexit has undoubtedly overshadowed other opportunities such as Finlech; according to research by London & Partners, London is the leading centre for Finlech start-ups in Europe, despite fears that Brexit would harm the industry.
TOP CITIES FOR CROSS-BORDER OFFICE INVESTMENT IN 2017

- **CENTRAL LONDON**: £14.2bn
- **NEW YORK**: £5.1bn
- **FRANKFURT**: £4.5bn
- **BERLIN**: £2.6bn
- **PARIS**: £2.3bn
- **AMSTERDAM**: £2.2bn
- **WASHINGTON DC**: £2.2bn
- **HOUSTON**: £2.1bn
- **SINGAPORE**: £1.7bn
- **Helsinki**: £1.6bn
- **UK**: £1.5bn
- **ISRAEL**: £1.1bn
- **INDIA**: £1.0bn
- **MIDDLE EAST**: £0.8bn
- **CHINA**: £0.7bn
- **USA & CANADA**: £0.7bn
- **ASIA PACIFIC**: £0.7bn
- **UK**: £0.7bn
- **USA & CANADA**: £0.6bn
- **ASIA PACIFIC**: £0.6bn
- **UK**: £0.5bn
- **USA & CANADA**: £0.5bn
- **ASIA PACIFIC**: £0.5bn

**Capital Markets Trends**

Despite a number of potential headwinds, the London investment market roared back to strength in 2017 with a 33% increase in transaction volumes.

**THE ULTIMATE GLOBAL MARKETPLACE**

Our global transactions data shows that London remains the ultimate marketplace for global investors in terms of both the volume and the percentage of cross-border deals. 40% of all transactions were from overseas investors totalling over £14bn spent in London last year. London attracted capital from over 15 different nationalities, however the key buyer group was again investors from Greater China. While investment was, as expected, down from mainland China due to tightening capital restrictions, investors from Hong Kong accounted for 39% of all the money spent on London offices last year.

**GLOBAL CAPITAL TRACKER**

Into 2018, we do not see investment demand for London letting up. While Brexit will cause periods of uncertainty, we believe that global buyers of London real estate will continue to transact. Using our Global Capital Tracker, we are currently monitoring 46.1bn of active capital; up 11% from the £41.5bn we recorded at the same point last year. This money remains dominated by requirements from Greater China, specifically Hong Kong, but also including noticeably increasing interest from Japan, South Korea and Singapore.

With 39% of transactions last year coming from a single geography, some commentators have voiced concerns over the reliance of current pricing on demand from China. Our Global Capital Tracker shows that rather than reduce, 2018 starts with nearly double the capital chasing London offices from this buyer group.

The data also shows a deep pool of demand from a range of other geographies and, while undoubtedly of significant importance, we believe that any subsequent reduction in requirements from China will be quickly replaced. In addition, we are currently tracking an extensive amount of ‘latent’ demand that is currently sitting on the sidelines waiting for any signs of weakness in the market. We believe that this should prevent any material reduction in requirements from China.

We expect that this period of high sales activity for more opportunistic assets. We believe that this should prevent any material reduction in requirements from China.

An improving confidence in the underlying occupier markets will support pricing for both prime and, increasingly, for opportunistic assets.

Favourable global pricing

A key driver for continued global demand for London offices is the attractive relative pricing on offer across the capital. London assets remain good value on a global basis with prime yields running at 4.5% for City of London offices and 3.5% for the West End. This remains ahead of not only the major Asian markets but also most of the key European markets as well.

**Rotation towards risk**

The strong demand and record pricing paid during 2017 drove a number of owners to consider asset sales, and the available stock of opportunities rose considerably in the latter part of the year, particularly in the City market.

Due to a relative dearth of availability over the previous few years, this came as a welcome change and helped drive the high transaction volumes recorded.

We expect that this period of high sales activity has now passed and assets will be brought into the market in a more restrained fashion during 2018. This market stability will allow investors to continue to take profits and recycle capital; we anticipate that an increasing number of sellers will look to rotate from relatively dry, prime stock into more opportunistic assets, given the increasingly consensus view of stabilising rents and a progressively more constrained development pipeline.

**Outcome**

Global investors have shown they are willing to dial out the short-term noise in order to buy into the solid fundamentals and relative value available from London real estate, and we expect them to continue to do so. Indeed, as the outcome of Brexit and the current political uncertainty become clearer, an improving confidence in the underlying occupier markets will support pricing for both prime and, increasingly, for opportunistic assets.

**The London Report 2018**

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The opportunity for developers is in understanding the requirements of this growth market*


total new jobs over the next ten years will be nearly

900,000

Source: Knight Frank Tenant Survey (2016-17)

Through Knight Frank’s Tenant Survey, we have focused relentlessly on understanding this specific question. The results showed that tenants would consider paying additional rent for amenities such as an on-site gym, an en-suite bathroom and weekly cleaning.

Private renters tend to choose smaller properties than owner occupiers.

Their desire to close to work and spend time in a productive way, whether working or socialising, means that private renters in employment will prioritise the location over size.

Trends identified in the Knight Frank Tenant Survey have already been recognised in cities such as New York. There, the city authorities held a competition in 2013 for a new housing model that would like to help New York’s growing number of “small houselords”.

The winner developed a scheme which is today known as Carmel Place, located between East Village and Midtown Manhattan. This development is comprised of 55 small residential units, ranging in size from 250 to 370 square feet, with nine to ten-foot ceilings, as well as balconies. It is fully let and has revealed a strong demand for compact homes.

Currently, more than half of all residencies in Manhattan are one-person units. Based on the 2011 Census, this proportion in Central London is around 36% (i.e. studio and one-bedroom residential units). The density of one-person units is slightly higher in the private rented sector at 40%.

The requirement among young workers to live centrally in cities in order to retain flexibility of tenure, and to access truly affordable rented accommodation, is clear.

The opportunity for developers in understanding the requirements of this growth market.

For city authorities there is an equally big prize in attracting talented workers supporting the urban economy for the benefit of all.

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