ST. BRIDE'S MANAGERS

London

The case for investment

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Executive Summary

This report reviews the prospects for London as a global city and its credentials for long-term investment. It has been prepared by our research partners, Ramidus Consulting Limited.

London World City

'London's attractiveness as a World City remains strong'

London is a World City.[1] Arguably it was the first, rapidly spreading its political, cultural and commercial tentacles around the globe in the latter part of the nineteenth century. It continued to grow throughout the twentieth century; pulsating with the economic cycle, but forever broadening and deepening its international relationships. In the 1980s, it was at the epicentre of the twin revolutions in international finance and in information and communications technology.

It is against this broad historical sweep that we evaluate the prospects for one of the most mature property investment markets in the world.

As the political and economic capital of the UK, London is Europe's dominant financial centre. It leads the world in international bond trading, foreign exchange trading and cross-border lending. At £160bn, London's economy accounts for almost a fifth of UK GDP and is larger than those of Finland, Portugal and Ireland. The past three years have witnessed seismic events in the global economy. The credit crunch of 2007 and the ensuing recession were dramatic. The demise of some of the biggest names in investment banking, and the effective nationalisation of large parts of the remainder were truly historic events. London suffered.

As a world city and global financial centre, London underwent one of its periodic downturns. Asset values and rents tumbled; speculative development virtually ceased; town centre regeneration schemes were postponed, and pressure to convert employment land to housing fell away. Bank lending to the property sector plummeted, and weakening occupational demand reinforced the fragility of the development and investment markets.

Today, while speculative development remains fragile and occupier demand uncertain, global investment in London's property market remains as high as ever. While the economy contracted, London's attractiveness as a world city remained strong.

London’s competitive position

‘Threats to London’s global role should not be underestimated’

London shares its world city status with Hong Kong, New York and Tokyo. There is a further tranche of cities that compete strongly (e.g. Los Angeles, Paris and Singapore); and a further, emerging group (e.g. Beijing, Moscow, Mumbai and Shanghai) competing in specific markets. While London maintains its importance in the world economy, it is subject to increasing competition.

The threats to London’s global role should not be underestimated. They are real. And in the modern, connected world, change can be sudden.

Standard & Poor’s expressed concern over the UK’s creditworthiness in the light of its public debt, raising the previously unheard of prospect of the UK losing its Triple-A rating. Another straw in the wind emerged with the publication of the de Larosiere Report which proposed separate regulatory authorities for banking (in London), insurance (Frankfurt) and Securities (Paris). Basle III is the latest measure to add to the uncertainty. Goldman Sachs and JP Morgan have both made veiled threats that their continued focus on London (Europe) might diminish, while HSBC has hinted that it might move its headquarters out of London.

Just as emerging global financial centres pose a potential long-term threat to London’s historic role in global financial markets, so smaller regional cities in Europe are challenging London’s role as a base for a more broadly-based set of businesses. A host of firms have already made a move to more tax-friendly centres around Europe, including: Colgate, Kraft, McDonald’s, Palmolive and Procter & Gamble (Geneva); Google and Wolseley (Zurich) and Regus (Luxembourg).

This trickle of HQs moving from London (and the South East) to more “tax friendly” European countries is not yet a major concern, but it is a strong signal that the UK’s tax regime could be influential in the longer-term.

In short, London does not retain primacy by right in a global economy. However, and this is the key point, London’s depth and breadth in commercial activity, and its cultural and political ties around the globe, afford it competitive advantage.

London’s enduring success

‘London leads New York in all areas of competitiveness, and in four of the five industry sector sub-indices’

In Spring 2007 – just before the credit crunch – PricewaterhouseCoopers sketched a very positive picture of London’s continuing strength.[2] The research showed that, despite challenges from fast-growing cities in emerging markets, London’s status as one of the top city economies of the world looked set to continue and improve. The obvious question is whether PwC would reach the same conclusion today, given recent economic events.

The 2009 Global Financial Centres Index[3] went some way towards an answer, hinting at the enduring strength of more established centres with a reference to “a genuine flight to safety”. The report argued that London and New York “remain the only truly global financial centres”, and that, despite the current economic climate “London is again in the top quartile of nearly all instrumental factors as well as the overall GFCI”. London leads New York in all areas of competitiveness and in four of the five industry sector sub-indices.

The latest GFCI shows, for the first time, London and New York equal first.[4] The main concerns voiced about London’s competitiveness are the fear of a regulatory backlash limiting the freedom of financial institutions, and the levels of corporate and personal taxation that might drive high earners abroad. The report also indicated that Hong Kong was making steady progress with it now being almost on an equal footing with New York and London as a global financial centre.

The GFCI report is clearly optimistic. It is based on a robust methodology, and it is up-to-date. It suggests that there will not be any structural change in the profile of demand for office space in London in the foreseeable future.

Many measures of London’s performance focus on financial services, but London is much more than that. It is an economic agglomeration of enormous depth. Business services, creative and media services, life sciences, medicine, technology and universities are all part of London’s rich tapestry of strengths. A diverse ecology is always more resilient to threat than a narrow one, and London is very diverse.

The on-going level of foreign direct investment (FDI) is a useful barometer of the country’s (and, by extension, London’s) attractiveness to overseas companies, and of their perceptions about the UK’s economic prospects. A 2009 government report revealed a fifth successive year of growth in FDI in the UK, up by 11%, with 1,744 investment projects.[5]

Despite the global economic backdrop, the UK maintained its position as the most popular destination for foreign investors in Europe and second in the world. Fifty-three countries invested in the UK, with investment projects from India increasing by 44% (108 projects) to become the UK's second largest source, behind the USA (up 30% to 621 projects). Other countries increasing their investment into the UK were Canada, France, Italy and The Gulf States.

More specifically in London, FDI in the year to April 2009 saw 178 projects, creating 6,190 new jobs (an increase on the previous year).

Overall, the FDI data suggest a very positive picture for London's continuing global role, not least because of the broad industry representation. A recent Ernst & Young study reported that the UK retained its position as 'the most attractive destination for inward investment in Europe in 2008. Despite current difficulties, London and New York are seen as the clear leaders with the capacity to rebound from the crisis. These global cities have become clusters of education, entrepreneurship and opportunities, drawing the most able talent from around the world.'[7]

And, of course, London is much more than a place of commerce. Its cultural backdrop, including the entertainment industry, its heritage, and its open and cosmopolitan outlook make London a very attractive tourist destination. A recent study from Cushman & Wakefield[8] found that New Bond Street is the most expensive retail location in Europe, and the fourth most expensive location in the world behind Fifth Avenue (New York), Causeway Bay (Hong Kong) and Ginza (Tokyo).

So, while nothing can be assumed, London is in a strong position. More importantly, it is continuing to evolve, and pulsate, and is visibly creating the physical infrastructure (such as Crossrail) that will continue to attract business.

London's evolving structure

'London has become a polycentric city'

London is a constantly evolving city; there is perpetual change in both its economic and its physical make-up. The decline of the docks in the 1970s is a classic example, leading ultimately to the emergence of Canary Wharf. Similarly, large parts of Broadgate now sit on an area which was once the heart of London's furniture industry. London is always changing, and responding to change.

Historically the core London office market was tightly defined by the Square Mile; West End and Victoria. During the 1980s, the Square Mile spread northwards and eastwards; while London Bridge City and Canary Wharf provided "off centre" alternatives. During the 1990s a necklace of high quality campus schemes emerged around the periphery of the core area – Bankside, More London, Paddington and Regent's Place.

These new centres have altered the pattern of demand. More London, for example, has become a business services cluster, with large lettings to Ernst & Young, Lawrence Graham, Norton Rose and PricewaterhouseCoopers. Similarly, Paddington has attracted a large number of corporate occupiers, including Kingfisher, Marks & Spencer, Misys, Orange, Prudential, Statoil, Visa and Vodafone.

Some parts of the traditional market have re-defined themselves. For example, in recent times, Victoria has cast aside its traditional association as the home of government. The completion of Cardinal Place in 2006 led the way, attracting 3i, Experian and P&O, and there are several further large schemes under consideration. There is evidence that Mayfair too is currently going through a phase of change.

Looking forward, London continues to evolve. At various stages of planning, there are proposals for Battersea/Vauxhall, Greenwich Peninsula, King's Cross and Waterloo. London has become a polycentric city. It always was in some senses; but the recent pattern of commercial development is something new.

One of the key lessons from London's emergent polycentric property market is that demand can be attracted from established markets to projects where suitable premises, for modern business, provide an attractive alternative to more traditional stock, and where large clusters of buildings (campuses) as well as large areas of public realm, can create critical mass and support retail and other service activity.

The experience of campus projects also suggests that infrastructure provision is a crucial ingredient of “critical mass”. The unarguable success of Canary Wharf can be traced to the construction of the Jubilee Line Extension. Paddington received a huge boost when the Heathrow Express opened in June 1998. Similarly, although the idea of redeveloping the railway lands around King’s Cross has been around for at least 20 years, it was the huge investment associated with Eurotunnel that gave the project credibility.

While much focus is on what happens in the inner area of London, for obvious reasons, the city’s hinterland should not be forgotten. One cannot exist without the other. Areas of outer London provide a huge pool of real estate, which is itself evolving, just as in the centre.

London and its Outer Metropolitan Area house a “sub-economy” providing all manner of goods and services, many for businesses in the core area. We call this “servicing the services”. A large proportion of these companies occupy so-called industrial property, or “sheds”. The shed is the workhorse of the economy, accommodating manufacturing, distribution, construction, services, studios, offices, or any combination of these uses.

Over the past couple of decades there has been relatively little innovation in shed design, partly related to building economics, and partly to the standard model of the UK institutional lease. However, there is an emergent demand for a new kind of product – the “smart shed”.

Such a product could accommodate businesses which occupy traditional sheds, but at the same time are involved in “clean” processes, have different servicing demands and employ staff for whom a shed environment is inappropriate. These companies are set to grow in number as London’s service economy and employment base grows. There is, therefore, an opportunity for another segment of the real estate market to evolve.

London's future

'London is likely to remain the number one city in Europe and maintain its global role alongside New York'

The period since the credit crunch has seen major changes in London's property markets. Some of those changes are undoubtedly cyclical and will see conditions ease as the economy emerges from recession. Others are potentially structural, while others are actually structural in nature, representing on-going, permanent change to supply-demand dynamics.

Potentially long-lasting implications lie in the damage that has been done to the UK's reputation for financial management, and London's reputation as a global financial centre has been dealt a blow. The threats to London's global role are real. The UK's creditworthiness and reputation, proposed changes to the system of financial supervision, competitive threats from other centres and the UK's tax regime have all been highlighted here.

But London is more than a centre of finance: it is a truly global city. And recent data on foreign direct investment are encouraging. London is likely to remain the number one city in Europe and maintain its global role alongside New York.

Serious though the recession has been, it will ease: London will pulse once more. Despite the worst recessionary pressures of the post-war period, unemployment levels failed to reach those of the early 1990s; the collapse of commercial and residential prices has stabilised, and economic indicators are showing the early signs of recovery.

Employment in London is forecast to grow to 5.45m by 2031, up by about c750,000 from 2007 levels.[9] Oxford Economics[10] recently forecast growth in London GDP of 3.4% pa between 2010 and 2012, to be exceeded only by Stockholm and Frankfurt. From 2012 to 2020 it forecast that London will be the fastest growing major European city, averaging 4% pa over the eight year span. The report forecast robust recovery in the City, with levels of growth outstripping the rest of the UK and most comparable cities around the world.

London's 25m sq m of commercial real estate is a fundamental building block of its world city status. As the city has developed over the years, in response to economic change, so its real estate markets have responded, providing world class buildings from which global business can operate. This relationship looks set to continue as a new generation of buildings, underpinned by investment in infrastructure, begins to emerge in the years ahead and as London continues to evolve as a world city.

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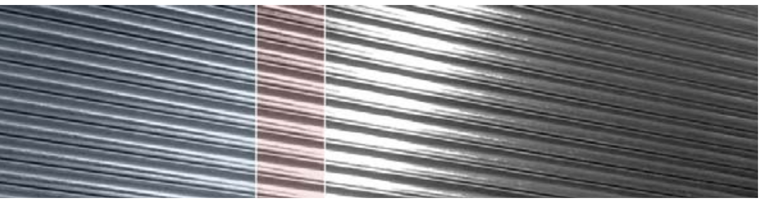

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