# LONDON MARKETS

London office property performance and key themes

Summer 2020

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# EXECUTIVE SUMMARY

In this Summer 2020 report, we take a view on what we expect to be the upcoming themes that will dictate the shape the London office market as it responds to Covid-19. It also features the results of a survey of our London based office clients taken in June and these findings feature throughout the report.

The central London overview takes an aggregated view on our submarkets, giving a complete view of the occupier market. Occupier activity started off well in Q1, however, Q2 take-up reached a decade low of 1.4 million sq ft, while availability rose across almost all our submarkets. Supply of newly delivered stock has been disrupted as developments have been postponed and completion dates pushed back. Tenant-controlled space reported a marked increase as tenants considered business strategies to consolidate floorspace.

Investment activity was dampened for many reasons, leading to the application of the RICS' material uncertainty clause in valuations. Investors - particularly overseas investors - were also unable to physically view assets following the ban on non-essential and international travel. Buyer and seller pricing expectations have differed throughout the pandemic, and this has further limited acquisitions in the office sector.

In response to evolving business strategies, we have outlined building characteristics that we anticipate will be important for current and prospective tenants to consider in a post-Covid environment. We expect older unrefurbished stock to be less desirable for occupation, while prime, and newly refurbished buildings, will become more in demand as their adaptability will suit current tenant requirements. We anticipate that Covid-19 might further the divergence in rental profiles between prime and secondary stock.

The ONS reported 57.2% of London's employees were working from home in April 2020, the highest of all the UK regions. A potential structural shift in employee behaviour has cast some doubt on the future and viability of the office. However, we consider that the office still has value to add in terms of relationship building and as a collaborative environment.

As some employees anticipate returning to the office we explore how reduced travel capacity and revised travel arrangements, focused on individual safety, may contribute to "commuter-friendly" locations, and how these may affect demand, supply and pricing of offices in London in the short and medium-term.

With Covid-19 taking most, if not all, the political and socioeconomic bandwidth this year, Brexit negotiations have flown somewhat under the radar. However, the risk of a no-deal Brexit has risen with the UK nearing the end of the transition period set for 11pm on the 31st December 2020. Negotiations on trade of goods and services have slowed considerably, compounding uncertainty for UK companies.

One of the UK's largest sectors, financial services, is at high risk of losing passporting and equivalency rights after the June deadline for a cross review of UK and EU financial regimes was missed. Thus, we explore what a no-deal Brexit may mean for London, focusing on London's importance as a global financial centre, the consequent impact on the financial service sector and the implications for the occupier market from 2021 onwards.


FURLA
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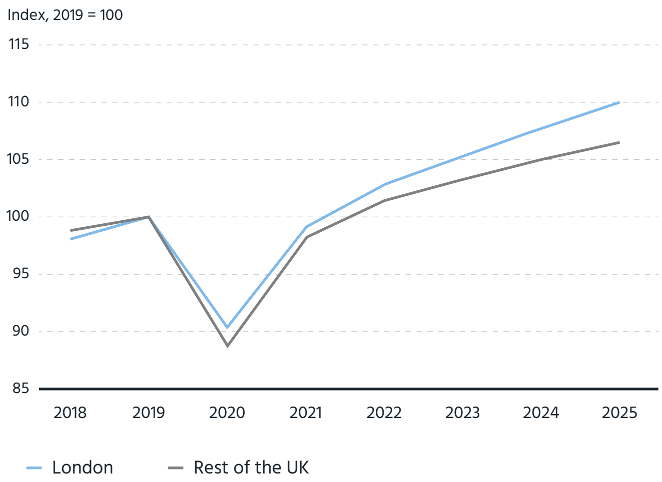
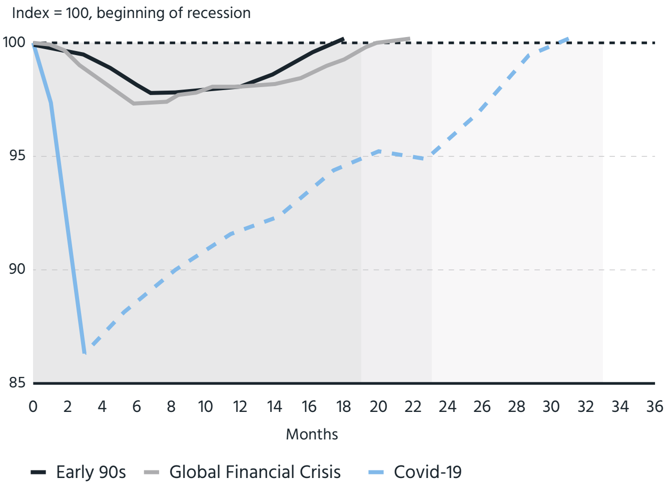
# CENTRAL LONDON OFFICE OVERVIEW

## THE LONDON ECONOMY

**London and Rest of the UK GVA forecast**
Source: Oxford Economics




**Number of months to return to pre-recession employment**
Source: ONS, Gerald Eve, GLA




### LONDON'S RELIANCE ON SERVICE SECTOR TO INSULATE AGAINST PROTRACTED DROP IN OUTPUT

The impact on the UK economy from Covid-19 has been severe and pervasive across all sectors. Anticipating a V-shaped recovery, Oxford Economics has forecast an unprecedented -10.9% decline in GVA in the UK in 2020 with a strong rebound of 10.4% in 2021. There are sustained output losses forecast in manufacturing in the UK, which is not expected to reach its 2019 GVA level for another decade. Removing London from the total GVA figures shows a steeper decline of 11.2% in 2020 across the rest of the UK and illustrates the faster growth rate in London post-Covid.

London's GVA is forecast to contract at a slower rate of 9.7% in 2020, with a rebound of 9.6% in 2021. London's reliance on the services sector means there is less risk of a sustained drop in GVA output, with services forecast to rebound faster than other sectors such as manufacturing and construction. Service sectors such as real estate activities, ICT, education and accommodation are forecast to contribute stronger GVA growth, and thus fewer sustained losses. Additionally, wholesale and retail trade, construction and transport and storage are expected to rebound faster in London compared with the rest of the UK.

### A LONG ROAD BACK TO PRE-COVID EMPLOYMENT LEVELS IN LONDON

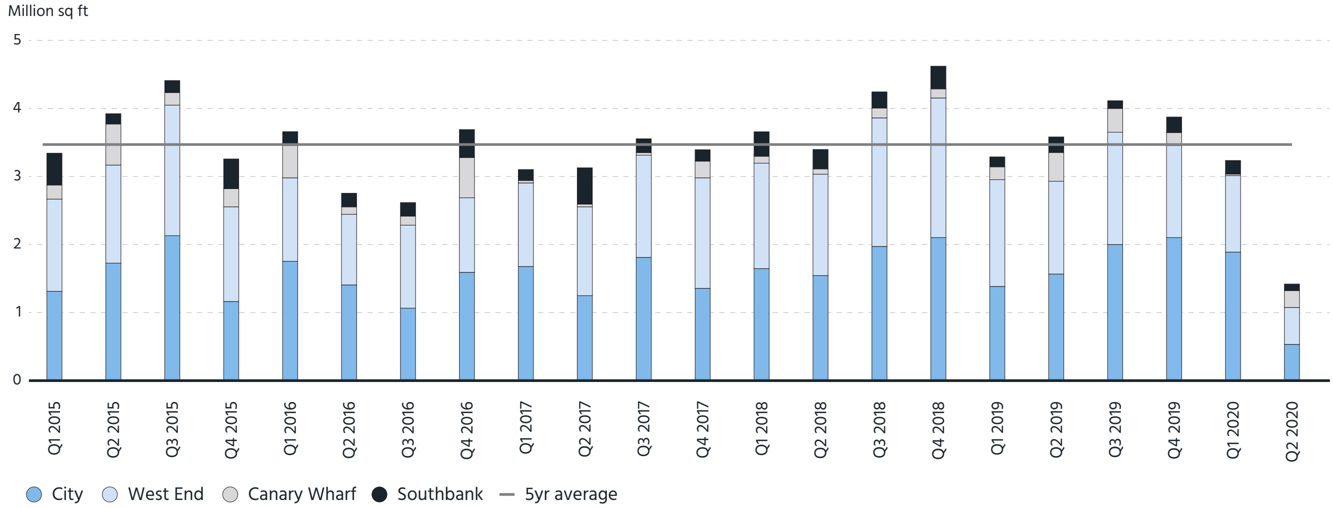
The recovery in London's employment level is expected to be slower compared with previous downturns, due to the severity of job losses, with the claimant count reaching 460,000 in June 2020, the highest level on record. The gravity of the demand shock across all sectors means the recovery is likely to be slower when compared with the global financial crisis and the early 90's recession. Employment is forecast to reach pre-Covid levels by the end of 2022.

The fall in overall employment is driven by sectors most directly affected by the lockdown, such as accommodation and food services, wholesale and retail, leisure and recreational activities. Serviced based office sectors such as financial services, real estate, ICT and professional and technical activities have a greater proportion of workers able to work remotely, thus job losses are more insulated. The GLA forecasts that out of the service-based sectors, business services will see the harshest fall in employment, with a decline of 9.3% in 2020.

# CENTRAL LONDON OFFICE OVERVIEW

## OFFICE OCCUPIER DEMAND

**Quarterly take-up by London market**
Source: Gerald Eve




### ABILITY OF PRIME BUILDINGS TO ACCOMMODATE POST-COVID REQUIREMENTS WILL HELP SUPPORT RENTS

Leasing activity in London started robustly in 2020, following the decisive general election result and the perceived political and economic clarity. Office take-up in Q1 totalled 3.2 million sq ft, slightly lower than the five-year quarterly average. The City accounted for just over half of the total, with four of the five largest deals, including Linklaters' 328,000 sq ft letting at 20 Ropemaker Street.

However, with the imposition of the lockdown in March, leasing activity was curtailed sharply at the end of Q1. In Q2, viewings were often unable to take place, and many potential tenants were hesitant to commit to new space during such extreme uncertainty. Take-up reached a decade-low of 1.4 million sq ft in Q2.

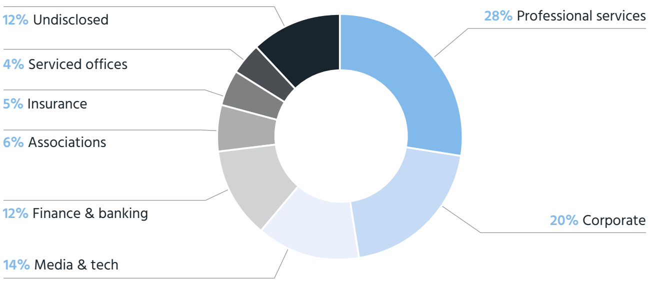
Despite this low total, there is still appetite for Grade A office space. BP's 205,000 sq ft commitment to 25 North Colonnade in Canary Wharf and Covington & Burling's 85,000 sq ft pre-let in 22 Bishopsgate on a 15-year lease in April is supportive of this. Good quality offices have been, and are likely to continue to be, more resilient and adaptive to the changing office environment over the coming months.

The rental profiles of prime buildings in good locations are also likely to be more insulated against downside risks than their secondary counterparts. The increased occupational flexibility on offer in prime buildings is likely to be more attractive to occupiers in H2 2020, which could prove supportive to prime rents. However, headline rents in more secondary locations and in older office stock are forecast to fall by the end of 2020, as more evidence comes through.

For all qualities of space, in Q2 we have seen examples of rent-free periods on 10-year leases moving out by 1-3 months to incentivise tenants to commit in the current environment. This would normally have a negative impact in net effective terms, but fit-out periods have also been extended by a similar amount, so there has been no material change in net effective or headline rents. With lockdown lifted and tenants able to easily view space, we expect more letting activity in H2 2020, which will provide more evidence for rental movements.

## Take-up by occupier sector, H1 2020

Source: Gerald Eve




**Professional services** occupiers accounted for the largest proportion of take-up in H1 2020. Law firms were the most active subsector, taking over 700,000 sq ft of London office space. **Media & Tech (TMT)** occupier demand was focused in the City and King's Cross in H1 2020. Take-up by occupiers in this sector totalled 631,000 sq ft in H1, driven by Google's sub-let of 135,000 sq ft in Euston Tower in King's Cross and Euston, albeit on a short term basis..

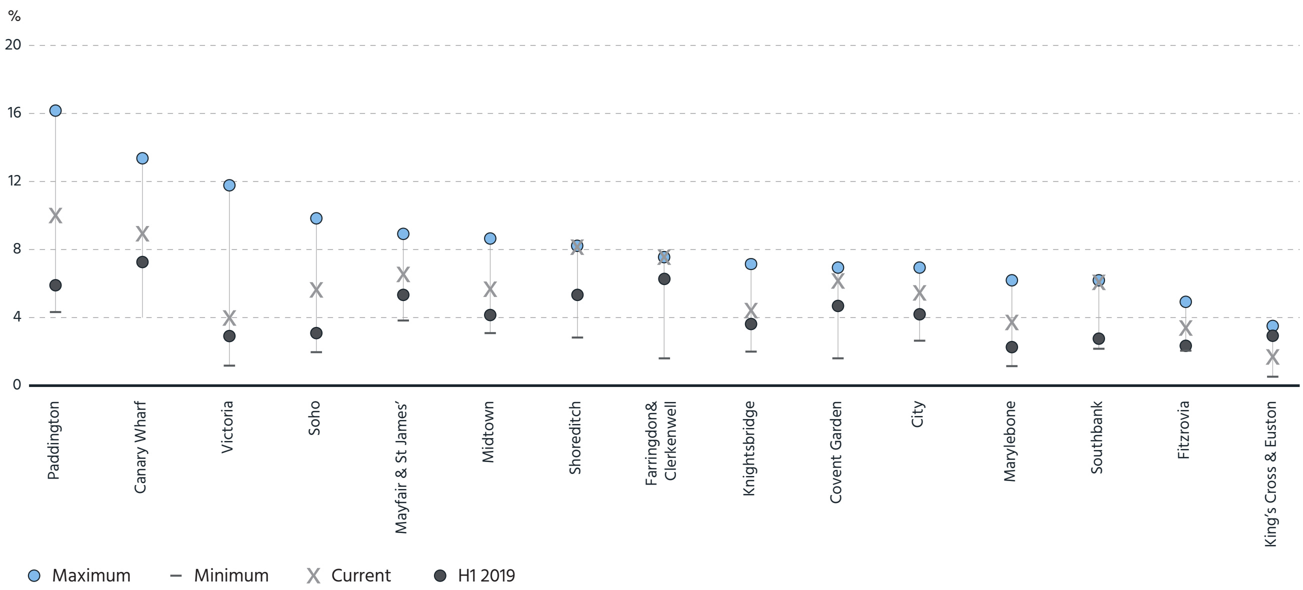
**Serviced office** take-up for H1 2020 totalled 169,340 sq ft, the lowest half-year in five years. As maintaining social distancing remains crucial to all office occupiers, the desirability of open and communal work areas has tempered. Large serviced office providers may look to release and consolidate floor space as revenues weaken, potentially leading to an increase in overall availability.

Potentially however, with flexibility in lease terms becoming increasingly important, serviced offices may at least offer in the short term an attractive substitute for companies that are reluctant to sign long leases in the current environment. Carefully managed, good quality serviced office space may see an uptick in demand to accommodate such occupiers, most likely in the outskirts of central London.

# CENTRAL LONDON OFFICE OVERVIEW

## AVAILABILITY AND SUPPLY

**Availability rate historical ranges by sub-market, Q1 2013 - Q2 2020**
Source: Gerald Eve



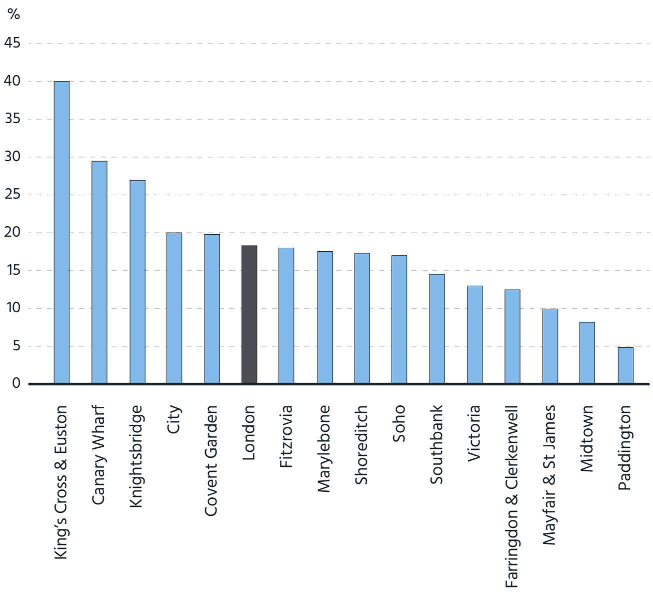

### MAJORITY OF MARKETS REMAIN BELOW HISTORIC PEAKS IN AVAILABILITY

The London availability rate increased from 4.9% in Q1 to 5.8% in Q2. Assessing each market's peak to trough in availability over the course of the last few years, it is possible to pinpoint where in the supply cycle Q2 2020 availability rates sit. Despite softened demand, most submarkets remain below historic peaks, and some have a long way to go to reach their highest historic levels.

Shoreditch, Farringdon & Clerkenwell and Southbank are at individual historic highs of availability, but the overall rate remains low in a broader London context. King's Cross and Euston stands out, with a lower availability rate than in H1 2019, as no new completed space has been brought to market in the last 12 months, coupled with take-up levels above average between Q3 2019 and Q1 2020.

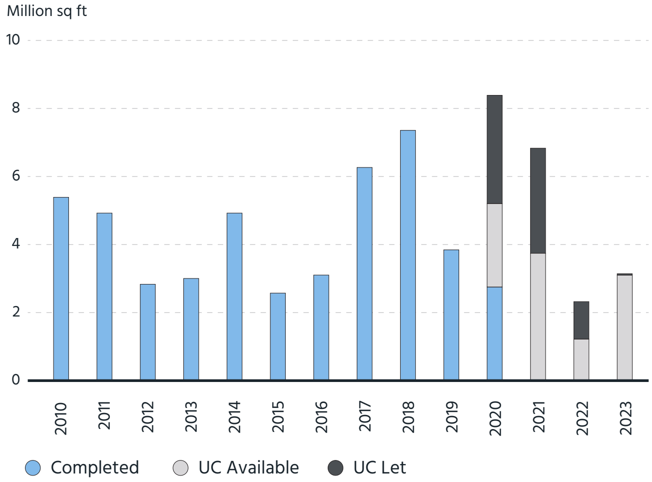
As occupiers sought to consolidate their footprint, the volume of tenant-controlled available space, including sub-lets and assignments, increased to 2.2 million sq ft in Q2 from 2.0 million sq ft in Q1. The Gerald Eve Occupier Survey results show that this is likely to increase over the course of the next six months as more businesses review their office occupancy strategies and seek to bolster cashflow.

**Sub-let & assigned space, proportion of total availability, previous 12m average**
Source: Gerald Eve



## DEVELOPMENT

**Development pipeline**
Source: Gerald Eve

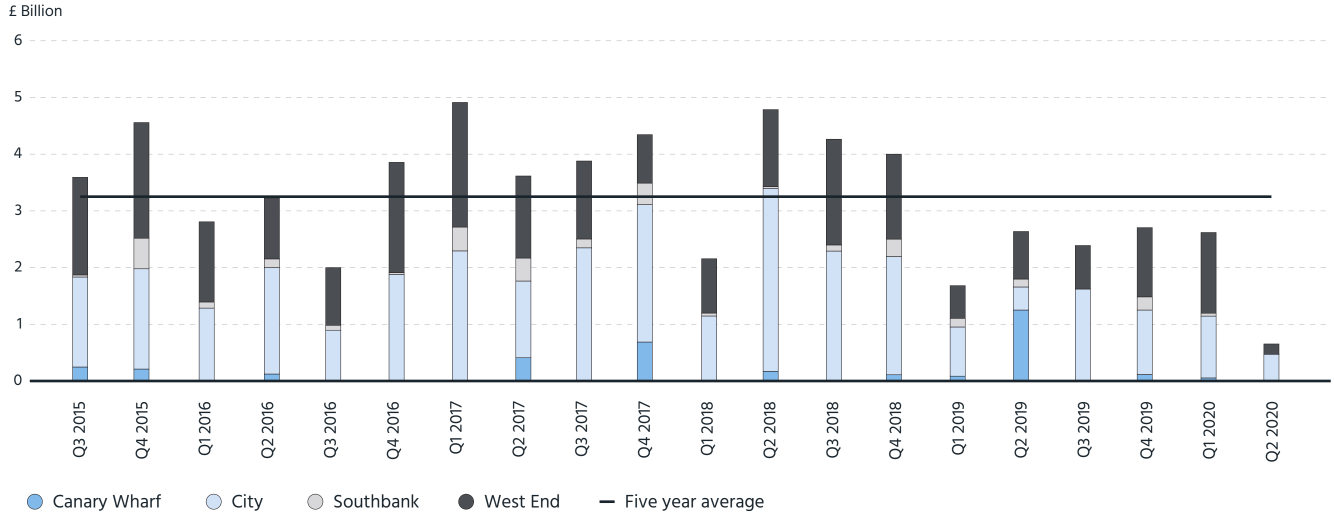



The closure of construction sites in March disrupted London's office development pipeline. Schemes expected to finish in Q1 and Q2 have been pushed back to the end of 2020. Some schemes expected to be delivered in H2 2020 are now expected to complete in 2021. We expect 5.4 million sq ft of space to be delivered in H2 2020, of which 56.7% is already pre-let. Limited and delayed completions over the coming 6-12 months will mean supply of new Grade A space will remain tight, which could provide further support for prime rents.

# CENTRAL LONDON OFFICE OVERVIEW

## INVESTMENT

**Investment volumes by main sub-market and five year quarterly average**
Source: Property Data, Gerald Eve




### A WEAK Q2 FOR INVESTMENT, BUT INVESTORS HAVE FAITH IN LONDON FUNDAMENTALS

After a strong Q1, with £2.6 billion of acquisitions, there was a marked decline in activity in Q2. The investment volume reached just £640 million, bringing the total for H1 2020 to £3.2 billion. This marks the lowest half-year of activity since the Global Financial Crisis and was 50% lower than the 5-year half-year average of £6.4 billion.

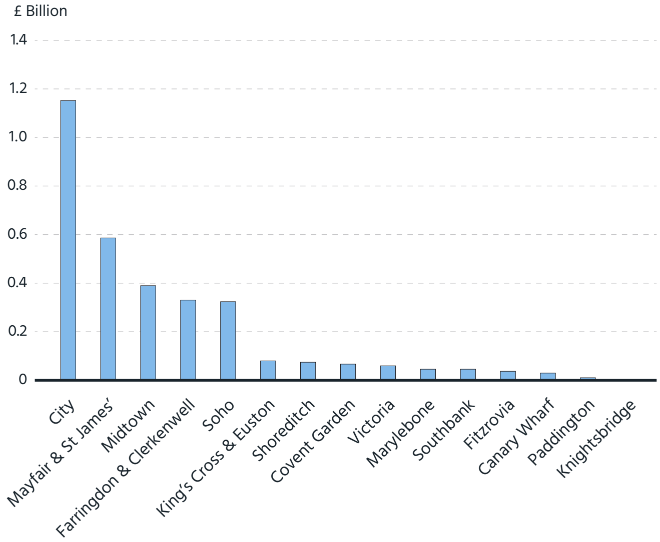
The lack of transactions can in part be accounted for by the RICS' implementation of the material uncertainty clause, restricting the valuation processes from the end of March. Furthermore, investors' inability to physically view potential purchases meant the due diligence process was elongated or placed on hold. Meanwhile, the overarching dichotomy between buyer and sellers expectations meant some acquisitions were pulled.

With many office based businesses taking advantage of the furlough scheme, levels of tenant default and distress have remained low. The debate has now rapidly moved on to how offices will be used and how best to future proof assets.

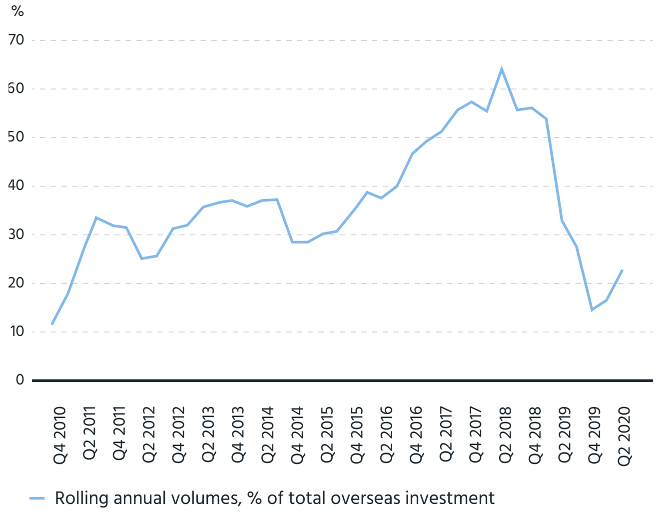
There are nevertheless still positive signs in the office investment market, and some large-scale deals took place in May and June. Notably, Union Investment purchased 55 Ludgate Hill from Goldman Sachs for £140 million / 4.5% NIY, following on from its £262.5 million / 4.4% NIY acquisition of 90 Lower Thames Street in Q1. Tenacity Group acquired 20 Farringdon Street for £120 million late in Q2 to give a further boost to the figures.

We expect investment activity to rise in the second half of the year following a record year of capital raising in 2019. However, there will be increased scrutiny of tenant fundamentals, greater due diligence, and vendor pricing expectations will likely limit a complete rebound to pre-Covid investment levels.

**Investment volumes by submarket, H1 2020**
Source: Gerald Eve




**Far Eastern share of overseas investment in London offices**
Source: Property Data, Gerald Eve




## GEO-POLITICAL CONCERNS AND SHIFTING CAPITAL ALLOCATIONS HAS SUBDUED FAR EASTERN INVESTMENT

Following the 2016 referendum, Far Eastern investors were particularly active in the London office market as they sought to take advantage of the depreciation in sterling. Acquisitions reached a peak of 64% of total overseas activity in Q2 2018. Since the beginning of 2019 this has fallen, averaging just 20% of foreign investment in the last four quarters, with Q4 2019 marking the lowest volume since Q4 2010.

Data from Property Data shows Other European investors have instead been the most acquisitive overseas investor recently, making 34.9% of all London office acquisitions in the last four quarters. The inclusion of German investors to this sum brings the total of continental European purchases up to 44.9% over the same period.

Far Eastern investment is expected to remain subdued over the next two years because of the shift in asset allocations by domicile. Such large historic volumes of acquisitions mean that some Far Eastern investors are now overweight in UK office allocations in a European and global context, and, will prefer now to target regional domestic markets or alternative well-performing UK assets, such as logistics.

Some investors are reviewing ongoing opportunities but are closely considering the impact of potential changes in the office market on pricing and have put acquisitions on hold until there is more certainty in the occupational market. Due diligence exercises are slower when capital is allocated, directly and indirectly, from Far Eastern insurance and pension funds, and the current environment is likely to only extend that.

However, London offices still offer an attractive yield when compared with APAC real estate markets. Geo-political concerns aside, if any further depreciation in sterling occurs following the UK's exit from the EU transition period at the end of 2020, this could act as a moderate boost for Far Eastern investment in the short term, but we do not expect a return to 2018 levels.

Hong Kong investor Link REIT made its first European acquisition in July, paying £380m for 25 Cabot Square. Far Eastern investors still have an interest in London offices and this deal could be the start of many more to take advantage of beneficial foreign exchange price fluctuations to balance out portfolio allocations. This would help shore up future investment volumes in the central London office market in the coming quarters.

# HOW WILL OCCUPIER REQUIREMENTS CHANGE POST-COVID-19 AND WHAT ARE THE IMPLICATIONS FOR THE CENTRAL LONDON OFFICE MARKET?

The traditional open-plan office environment is under scrutiny. Many occupiers are now reassessing the size, location and design of their central London offices to support their long-term business needs.

A large proportion of current office space is presently unfit for a safe return to work for **all employees** and cannot be utilised in the same way as before. Office buildings that are flexible in their layouts and occupier provisions have been best positioned to adapt. Landlords and developers will need to accommodate new post-Covid secure criteria. Buildings also need to be more sustainable, curbing carbon emissions from the real estate sector as ESG becomes ever more prevalent. This could become a core practice if further regulation continues to be put in place.

**A further shift in the gap between prime and secondary?**
Practically adapting workplace design to encourage and maintain social distancing is the immediate challenge, but there are longer term implications to the central London office market. For instance, demand for increased lease flexibility and new requirements for a safe commute to the office may redefine a 'prime' office. This could have pricing implications as investors view offices through a new lens. Offices are more adaptable compared with other property sectors, alternative use options could become a theme in areas where there is an undersupply of other types of real estate, such as residential.

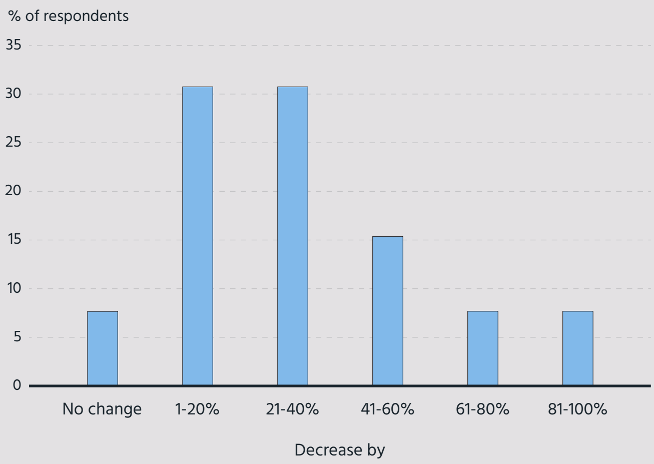
Buildings with problematic characteristics could see yield profiles change. Capital values may fall in tandem with the associated liabilities of projected increases in capital expenditure needed to incorporate new occupier requirements. Location traits viewed negatively by occupiers which can't be redesigned could see sharper movements. These areas have been highlighted in our analysis on walking times and cycling routes from major London rail stations.

The use of office space will need to shift away from large physical workspace if working from home levels remain elevated. Coming to the office will need to provide value-add incentives and these will happen through controlled interaction and collaboration with clients and colleagues. Better quality buildings providing these facilities will be more attractive compared with traditional, purely functional office units, accelerating the divergence between prime and secondary space.

**How do occupiers intend to adapt their office space requirements?**

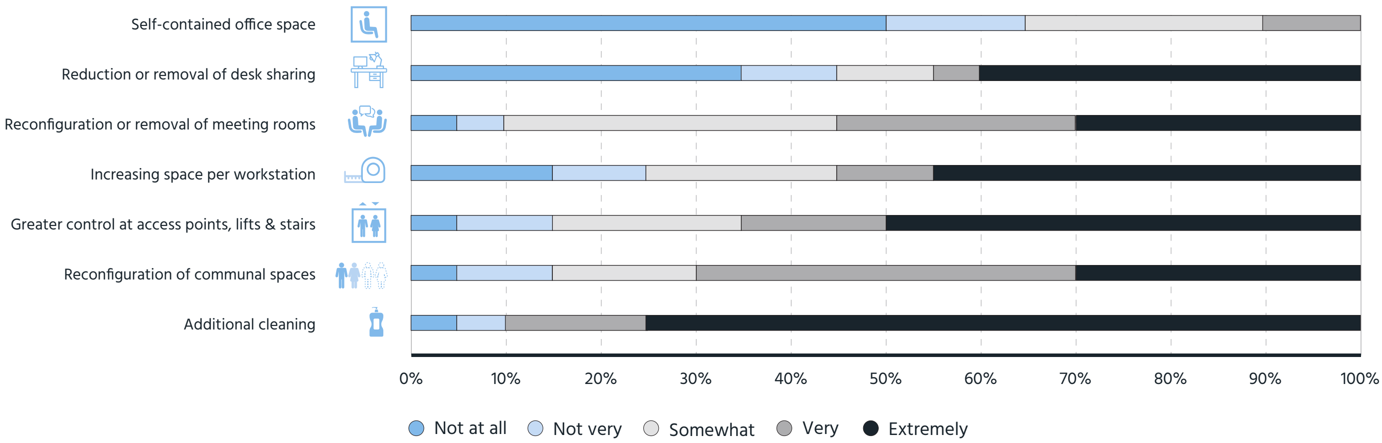
An office space survey conducted by Gerald Eve shows 92% of respondents are intending to reduce their office space requirements. Most occupiers reported that they would reduce their requirements by 20-35% in the second half of 2020. As business strategies evolve, a reduction of corporate footprints could mean softening demand and a return of office space onto the market.

**How do you expect your office space requirements to change in the second half of 2020?**
Source: Gerald Eve Occupier Survey, June 2020



## How important are the following building criteria to your return to the office?

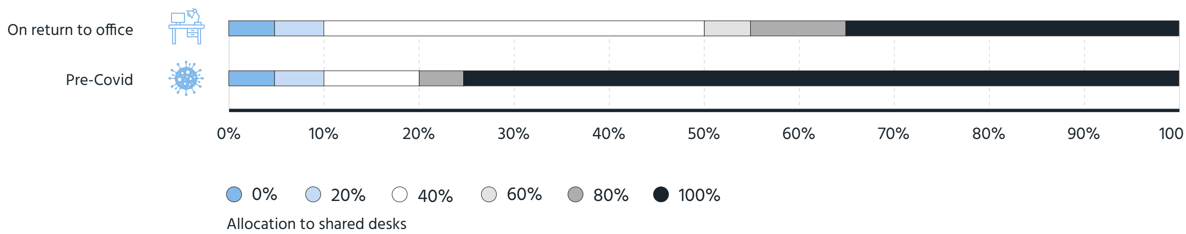
Source: Gerald Eve Occupier Survey, June 2020




Perhaps unsurprisingly, our survey shows that 90% of respondents see additional cleaning as the most important consideration for the return to the office. The respondents' priorities on reconfiguration of communal spaces and greater control at access points also reinforces the benefit of flexible interiors that can be easily modified.

## How do you expect to change your desk allocations between shared and fixed desks?

Source: Gerald Eve Occupier Survey, June 2020




Regarding shared desks, 65% of respondents had 100% allocations to shared/hot desks in their office pre-Covid. However, only 35% said they would retain a full shared desk allocation on the return to the office, and many of these respondents also made reference to rotational team attendance or increased flexibility around working hours..

Respondents with lower shared desk allocations reported more focus on increasing space per workstation, meaning occupiers will need to remove desks to accommodate a lower employment density, thereby reducing their employee footprint in the office, even at full capacity. Perversely, this could mean smaller occupiers may actually take slightly larger office space.

## HOW HAVE OCCUPIER REQUIREMENTS CHANGED POST-COVID-19?

### VIEWED NEGATIVELY

| | Why is this seen as a negative? |
|---|---|
| **Tower floors – particularly 1960's office stock** | Older air circulation units are ill equipped to filter out virus particles.<br>Lifts will circulate air between floors and force people into a confined environment. |
| **Comfort cooling** | Facilitates spread of virus through recirculation of air within a building. Incorporation of outside air will become increasingly important. |
| **Hot desking & collaboration lounges** | Sharing of contact surfaces will mean daily deep cleaning will be necessary for employee safety.<br>Collaboration areas encourage a high density of employees to congregate in one space. |
| **Communal atriums / terraces / amenities** | Large congregations of people will have to be actively managed to support social distancing measures.<br>Sharing of amenities within offices between occupiers will become disadvantageous as employers look to minimise the risk of spread between employees in the building. |
| **Cluster 'hot spots' & pinch points** | Face to face collaboration will suffer as employees are discouraged from congregating in large groups.<br>Kitchens and other shared spaces will have to be prepared in advance to facilitate safe use. Small pinch points in offices may have to be expanded to maintain social distancing. |

Our London headquarters is a fairly new building and we are based on the third and fourth floors, so we could work around the issues of reduced lift capacity and air conditioning system upgrades to make it a safe space for our staff. After an initial struggle to obtain the most in-demand Covid supplies, the challenge was configuring the office space to allow for social distancing but also give us sufficient capacity going forward.

**Deborah McVerry**
**Facilities Manager at Gerald Eve**

## VIEWED POSITIVELY

| + | Why are these building characteristics viewed positively? | Longer term changes to property market |
|---|---|---|
| **Volume & light** | Promotion of wellbeing is an increasingly important consideration post-Covid. | Planning and design considerations. |
| **Air circulation capacity & natural ventilation** | Buildings with appropriate ventilation will have better air quality and lower associated liabilities. | Improvement of existing HVAC systems and natural airflow to incorporate new safety measures. |
| **Generous receptions, cores & circulation areas** | Enables staff to move around offices more freely and retain social distancing measures. | Features integrated into future fitouts and developments. |
| **Multiple exits** | Enables people to keep to social distancing measures as they can exit the building easily and safely. | Designated exit points if a building has multiple tenants. |
| **Self-contained units / ground & 1st floors** | Occupier will have autonomy over their space, preventing cross contamination and not using lifts will reduce chance of the virus spread. | Lower floors could attract a rental premium with ease of access becoming paramount. |
| **Flexible layouts** | Capacity to easily change office layouts to accommodate changing occupier preference. | Interiors could shift to accommodate a more modular type of structure, allowing for quick renovations. |
| **Multiple stair core / generous lift capacity** | Allows easing of the vertical transfer of employees throughout the building while adhering to social distancing. | Planning and design considerations to incorporate increased capacity of stairwells and lifts. |
| **Wellness criteria** | Multiple companies are reporting that improving employee wellness is vital to staff satisfaction. | Push to include and expand wellness amenities and culture within office premises. |
| **Demised terraces** | Self-contained outdoor space as additional area, improving wellness criteria and air circulation. | Planning and design considerations. |
| **Cycling amenities incl. showers** | TfL expanding cycling infrastructure coupled with restrictions and risk associated with tube journeys, increasing number of cycling journeys | Fitouts required to increase capacity and current developments may be amended to include additional cycling amenities. Offices close to cycle or scooter hire docking stations could prove more attractive. |
| **Short term lease flexibility** | With the expected future office environment constantly evolving, the ability to change lease terms and/or space requirements will be at the forefront of occupier's minds. | Strengthening of tenant position during lease negotiations.<br><br>Traditional leases may shorten, have shorter break periods and rent-free periods move out. |
| **Turnkey solutions / Cat A+** | Fitted out space direct from landlords has been positively received by occupiers who no longer have the Capex to fit out space that they may only need for 2/3 years. | Both service office and landlords will need to re-double efforts to attract occupiers given the emergence of good quality tenant space post-Covid that may offer similar short-term flexibility. |
| **Zone 1 station hubs – lower "transport nodes"** | Travel capacity constraints and social distancing associated risk means alternative travel is preferable. | Offices within 20-to-30-minute walk time from train stations may become increasingly in demand. |
| **Intense building management programme** | Can coordinate to keep employees safe and reduce associated liabilities. | Continued active asset management for Landlords. |
| **Smart building tech** | Construct analysis on employee density in real time. Internal building measurements and automated response to improve internal conditions. | Incorporation of smart tech in buildings and consequent improvement of smart infrastructure.<br><br>Acceleration of the use and adoption of Internet of Things within real estate. |

# HOW MIGHT NEW COMMUTING PATTERNS INFLUENCE OCCUPIER DEMAND FOR CENTRAL LONDON OFFICES?

As restrictions on the use of public transport are lifted, significant improvements are being made to cycling routes and pedestrian infrastructure to incentivise alternative methods of commuting to central London offices. Accommodating these new methods of travel will become increasingly important to office occupiers.

Office markets in the City, Paddington, Southbank and Victoria could benefit from these new commuting patterns, especially the 'one stop' commute, and, also have proportionally better quality stock more suited to implementing social distancing measures.

Revised travel arrangements, lower public transport capacity and new "commuter-friendly" locations are likely to influence future occupational demand, supply, and pricing in the London office market.

Most London occupiers have or will soon open up their offices, giving staff the option to return. Each occupier will approach this differently, with variants of multiple split teams of employees and staggered shift patterns.

There are sectoral differences – for example, some tech companies have encouraged all staff to continue working from home until early 2021. Other office occupiers for which business generation is more reliant on face-to-face engagement are actively encouraging staff to return, such as real estate based companies.

National Rail stated that maximum passenger capacity will be at only 10-15% of normal levels for the remainder of 2020. This could lead to a situation where workers substitute tube travel with walking or cycling from either their homes in London or the major commuter train stations. Consequently, there may be increased demand for office space that is more suitable to a one-stop commute with ease of access on foot or by bike.

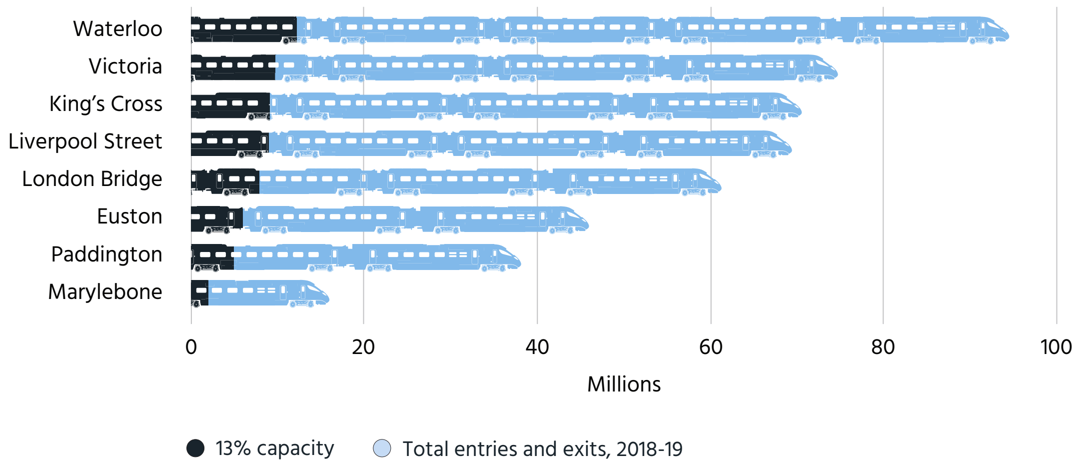
**The impact of travel disruption caused by Covid-19 into and within London**

Data from the Office for Rail Regulation shows the number of journeys made into and through major London train stations over 2018-19.

Over 2018-19, Waterloo was London's busiest station, with a total of 94.2 million unique entries and exits. Only 12.2 million journeys would be possible at 13% of capacity and potentially this won't return to normal until 2021. Employment figures from Oxford Economics show that there are just under 2.5 million office based workers in London. The capacity constraints mean that roughly 320,000 are able to travel safely on the limited services, forcing the need to consider alternate modes of transport.

### Number of entries and exits in London's major stations, 2018-19

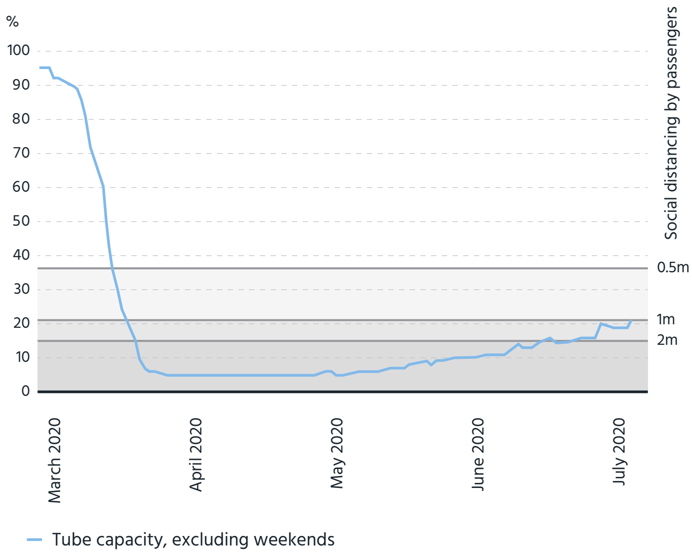
Source: Office for Rail Regulation




In February 2020, 106.2 million journeys were taken on the tube. With an upper limit of 20% passenger capacity on TfL services, with 2m social distancing, over 85 million fewer journeys can be made per month. Even with 1 m social distancing in place, this is still just under 80 milllion fewer journeys. The Covid-19 tube and bus challenges far outstrip those during the London Olympics, where services could still run at 80% capacity and ensure safe travel.

### Underground capacity during Covid-19

Source: Department for Transport, TfL, UIPT



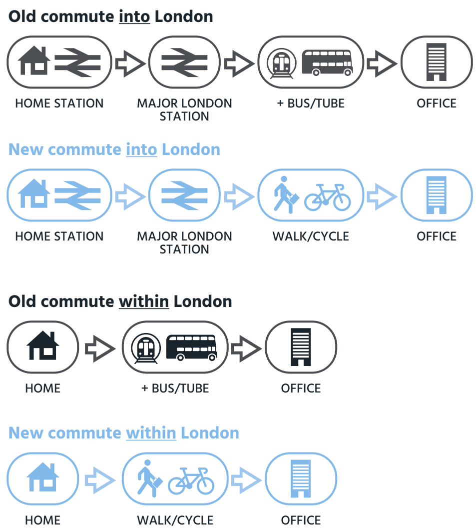

Santander
19601
Diverted traffic

# WHAT IMPACT COULD THE ADOPTION OF NEW METHODS OF TRAVEL HAVE ON LONDON OFFICE PROPERTY?

The Mayor's new **Streetspace initiative** has been put in place to encourage a shift towards walking and cycling to workplaces to avoid multiple bus and tube journeys.

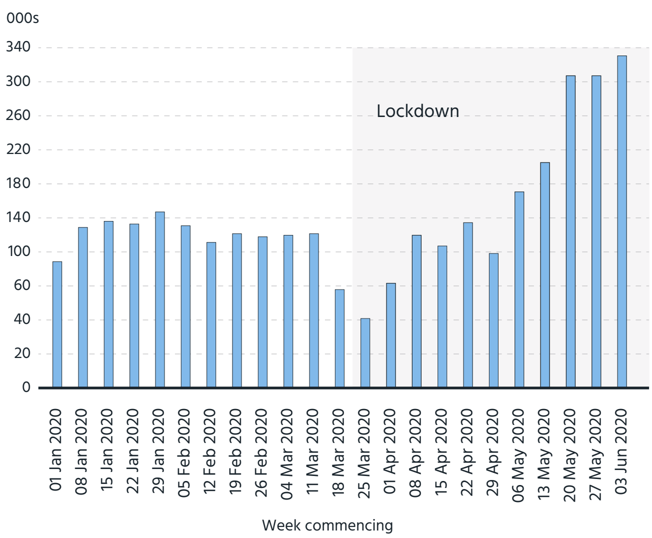
The current plans are to fast-track projects to give space to new cycle lanes and widen pavements to enable social distancing. Estimates are that cycling could increase tenfold and walking fivefold post-lockdown. The Mayor's office reported in July, an additional 15,815 sq m of space for walking has been completed and 14 extra docking stations for Santander bicylces will be installed by the end of 2020.

A record number of journeys have been made using Santander bicycles since travel restrictions were eased in the UK. Between April and May, 1.43 million journeys have been made, with a record high of 312,600 hires made in the week commencing the 20th May. The shift towards cycling to get into and around London became an immediate reality as soon as lockdown conditions were eased.




**Santander weekly cycle hires**

Source: TfL

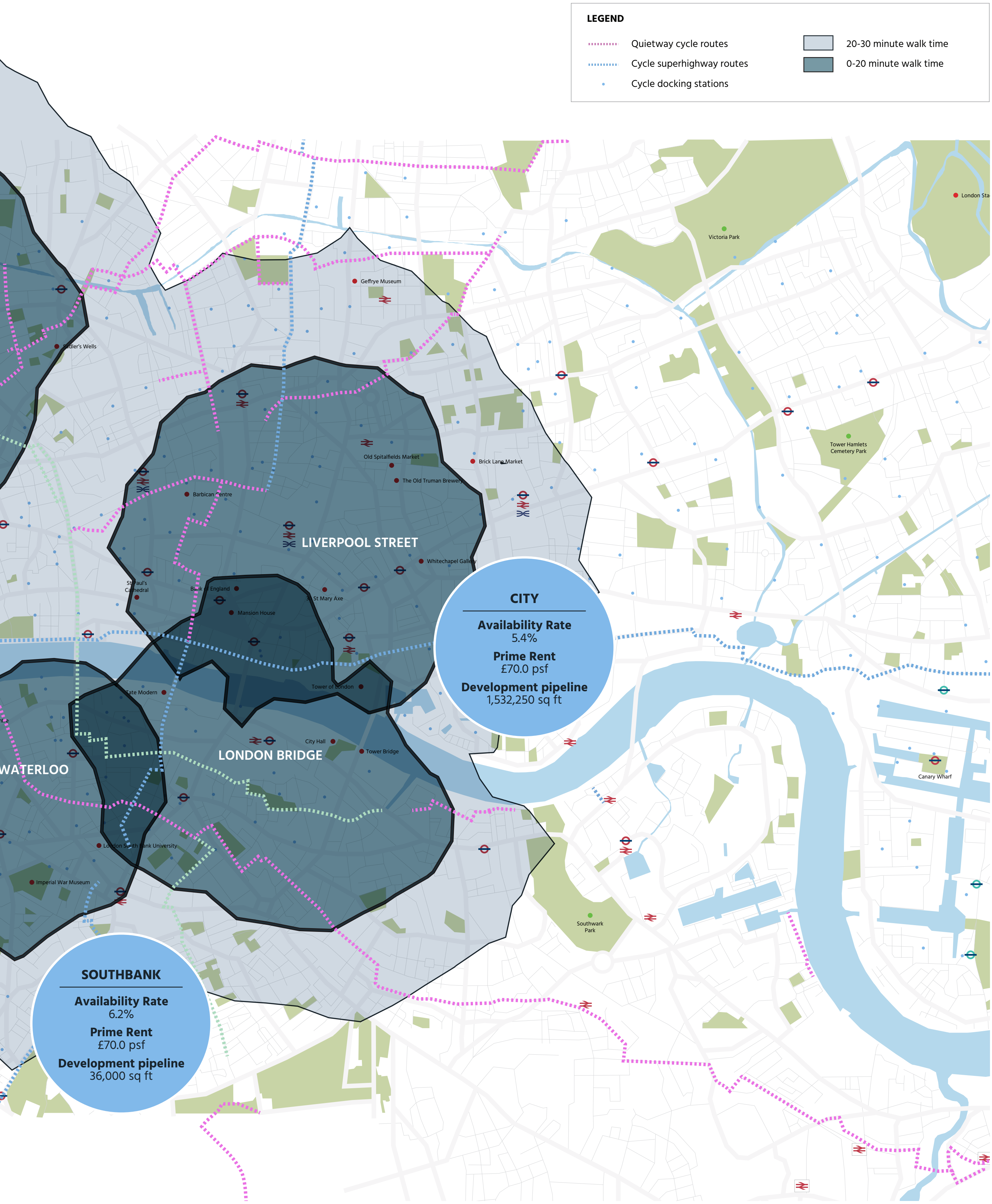



This behavioural change is likely to lead to a permanent uplift in cycling around London, especially as office workers return. The challenge is to identify what impact this switch could have on the London office property market. To this end we have modelled various walk times from London's major train stations and overlayed TfL SuperCycle highways to illustrate areas that are easily accessible on foot and by bicycle.

The crossovers of walk times on the map are areas that are particularly accessible for a one-stop commute. Where these segments overlap could prove attractive to those London office occupiers who wish to offer employees a safer and easier journey to the office.

It's possible that prime rents in these areas are more likely to be protected if these new location preferences become permanent, especially so given the already-tight supply conditions in some submarkets. These include areas in the core and north of the City, Victoria, Southbank, Kings Cross & Euston and the area around the Paddington basin.

# CENTRAL LONDON WALKING TIMES FROM MAIN RAIL STATIONS AND CYCLE PATHS



LEGEND
Quietway cycle routes
Cycle superhighway routes
Cycle docking stations
20-30 minute walk time
0-20 minute walk time
LIVERPOOL STREET
LONDON BRIDGE
WATERLOO
Geffrye Museum
Old Spitalfields Market
The Old Truman Brewery
Brick Lane Market
Barbican Centre
Mansion House
Tate Modern
Tower of London
City Hall
Tower Bridge
Imperial War Museum
Victoria Park
Tower Hamlets Cemetery Park
Canary Wharf
Southwark Park
CITY
Availability Rate
5.4%
Prime Rent
£70.0 psf
Development pipeline
1,532,250 sq ft
SOUTHBANK
Availability Rate
6.2%
Prime Rent
£70.0 psf
Development pipeline
36,000 sq ft

## MARKETS WITH BETTER QUALITY STOCK BEST SUIT POST-COVID OCCUPIER REQUIREMENTS

In general, we are likely to see an increase in demand in areas with newer stock, which can better accommodate social distancing protocols and is more suited for the post-covid office environment. These areas include the City, Paddington and Victoria, where proportionately, stock is of a better quality.

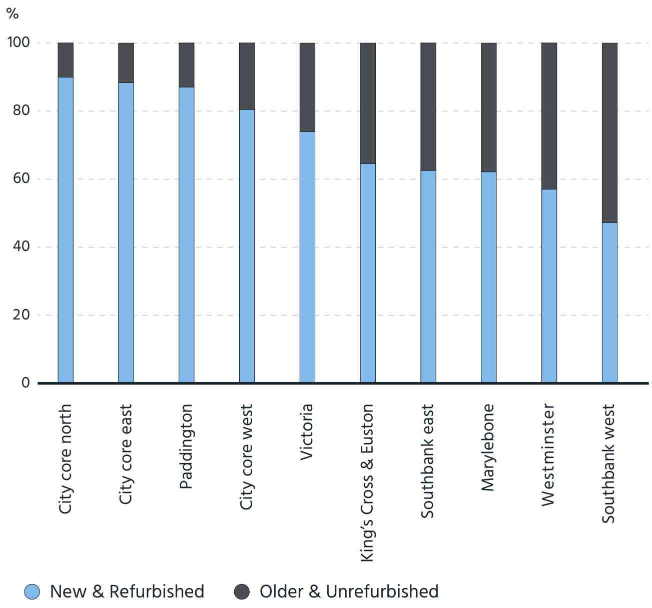
If these trends persist because of continued dampened demand for pre-Covid travel routes and redistribution of locational demand, it could trigger a response from developers to pursue schemes in hotspot locations, particularly in areas that have seen structural redevelopment in the last few years, such as Kings Cross, Southbank and Victoria.

There may also be a renewed impetus to refurbish poor quality office stock within these areas, particularly in Southbank, because of the limited volume of available stock in the pipeline and the current composition of stock quality.

These hot spot locations are idenitified as benefiting from the theme of the new commute and there is noticeable ripple effect towards the outer areas of the central London office market. This could further push the consideration of smaller hub offices in outer locations used in tandem with a more central office HQ.

**Proportion of total office stock by submarket and quality**

Source: CoStar, Gerald Eve



# WHAT ARE THE POTENTIAL IMPACTS OF A NO-DEAL BREXIT ON THE LONDON OFFICE MARKET?

Brexit negotiators missed the deadline of 30th June 2020 to complete assessments of regulatory regimes for financial services, a prerequisite for allowing EU market access from 2021. With the end of the Brexit transition period set for 11pm on the 31st December 2020, if no deal is reached, current alignment on UK and EU regulation will cease, with implications for all the UK, particularly financial services in London.

The base case scenario is that some form of deal is agreed for financial services by the end of the year, allowing operations between the UK and EU to continue. However, with Covid-19 using up political resources on both sides, time is limited for a comprehensive deal to be struck. Oxford Economics estimate a 40% chance of a no-deal Brexit occurring, while estimates from banks and other consultancies estimations range between 10-65%.

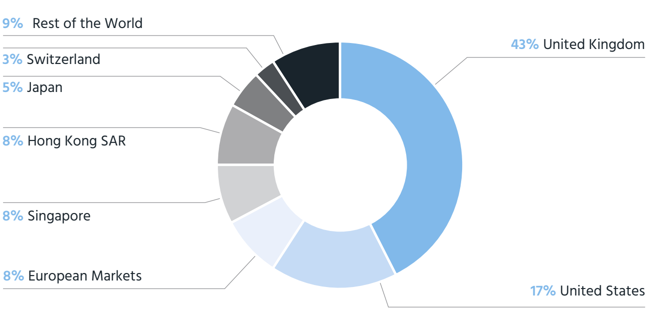
## LONDON'S IMPORTANCE AS A GLOBAL FINANCIAL CENTRE

Data from the Bank for International Settlements show that the UK accounted for 43% of global turnover of foreign exchange instruments in 2019, more than double the activity in the US, the next largest market. Currency exchange will be limited with a loss of passporting, heavily reducing the volume of over the counter (OTC) instruments cleared through London.

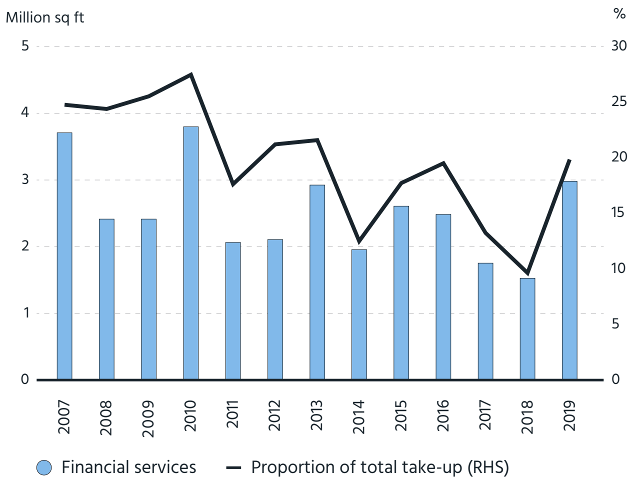
In equity trading, the London Stock Exchange Group is one of the largest exchanges by market share in Europe, in the month of July 2020 it accounted for 18.6% of all European market activity, with £5.7 billion of securities cleared.

A no-deal Brexit will have widespread operational impact on financial services in London, none more so than in the UK's £9 trillion asset management sector, which is also at risk of protracted uncertainty and regulatory disruption.
The Investment Association trade body has called for policymakers to push for equivalence, warning if there is continued uncertainty, funds could move resources and capital from the UK to Europe.

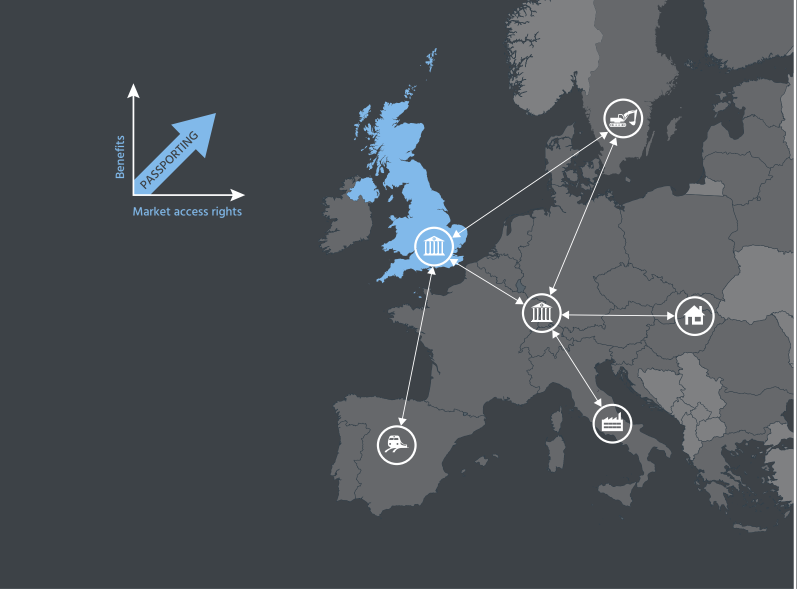
**Turnover of OTC foreign exchange instruments in 2019, by country**
Source: Bank for International Settlements

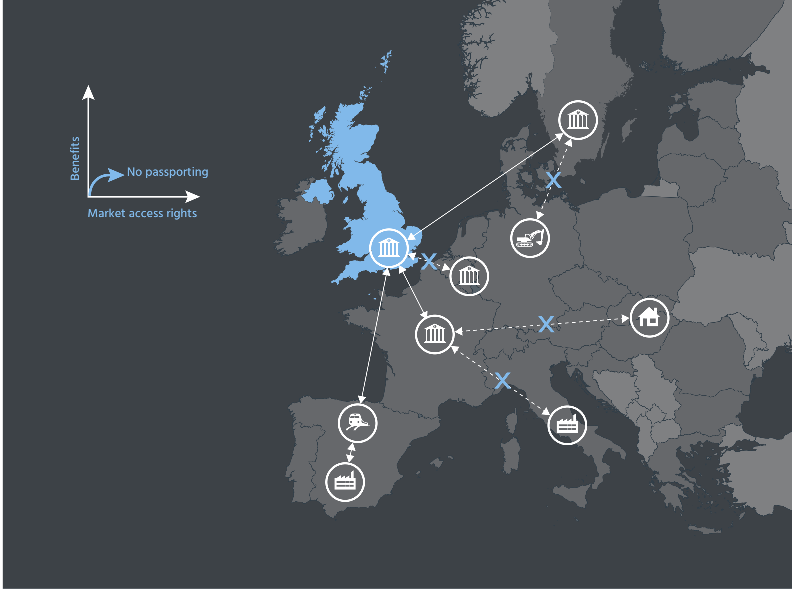



**Financial services annual take-up**
Source: Gerald Eve



# WHAT IS PASSPORTING?




## How does passporting work?

- 'Passported' entity can provide complete financial services across the UK and EU, including:
  - > Advice
  - > Foreign Exchange
  - > Loans
  - > Bond Issues
  - > Hedging
- Able to establish an arm in any other EU country and run the same services as their domestic market
- No duplication for entities and low associated costs

## What does the loss of passporting mean?

- UK loses passport rights and must apply for a license for each EU country and limited to one country at a time
- Equivalence lost if there is divergence between EU and UK financial regulatory frameworks – restriction of financial flows
- Licenses are not available in many EU countries and range of services is vastly limited
- Duplication of entities and high regulation costs

When the UK leaves the EU and EEA, it will no longer be covered by passporting frameworks or freedom of trade guaranteed by EU treaties. Losing passporting means that non-EU firms face regulatory barriers in providing cross-border financial services, such as banking and investment, to customers and clients in the EU. The ability to provide these cross-border services from the UK to businesses in the EU would be limited and be contingent on whether equivalence is granted or the domestic national market access restrictions of individual EU countries.

## THE PROSPECT OF A NO-DEAL BREXIT THREATENS FINANCIAL SERVICES OCCUPANCY IN LONDON

Financial services firms are a major element to the health of central London, accounting for 19% of Inner London's GVA in 2019. Financial companies account for an average 18% of total London occupier demand each year. Well over half of this is typically based in the City of London. However, the sector now faces the prospect of an unprecedented change in regulation, with many occupiers also reviewing their post-Covid office occupation strategies.

In the event of a no-deal Brexit that does not include passporting rights and equivalence for the UK financial sector, the additional regulation and costs associated with trading is likely to soften demand for London office space, especially in the City and Canary Wharf.

During Covid-19, there has been a rise in tenant-controlled available space as businesses have sought to reduce their corporate footprint, and this is expected to continue to rise as tenants release more office space back to the market over the next 6-12 months. This could intensify post-Brexit, especially in the key finance submarkets if the UK and EU fail to reach a trade agreement.

Additionally, credit conditions have tightened since March as companies have sought to protect cashflow and are less willing to lend. This will be compounded by debt financing from EU banks and insurance funds becoming more limited due to regulatory misalignment, potentially further limiting financing for new developments in London, as terms become less attractive.

We expect that if there is the loss of passporting and equivalence, there could be negative pressure on office rents, particularly in submarkets where financial services are clustered. Our baseline forecast is that prime rents will begin to recover towards the end of 2021, however, with the loss in demand and rise in available supply, the conditions for rent level recovery are less positive.

Our base case is that some form of deal is finalised, with passporting and equivalence remaining in place for financial services in the UK from 2021. However, if no deal is agreed, we will be presented with a perfect storm scenario created by the negative effects of Covid-19 and a no deal Brexit occurring simultaneously. We will seek to quantify the effects on market conditions and analyse these potential impacts to the London office market in future research.

# GERALD EVE IN THE MARKET – UNLOCKED DURING LOCKDOWN

**Belgrave House, 76 Buckingham Palace Road, SW1**

Having acquired 31,000 sq ft in Q4 2019, Gerald Eve have just completed the sub-letting of 8,000 sq ft at a rent of £82 per sq ft and a rent-free package of 18 months which remained unchanged post-Covid.

**30 St Mary Axe, EC3**

We have recently let part level 11 (c.7,700 sq ft) on behalf of Swiss Re, to law firm Forresters. Rent agreed at £62.00 psf with a rent-free package of 26 months. **We remain under offer on the remaining part of the floor with just level 10 and part level 13 remaining available.**


**2-5 Old Bond Street, W1**

Acting for a Hong Kong private client, we have agreed a lease with a private bank to acquire 3,000 sq ft on the fourth floor at a rent of £86.50 per sq ft and a rent-free package totalling 19 months which remained unchanged during lockdown. We will shortly be bringing to market two other floors in the building.

**1 Old Queen Street, SW1**

We advised our client on the acquisition of 1 Old Queen Street, SW1. The property comprises 21,786 sq ft of office accommodation, with vacant possession achievable in 6 months. Quoting price was £23.35m, reflecting 4.67% NIY and £1,071 psf.

**10 Crown Place, EC2**

On behalf of Close Brother Group, Gerald Eve negotiated a reversionary lease of the whole building at 10 Crown Place, comprising c. 50,000 sq ft.


**27-30 Lime Street, EC3**

We advised on the sale of the long leasehold interest of 27-30 Lime Street, EC3 to a private investor. The property comprises 12,069 sq ft office and retail accommodation multi-let to 6 tenants. Quoting price was £9.5m, reflecting 5.92% NIY and £787 psf.

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