

London - Number 1 World City

Dove and Hawk visit London



September 2011

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London topped the St Bride's ranking as the most secure destination for long-term property investment. Dolly Dove and Harry Hawk discuss the reasons behind this and debate its future prospects.

Dove: Good morning Harry. Have you recovered from your jet-lag following our recent trip to the US?

Hawk: I sure have, although those cross-Atlantic winds were brutal weren't they? Anyway, it's great to be back in London. Never more true is that saying by our old mate Samuel Johnson... "when a man is tired of London, he is tired of life".



Dove: Blimey Harry...What's got into you? When did you become all philosophical? Have you been brainwashed by those guys at St Bride's Managers and their World Cities publication which has London as Number 1 World City?

Hawk: Nothing of the sort. I can't argue with their results though. I always knew that our nest was located in the Number 1 World City. With London expected to continue to grow it sure looks like the place to be and where we should be growing old together.

Dove: Hmm! I am not so sure Harry. Given all the difficulties that the UK is currently experiencing...remember the riots? I am struggling to believe that London really is the most secure destination for long-term investment.

Hawk: Well, let the facts speak for themselves. London was ranked first or second in five out of the eight themes analysed in the St Bride's Managers research and ended up with an overall score of 66.80. Only Hong Kong (65.68), Singapore (63.87) and New York (63.46) got anywhere near.



Dove: But the UK economy is taking a hammering at present. Why would you really want to invest somewhere that is teetering on a double-dip recession?

Eight themes were considered - London topped the overall rankings

St Bride's Managers World Cities

| Theme | London Ranking (Out of 20) | Top 3 Ranking Cities |
|--------------|----------------------------|--|
| Access | 1st | London (1), Paris (2), Singapore (3) |
| Knowledge | 1st | London (1), Paris (2), New York (3) |
| Economy | 1st | London (1), Paris (2), New York (3) |
| Business | 2nd | New York (1), London (2), Hong Kong (3) |
| Property | 2nd | Hong Kong (1), London (2), Paris (3) |
| Living | 8th | Geneva (1), Singapore (2), Amsterdam (3) |
| Risk | 8th | Stockholm (1), Geneva (2), Hong Kong (3) |
| Constitution | 11th | Singapore (1), Hong Kong (2), Geneva (3) |

Source: St Bride's Managers

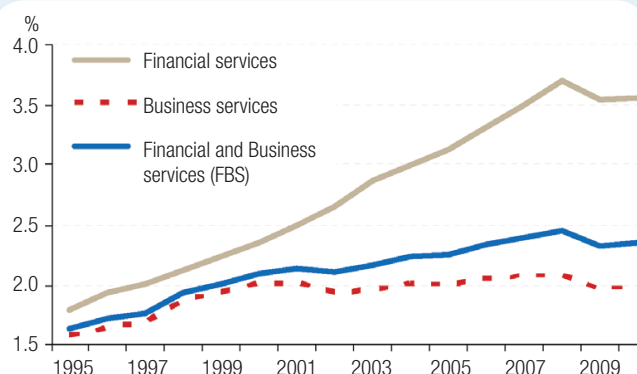
Hawk: Dolly – you've missed the point! These are long-term, not short-term 'buy/sell' indicators. London is the world leader in international finance and business services. Did you know that London has a 37% global share of foreign exchange turnover; that 17% of the global foreign equity market is traded in London; that 70% of global bond turnover is traded here too; that 551 foreign companies...

Dove: Stop, stop. My head is spinning. All that might well be the case now but surely Asia is the financial place to be in the future?

Hawk: London's financial and business services sector grew by 6% per annum between 1996 and 2008. True, this is slower than in the emerging financial centres in Asia, but it is still nevertheless noticeably faster than in other mature economies and from 2012 to 2020 London is forecast to grow again with an average of 4% per annum.

London has taken an increasing share of global financial and business services activity relative to other centres

London GVA as a % of Europe, USA and Japan Total



Source: Oxford Economics

Dove: But haven't quite a few businesses moved from London to more tax efficient centres?

Hawk: It's true that the likes of Colgate, Google and Regus have gone to Zurich, Geneva and Luxembourg and this is something that the Government and the Mayor will have to keep an eye on. I am not saying that challenges don't exist, as they do in every global city, but London is still incredibly well placed to remain the leading location for business. On top of that, London's population is also predicted to continue to grow robustly. In fact, the population has grown every year since 1988.

Dove: Oh great! More people, more traffic, more pollution. What possible positives can there be from more people living in London?

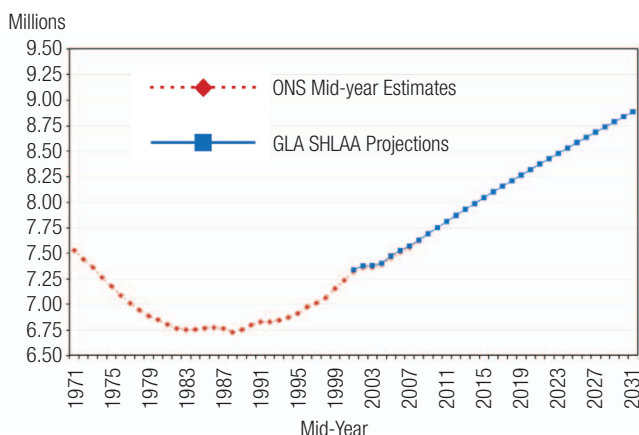
Hawk: For investors the positives are massive. Population growth is the most fundamental and dynamic driver behind the real estate market. It increases demand for goods and services. More people inevitably mean more demand for housing, more jobs and therefore more demand for property, more retail spending and more shops, and more demand for social infrastructure, such as schools, colleges, universities and healthcare. It becomes a virtuous circle.

Dove: So are you saying that population trends provide a picture of where and what you should invest in?

Hawk: Absolutely Dolly. The majority of the UK population growth over the next 25 years will be concentrated in London and the South East. The capital's population is set to expand by 1.5m to top 9m by 2031. Adding this many people to the city will create intense competition for land.

London's population has grown every year since 1988 and is expected to continue

London's Population 1971-2031



Source: GLA DMAG

Dove: Fair enough, but over our life time London has constantly evolved, particularly in its physical make-up. Won't that mean that competition for land will be less intense than you are suggesting? London is now a polycentric city. High quality schemes have emerged around the periphery of the historical core, in areas such as More London, Paddington and Regent's Place. And from what I have gathered recently, the shape of London will continue to evolve with the proposals for Battersea/Vauxhall, King's Cross and Earl's Court. These new emerging locations will surely take the sting out of rising rents and land prices?

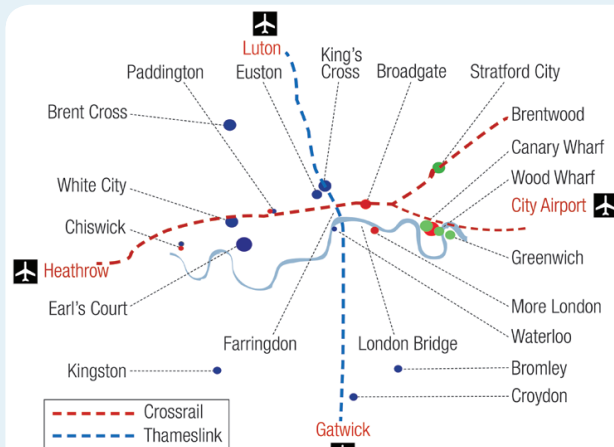


Hawk: That's not a bad point Dolly and it's one reason why rents won't peak and trough so much in the future. But more importantly, how disastrous would it be if London couldn't offer the type of space wanted by new and/or growing businesses? They would be forced to go somewhere else, wouldn't they?

Dove: So where should investors be looking to invest within London?

Recent patterns of development and major infrastructure projects are changing the shape of London

Polycentric London



Source: Ramidus Consulting Limited

Hawk: Currently most investors simply focus on the West End or in the City. However there are so many other interesting opportunities in London that are emerging outside these traditional core areas. Take Crossrail for example. It will produce a number of new 'hotspots' where prices are likely to increase over and above the market in general – Farringdon, Tottenham Court Road and Paddington as examples.

Dove: So what is Crossrail all about then?

Hawk: It is a new train line that is going to transform west-east travel across London, and most particularly Heathrow to Canary Wharf. The trains will be faster and twice the length of existing tubes. But more importantly it will open up new areas for regeneration.

Dove: It's going to cost a shed load of money though isn't it? £15.9 billion was the latest number I heard.

Hawk: Yes it's a lot, but it will be worth every penny, not least because it will generate up to 14,000 direct jobs over the next few years and another 55-60,000 indirect/supply chain jobs too.



Dove: As much as I hate to admit it Harry, I think you're right. I'd always associated investing in commercial property in London as investing in high quality offices in the West End or around The Bank of England or a shop on Bond Street. I'd never really considered these other locations that you are talking about.

Hawk: Well why don't we take a quick trip up over to The Shard at London Bridge? I know it is still under construction so we'll need to be careful but it will certainly give us a great viewing point to see what's happening across the capital.

Dove: Great idea Harry...I'll race you there.

Working in London

Some commercial property investors regard London, as a location, as too expensive to invest in. From the top of The Shard, Dolly and Harry dispel some longstanding myths.

Hawk: Hey, what a view?

Dove: Absolutely brilliant and it sure does give us a 'bird's eye view' of London, doesn't it? Come on then Harry tell me how you define London if it's not just the West End and the City.

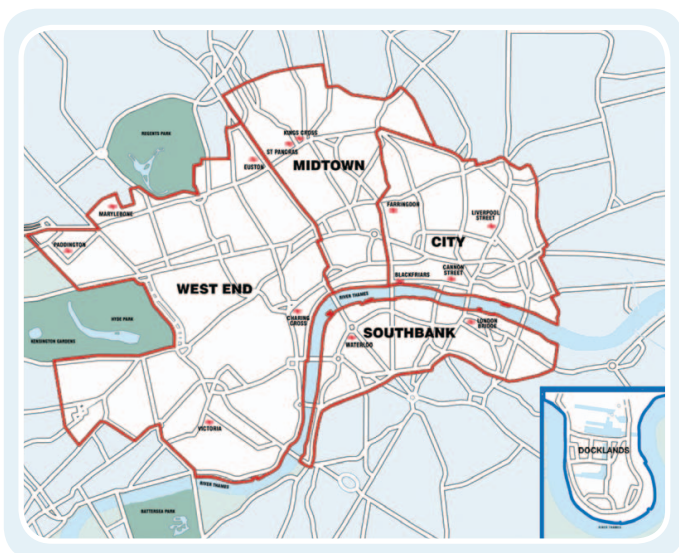
Hawk: If you ask the Mayor of London, he'll say that London comprises the thirty-two London Boroughs plus The City of London. However other people define London as the area inside the M25, whilst others use the boundaries of the Central Activity Zone (CAZ). It really depends on who you talk to.

Dove: How do those chaps at St Bride's Managers define London? They seem to know what they are talking about.

Hawk: They adopt a different definition for each sector. Quite an interesting approach actually.

Dove: So what do they define as Central London Offices?

The Central London Office market consists of five main markets: the West End, the City, Midtown, Docklands and Southbank



Hawk: They have sub-divided the central office district into five distinct regions. It is very similar to the boundaries of the CAZ as shown in the London Plan but with the addition of the Isle of Dogs centred on Canary Wharf. So it's a big area with plenty of opportunities to invest in.

Dove: That may be, but London offices are just so expensive aren't they? The last I heard was that prime initial yields were back down to 4% in the West End. Where is the value upside in that?

Hawk: There you go again Dolly. Concentrating on those historic core areas. Think wider than them! Yes yields have compressed as Central London offices remain a key target for international investors but yields are not 4% everywhere. There are still some great deals to be done. You just have to be 'in-the-know'.

Dove: But total returns from Central London offices have been rubbish over the years.



Hawk: Where on earth did you get that from? That's just simply not true. If you had invested in London offices over the last 30 years you would have easily outperformed IPD.

Dove: What? Even if I had invested solely in the City? I doubt that somehow!

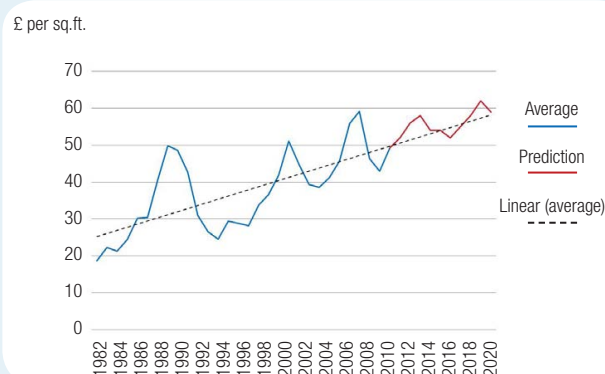
Hawk: Okay, but if you look at the IPD data closely you can see that out of the last 30 years, City Offices were either in the top three or bottom three sub-markets 19 times (63%). Therefore if you got your timing right you would have made a ton of money and a lot of well-advised investors have done just that.

Dove: That's all well and good, but no-one really cares about historic performance do they? The question is what is going to happen in the future?



The rental trend for London Offices is upwards with rents expected to continue to grow and become less volatile

All London Office Markets Rental Change



Source: Morgan Capital Partners / Focus

Hawk: Investor interest is certainly set to continue for the foreseeable future as they look to exploit the buoyancy of London's micro-economy. Morgan Capital Partners, a member of the St Bride's Business Alliance, believe that office rents will continue to grow but what's more, rents will become less volatile than they have been in the past. As we were discussing before, I doubt rents will peak and trough so much in the future as the new emerging office locations will act as pressure release valves.

Dove: But can I access the product? Aren't foreign investors taking the lion's share of the London office market and outbidding domestic investors?

Hawk: Remember there is circa 200 million sq. ft. of office stock in London, not to mention all the new schemes being built. It is true that foreign investors are extremely active at present, and in 2010 they took 53% of transactions by value, but that's hardly surprising given that sterling's trade weighted average is 16% below its 10 year average. Simply put, UK real estate, not just London Offices, looks cheap in capital value terms to foreign investors. However many of them have not ventured into the new hotspot areas yet so opportunities do exist.

Dove: Does the same apply for London Industrials? I must confess I have never really given this sub-sector a great deal of thought as it all sounds a bit messy to me.

Hawk: I really love London Industrials! When I say London Industrials what I mean is industrial properties located inside the M25. These properties include warehousing facilities to store and handle the goods from producer to consumer in supply chains; industrial properties covering industry, warehousing and waste; as well as transport depots and utilities. This is the same definition that the guys at St Bride's use. There's circa 270 million sq. ft. of industrial properties in London according to the Valuation Office.

Dove: Crikey. That's a lot of space! Are there any well-known industrial locations, like there are with the office market?

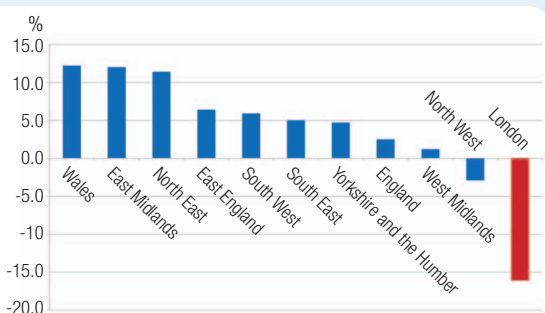
Hawk: There are heavy concentrations in the Thames Gateway area and in West London, notably around Heathrow Airport and Park Royal. There are also large amounts of floorspace in the Lea Valley area and along the A24 and A23 in South London. But the bits I really like are the pockets of concentration right in the middle, especially south of the river where land is coming under massive pressure from more valuable alternative uses.

Dove: So has there been a significant loss of industrial land recently? Every time I fly over London I keep seeing new housing schemes being built.

Hawk: You had better believe it! Over the period 1998-2008, London saw a loss of approximately 16% of its industrial space, the highest loss of anywhere in the UK.

London has seen a significant loss of industrial land, particularly for the Olympics, Westfield(s) and Crossrail

Change in Industrial Space 1998-2008



Source: Office For National Statistics

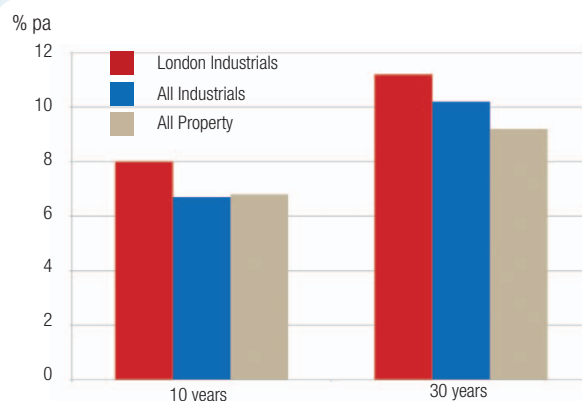


Dove: In a strange sort of way that has to be good news for investors, doesn't it? Won't the reduction of industrial land put pressure on rents?

Hawk: How very insightful of you Dolly. If you look at IPD data, London Industrial rental value growth has consistently out-performed All Property and All Industrial over most time horizons. But it is not just rental growth. If you look at total returns, London Industrials have consistently outperformed too. In fact London Industrials were the best performing industrial sub-market over the last 10 years.

London Industrials have consistently outperformed IPD

Industrial Total Returns



Source: IPD

Dove: But will this out-performance last?

Hawk: Yes, I believe it will. London's highly competitive economy will provide momentum to the industrial sector, generating good occupier demand and at the same time, industrial land will come under increasing pressure from higher value competing uses. And hey presto. Great returns!



Dove: I really like the sound of that but I can't believe the story is equally as compelling for London Retail.

Hawk: You'd be surprised. Why don't we shoot over to Oxford Street? That will give us a great indicator of the state of play.

Dove: Great shout Harry. Plus I can get that new handbag I have been after for ages. See you there.

Living in London

London is a 24 hour, seven days a week city. A place where people used to just work but now also shop, party and live. Dolly and Harry discuss the health of the London Retail and London Residential markets.

Dove: So Harry, is the story for London Retail equally as compelling as offices and industrial given the fact that so many people now prefer shopping on-line?

Hawk: If you look at total returns, London Retail has outperformed IPD. Furthermore London was the only place to see average prime rents increase last year, by 6% in the centre and 1% on the periphery. One of London's greatest strengths is its reputation as a global shopping destination, which attracts 14 million tourists every year.

London is easily the most visited global city by tourists

International Tourist Arrivals

| City | Rank | 2009 Arrivals ('000) |
|---------------|------|----------------------|
| London | 1 | 14,059 |
| Bangkok | 2 | 9,985 |
| Singapore | 3 | 9,682 |
| Kuala Lumpur | 4 | 9,400 |
| Antalya | 5 | 8,867 |
| New York City | 6 | 8,479 |
| Dubai | 7 | 7,783 |
| Paris | 8 | 7,749 |
| Istanbul | 9 | 7,743 |
| Hong Kong | 10 | 7,010 |

Source: Euromonitor International

Dove: What do you mean by centre and periphery?



Hawk: Sorry Dolly, I should have clarified that for you. The chaps at St Bride's have broken London Retail down into two categories. Firstly 'inner/tourist London' and secondly the 'wider residential markets' such as Croydon, Bromley and Kingston.

Dove: So where do the two Westfield Shopping Centres fit in?

Hawk: They are transformational. Did you know that Westfield London had 26 million visitors last year? Twenty five years ago people talked about going shopping, now it's all about destinations: 'I'm going to Westfield, or I'm going to Brent Cross.' The rise of the so-called 'super-mall' is here to stay.

Dove: But how can you invest into these things? They are huge aren't they?

Hawk: You are right Dolly. Probably through funds or the listed market. But that's a topic for another day.

Dove: So are these 'super-malls' good news for London retailing?

Hawk: Yes and no. Clearly their rise is at the expense of the secondary

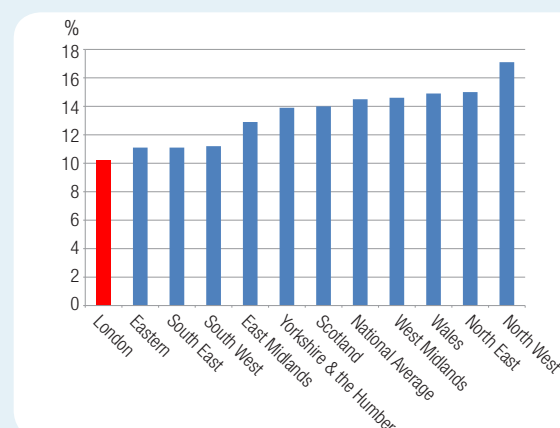
shopping districts. But the likes of the Bentall Centre in Kingston and the Whitgift Centre in Croydon will do fine as they have big enough catchment areas to cope. However many of the traditional suburban high streets are a real worry. Shops are emptying and there are towns that appear to be on their last legs.

Dove: So are you telling me that you're not a fan of all London Retail then?

Hawk: One of the best ways to answer that is by looking at regional shop vacancy rates. London, at a national level, has the lowest shop vacancy rate, but if you look at Cushman and Wakefield's research from August 2010 (and things have probably taken a turn for the worse nationally since then) London remains the most polarised regional market with the centre recording one of the lowest national availabilities of only 5.1%, whilst the suburbs recorded the highest at 17.4%.

London has the lowest average regional shop vacancy rate

Availability of Retail Units by Region (H1 2011)



Source: Local Data Company

Dove: So Outer London looks like a place to avoid then?

Hawk: For the time being you are probably right Dolly but I wouldn't recommend forgetting about these centres for good. Help is being provided for these areas. For instance, the Mayor of London has recently launched a £50 million regeneration fund. But you really do have to be picky about where you choose to invest.



Dove: So where should an investor be looking? A gentle stroll down Bond Street or the King's Road?

Hawk: The future of London's inner/tourist market still looks bright and there will be no let up in the demand for representation especially from international retailers as we lead up towards the Olympics. Availability in prime locations remain at their lowest level for the past two decades. Based on simple economic principles, the significant imbalance between supply and demand

has resulted in record rents being set particularly in the West End. The same rosy pictures goes for the City following the opening of One New Change. And of course there is A1 retail warehousing and supermarkets to look at too.

Dove: Wow. London offices, industrials and retail all seem to be good bets. So why historically haven't UK investors had a higher weighting to London?

Hawk: I have absolutely no idea Dolly. It remains one of the world's great mysteries. As does their limited exposure to the residential sector.

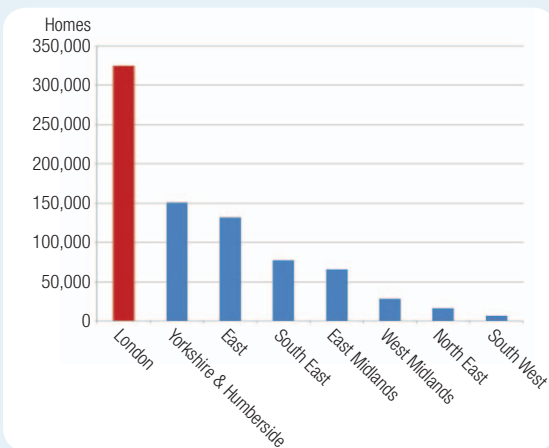
Dove: I know. I never really understood that either. I accept that there used to be prohibitive legislation and institutional investors never liked the idea of tenants phoning them up at the weekend when things went wrong. But don't the economic and demographic trends we discussed earlier only mean it would be madness for investors not to explore the residential sector?



Hawk: Residential is the gem in the box, no doubt. But again you need to pick your locations carefully. I am sure you are aware of the housing shortage the UK is facing. A shortfall of 750,000 houses within 14 years and the largest shortfall will be in London. A gap of 325,000 units!

The largest supply and demand imbalance of housing will be in London

Estimated Shortfall of Homes in 2025



Source: Institute for Public Policy Research (IPPR)

Dove: So presumably that will continue to support capital growth Harry?

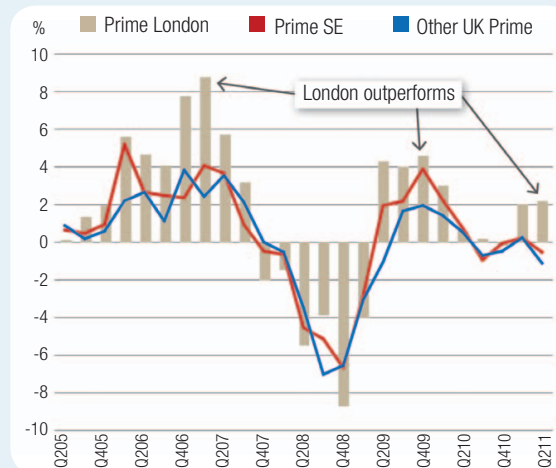
Hawk: Yes, it will. If you accept the most recent forecasts published by Savills, prime Central London is forecast to see 34.4% house price growth in the five years to the end of 2015. Massive, massive growth!

Dove: But what about the London rental market?

Hawk: Prime London rental values have risen by 9.7% in the year to June 2011 putting them 3.9% above their 2007 peak. The gap between London and the regions is also evident too. For 2011, Cluttons forecast rental value growth of 11%, with above inflation levels of rental growth over the next two to three years thereafter.

London is virtually the only part of the UK where house prices are rising

Quarterly price movements in UK Prime areas



Source: Savills Research, August 2011

Dove: Wowzers, that's huge growth. Resi is definitely worth a look at then isn't it! But is it the only 'non-conventional' sector I should be looking at in London?

Hawk: Absolutely not. Institutions have got to become smarter in their investment thinking. They have to be much more aware of the economic, social and demographic changes going on. For instance, London's reputation for education will continue to attract students, its population shape is changing with more school age Londoners in 2026 and 2031 than today, not to mention the current structural deficit of purpose-built student housing in the capital. Throw in tighter planning policies, the continued lack of funding sources and you have to conclude that student accommodation is one sector to closely monitor in the coming years.

Dove: Do you know what Harry? I am overwhelmed by all this. London really seems to be the place to be and invest in. I never realised the full extent of the place, its' evolving shape, not to mention all the opportunities that exist here. I now really regret that I didn't invest more here earlier when I had the chance rather than chasing all those opportunities across the rest of the UK in search of supposedly higher returns.

Hawk: You and me both Dolly. So what are you going to put into your shopping basket?



Dove: Well, I definitely want some London Industrials, a piece of the action around the emerging office centres like Farringdon and also some London resi. And of course that lovely handbag!

Hawk: I couldn't agree with you more Dolly, bar the handbag of course. Anyway I am parched so let's head over to the old 'Bull and Bear' pub which the team at St Bride's frequent for a drink. My treat.

Dove: You know I'll never turn down a free drink from you Harry. Let me buy that handbag and I'll see you there shortly.

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