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Brexit Casts a Shadow Over London's Office Market

| By Natalie Dolce
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Alistair Subba Row, partner of Farebrother/CORFAC International out of London.

LONDON—Activity in London's capital markets sector has slowed since the beginning of the year. Most of the investment property acquisitions being conducted in recent months are from private family offices with cash that are seeking better yields than bank deposits and meager interest payments. Those thoughts are according to **Alistair Subba Row**, partner of **Farebrother/CORFAC International** out of London.

U.K. funds and property companies have been quietly monitoring the markets but not buying, he says. On the leasing side, the majority of completed transactions have involved small business occupiers (up to 10,000 square feet) or with companies that for one reason or another needed to execute a lease in line with their business strategy.

"Most mid-to-large occupiers are watching the market, putting on hold any short-term plans for expansion that involve sizeable lease commitments. Whilst first quarter sales and take-up (leasing/gross absorption) data does not indicate an outright collapse of the market, the numbers are soft. London Midtown and the West End do seem to be holding up," he says.

During the first quarter a total of £12.1bn was invested in the U.K., down 26% from the Q1 2015 figures. Of this £4.0bn was from foreign investors, a year-on-year drop of 44%. "We believe that second quarter figures will show similar traits when they become available. This is because of the continued uncertainty over Brexit, or Bremain. The national referendum to remain or exit the European Union is June 23, 2016."

By way of an example, his company is working with a client on a potential £100 million Central London investment acquisition. "The uncertainty that the 'in or out' of Europe referendum has created meant that this investor decided not to bid. Others investors felt the same and the property was subsequently withdrawn after the remaining interest failed to reach the desired exit price. Not all sales have been unsuccessful with ENPAM, the Italian Pension Fund for Doctors and Dentists, paying £400m for a 50% stake in Principal Place, a 600,000-square-foot new office building let to Amazon as their UK HQ. The yield is reported to be 4.25%."

Interestingly there have been some isolated investment sales occurring with a new clause that was never used before in purchase agreements, he says. "The newly named 'Brexit clause' will allow some purchasers to rescind the purchase if the vote is to leave.

Office Development Boom Continues

These are unprecedented times for everyone in the UK and London's commercial real estate business, particularly within the context that London is experiencing an office development boom, says Subba Row.

"Construction started on 51 office buildings in London from October last year through March 2016, according to Deloitte, more than any six-month period in the accounting firm's 20 years of tracking the U.K. capital's real estate market. Office space under construction was 14.2 million square feet at the end of March, up 28% from September and the highest since the first quarter of 2008."

About 40% of the space is pre-leased and the balance will come to the market in phases without occupancy commitments, he adds. "Sustained periods of low take-up due to the pending referendum will undoubtedly increase London's currently low vacancy levels."

In addition to economic consequences of leaving Europe, the future political consequences are even more difficult to read, he continues. "It is my firm opinion that now more than ever, we need to be at the table with our European neighbors, not away from them. Britain has a population of about 65 million, we are the 5th largest economy in the world and there are numerous areas of business within the European Treaty of Rome that would need be negotiated if we leave Europe. The long period of time required whilst these agreements are being negotiated will no doubt create further business uncertainty and inactivity."

US property investment in the U.K. is also down at the moment, he explains.

His colleague, **John Homsher**, CCIM and the 2016 president of CORFAC International, who is also a partner with Chicago-based Podolsky|Circle CORFAC International, says that "a vote to exit the EU will have a much bigger impact on the London market than anything in the states."

Homsher explains that "Maybe some Brits will keep more of their money at home but I don't think they would completely shut off the spigot. People that invest globally are smart and sophisticated and they invest for income, growth and preservation of wealth. The U.S. is a safe haven for property investing and U.K. money, along with capital from all over the world, will continue to come to America."

Indeed, recent data released by Real Capital Analytics in its January U.S. Capital Trends revealed that foreign investors plowed $91.1 billion into U.S. commercial properties in 2015 with Canada, Singapore and China the biggest investors at $28 billion, $23 billion and slightly more than $10 billion, respectively, explains Subba Row. "From the EU, only Germany made the top 10 list of investors in American property, with about $4.5 billion."

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