Research Blast

European Real Estate Market, Brexit Thoughts & Views – July 2016

European financial office markets post-Brexit

Let us say it upfront: London is the number one global financial center and is not easily replaced. Were London's position to be challenged, it would not only be a major risk for the UK economy but also a broader threat to the EU, if not the rest of the world. London has benefit significantly from the EU's four principles – free movement of goods, services, people and capital – creating a unique environment to attract talent and gaining access to a combined population larger than in the US. Furthermore, UK government policies have supported London's financial and business service sectors, and together with strong transport links to the rest of the world have made London almost unique.

With the vote for leaving the EU, the framework for the financial service sector is likely to change even though it is far too early for specifics. But the assumption that London's financial and business service sector will be able to keep its access to the EU market for services and capital while restricting free movement of people is quite optimistic in our view. A prolonged period of uncertainty surrounding whether and when Article 50 is triggered by the UK government may increase the level of risk that, in particular, companies within the financial and business services sector are facing.

With the referendum result now two weeks old, we have spoken to several major real estate brokerage companies whether they can find any anecdotal evidence for future planning. The response was positive, in particular from US financial companies. While companies are not rushing to make decisions, they are more likely to do so within the next 12 months. According to the brokerage companies, location preference is currently Dublin, followed by Frankfurt and Amsterdam. So far, Paris and Luxembourg do not seem to be highly preferred.

Even though it is highly unlikely that financial services companies would all relocate to a single city, we would now like to discuss whether the following office markets have the capacity to partly substitute for and/or complement London.

Dublin – Well-established financial center but not on a global or European scale
Flexible labour laws and strong economic ties to the UK and US through a shared language keep barriers of movements relatively low. Geographically, Ireland is relatively isolated from continental Europe. Even though transport links to the continent and the US are very good, links to the rest of the world are more limited. The office market is relatively small (ca. 4.1 million sqm). The recovery of the Irish economy has pushed office vacancy down significantly. In particular, the city center sub-market has a very low vacancy rate of less than 6%, which could be challenging for occupiers to find the right sized space. However, unlike other European cities, Dublin is in an office development cycle, which should bring centrally-located office space on the market relatively soon. Over the next three years Dublin's office stock may increase by more than 12% of which close to 50% is speculative. While six months ago, we were expecting an oversupply situation in Dublin, the current strong development pipeline could actually be a positive for attracting companies.

Frankfurt – Germany's financial center with a global reach
Frankfurt's profile is slightly more biased towards banking and less towards asset management. Financial companies may find it attractive to be close to the European Central Bank (ECB), other European regulatory bodies and being based in EU's biggest economy. Labour laws are not as flexible as in the UK; however, there are no major constraints for management positions. With the EU's third largest airport, Frankfurt not only offers excellent connectivity within Europe but also to the rest of the world, actually having the highest number of flights to China of any European airport. Frankfurt's office market is aimed towards the financial service sector, which has been challenging since the Global Financial Crisis (GFC). Although office vacancies have recently fallen slightly, vacancy rates in the traditional locations (Bankendistrikt and Westend) for financial services remain above 12%. More than 500,000 sqm of office space in the city center are available and close to 50% is of Grade "A" quality. As with Dublin, Frankfurt's current challenges could also be Frankfurt's opportunity.

Amsterdam – Europe's best developed pension system and in a strong position for asset management
Market friendly policies and the population's excellent English language skills keep barriers for movement relatively low even though a 20% cap on bankers' bonuses might be seen as a negative for some parts of the financial services sector. As the EU's fourth largest major airport, Amsterdam offers excellent transport links to all parts of Europe but also to the rest of the world. As with Frankfurt, the proximity of the airport and the city center is a strong point for Amsterdam. The Amsterdam office market has experienced a very challenging time and vacancy is still elevated (above 12%). However, Amsterdam's major sub-market (Zuidas) for financial service companies has been recovering for a while and could be challenging to find appropriate office space. The development pipeline is still thin but could respond relatively quickly should companies decide to move to Amsterdam.

Paris – The Ile-de-France region is Europe's biggest economic agglomeration
As France's political and economic capital, Paris provides very a good transport infrastructure and links all over the globe from EU's second biggest airport. Paris is home to major French banks and asset management houses; however, the city lacks a global profile, with its reputation as a business location suffering over the last few years. In particular financial and service companies prefer a relative flexible labour law environment and a broad knowledge of the global working language – English – which makes it less surprising that the requests from banks for Paris is muted. As Europe's largest office market, Paris has a lot of potential; however, it is very difficult for financial companies to find suitable office space in the Paris CBD. On the other hand, La Défense is well positioned for this type of occupiers, offering large – and currently vacant – floor spaces. The office market recovery has also started in Paris; in particular in La Défense which also offers development potential in the medium term.

Luxembourg – An important center for asset management and service functions for financial services
A constraint for banks, in particular investment banks, is the limited connectivity of Luxembourg to the rest of the world. With a total office stock of ca. 4 million sqm, Luxembourg is relatively small. Even though the main office sub-market, Kirchberg, still offers development opportunities, the current low vacancy of less than 4% make it difficult for financial services companies to find suitable office space to relocate.

Out of the box
On the visionary side, the challenges which financial services companies face due to UK's vote to leave the EU might be a catalyst for the whole industry in Europe. Currently, a broad range of services and level of staff is located in London. The macro trends in the financial services industry for rationalization and increased technology prevail. The challenges owed to Brexit may even accelerate this process, and this could mean that only regulated functions might relocate to the cities mentioned here. In particular, back-to-middle office functions might be cut altogether or moved to cost-efficient locations within the EU. In recent years Poland has established itself as an important service hub for the financial services sector, with Hungary and Romania also moving in to this direction. Cities such as Warsaw, Wroclaw, Krakow, Budapest, Bucharest and Cluj are well positioned for attracting this type of services.

In summary, Brexit is a threat for London. Financial services companies may not rush through the door to relocate; however, should uncertainties with the UK's future relationships with the EU continue for too long, companies may re-assess their options and execute in the interest of their stakeholders. The five cities where financial services could be relocated to are in different positions to accommodate parts of London's current role. They may not, however, replace London completely, which will be a challenge for the whole of Europe. By reassessing the current business model, Brexit could be a catalyst for the industry as whole and may place new/other locations on the European financial services map.

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