Knight Frank

UK Logistics Market.

MID YEAR REVIEW 2021

OCCUPIER MARKET - H1 2021 SUMMARY

- Preliminary figures show take up of industrial and logistics units (over 50,000 sq ft) totalled a record 30.8 million sq ft in H1 2021, double that recorded in H1 2020.
- Retailers and distribution firms (including 3PLs) have dominated take up so far this year, collectively accounting for 76% of space taken (in units over 50,000 sq ft).

RECORD LEVELS OF TAKE UP

Preliminary figures for H1 2021 show 30.8 million sq ft of take up (units over 50,000 sq ft). Distribution firms and online retailers continue to take space as they expand their online and home delivery capacity. Retailers and distribution companies collectively accounted for 76% of take up so far this year.

Online sales accounted for 28% of retail spend in 2020, up from 19% in 2019, and in the first five months of 2021, this rose to 32%. As lockdown measures ease further in the second half of the year, the proportion of internet sales will decline, yet online platforms will continue to play a much bigger role in the retail market than they did pre-pandemic and this will necessitate more structural changes in retail supply chains.

Online retail sales are forecast to rise over the next few years. The rest of 2021 will see continued demand driven by long term strategic planning from operators, bringing forward their e-commerce growth strategies.

MANUFACTURING DEMAND RISING

The Covid-19 pandemic and associated economic uncertainty weighed heavily on the UK manufacturing sector in 2020. Manufacturing orders dropped sharply, supply chains were disrupted and some production lines were shut-down. Brexit only added to the worries for many manufacturing firms and expansion or relocation plans were put on hold.

However, many manufacturing firms have seen a reversal in fortunes in H1 2021 and this has led to an uptick in take up. Manufacturing firms have accounted for 19% of take up in the first half of 2021.

NEW SOURCES OF DEMAND

In the first half of the year, electric vehicle manufacturers LEVC and Arrival both took additional space. Arrival recently expanded their existing base at Axis 9 in Bicester. London Electric Vehicle Company (LEVC) agreed a lease on 166,000 sq ft at DC5, Prologis Park Ryton, Coventry. Both Arrival and LEVC focus on the production of electrically-driven vehicles for the commercial sector, with firms increasingly demanding smarter, more sustainable fleet vehicles.

There have been other growing sources of occupier demand, such as film studios. Both Warner Brothers and Garden Studios have taken space in London and the South East in the first half of 2021. The media sector has also been a growing source of demand in Wales, with Great Point Media and Urban Myths Filming both taking space last year.

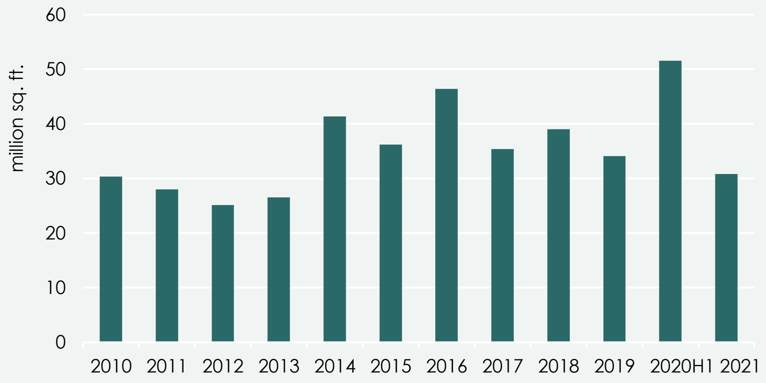
Construction industry producers and suppliers have also been active in acquiring space so far this year.

76%

take-up by **retailers and distribution companies** in H1 2021

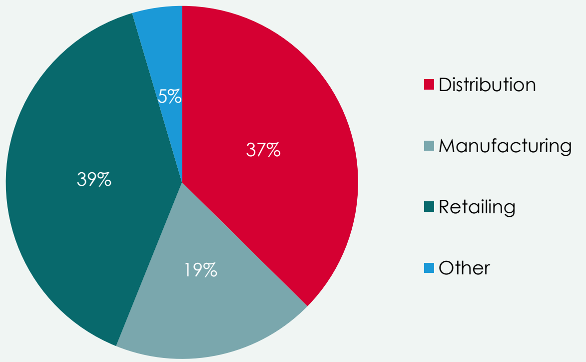
Source: Knight Frank

Take up (units over 50,000 sq ft)



Source: Knight Frank

Take up by occupier type H1 2021 (units over 50,000 sq ft)



Source: Knight Frank

RISING BUILD COSTS HAMPERING SUPPLY

“Low levels of availability will dampen occupier market activity in H2 2021”

Supply is currently tight and occupier demand is encouraging development activity. However, shortages of construction materials is driving up build costs and some developers and occupiers are being forced to postpone starting or completing schemes.

Due to robust levels of take-up, the level of availability, particularly of high quality space, has diminished over the past 18-months. Preliminary Q2 2021 figures show there is currently just 43 million sq ft of existing space currently available. This represents just 8.4 months of supply (based on current rates of take up), and much of this space is either under offer or does not meet current occupier requirements in terms of locations or specification.

There is a further nine million sq ft of space currently under construction on a speculative basis, but even with this, supply remains highly constrained. Lack of availability is particularly acute in the big box market, occupiers looking for units in excess of 350,000 sq ft are faced with very limited options.

Occupiers struggling to find existing units that match their requirements must either compromise in terms of location or specification; look to secure a pre-let; or look to build-to-suit options. Occupiers unwilling to compromise may need to put their expansion or relocation plans on hold as they await development completion.

9.0m sq ft

of speculative development

under construction and available H1 2021

Source: Knight Frank

LONG LEAD TIMES AND RISING PRICES

Delivery times for construction materials have increased sharply as supply chains struggle to keep pace with demand. Developers are having to reconsider their construction programmes to take into account longer lead times for materials, particularly cladding. Some are choosing between starting work later, to match the later delivery of cladding and other steel products, or adopting a stop-start construction programme.

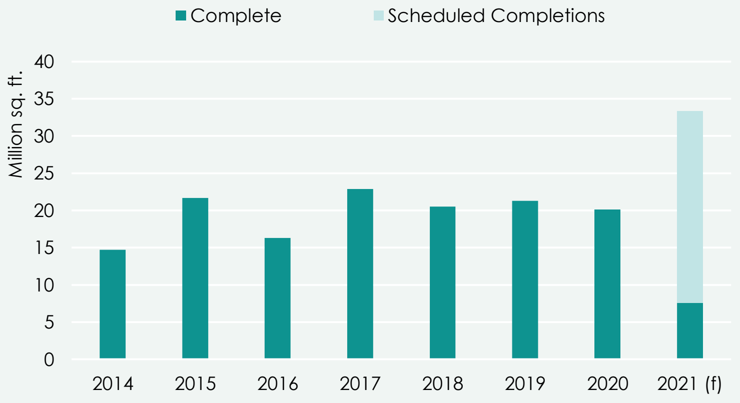
High demand coupled with supply shortages has led to steep price rises for construction materials in recent months. Steel, timber, cement, aggregates and plastic are among the products that have been on the Construction Leadership Council’s list of products facing supply constraints. They have warned that the ongoing construction materials shortage is set to continue and prices could keep rising.

Data released by The Department for Business, Energy & Industrial Strategy (BEIS) this month showed the price of fabricated structural steel increased 13.5% between March and April and prices are up 31.8% in the year to April 2021. The price of concrete reinforcing bars (rebar) has risen 37.3% over the past year.

The Metal Cladding and Roofing Manufacturers Association (MCRMA) has reported that lead time have been extended over recent months and prices have increased accordingly. While delivery times have gone from weeks to months, the cost of basic galvanised steel cladding has risen 50% over the past six months.

The total amount of space under construction, scheduled to complete this year has dropped over the past few months as expected completion dates are pushed forward into next year, construction starts postponed or schemes are put on hold. With the materials shortage set to continue, further delays are likely, and the amount of space scheduled to complete in the second half of 2021 is expected to decline further.

Development completions (units over 50,000 sq ft)



Source: Knight Frank, Glenigan

INVESTMENT MARKET – H1 2021 SUMMARY

- A record £6.0 billion was invested in the industrial and logistics sector in H1 2021 (preliminary figures), more than double the level recorded in H1 2020 and 54% higher than the previous H1 record set in 2018.
- Portfolio deals totalled £2.0 billion in H1 2021, representing one third of the total transacted.

INVESTMENT MARKET ACTIVITY

Strong occupier market dynamics continue to drive activity in the investment market. Investment into UK industrial and logistics totalled a record £6.0 billion in H1 2021, more than double the £2.7 billion recorded in H1 last year and up 54% on the previous record H1 in 2018.

Overseas investors have accounted for just over half of the total spend so far this year. This is higher than in previous years, in 2020 overseas investors represented 44% of investment and 38% in 2019. While buyers from the US continue to dominate, there has been a rise in capital coming from Middle Eastern investors. In February, Bahraini Investcorp acquired a portfolio of industrial assets in South Wales for £69 million.

The favourable structural trends in the online retail market and robust occupier market are also attracting new sources of capital to the UK logistics market. Investors that have traditionally focused on retail and office are increasingly seeking to diversify their holdings and tilt their portfolio towards logistics. For example, British Land recently announced a shift in their strategy, seeking to target fulfilment and urban logistics. They acquired their first logistics asset, a Waitrose fulfilment centre located in North London for just under £90 million earlier this year.

PORTFOLIOS AND PLATFORMS

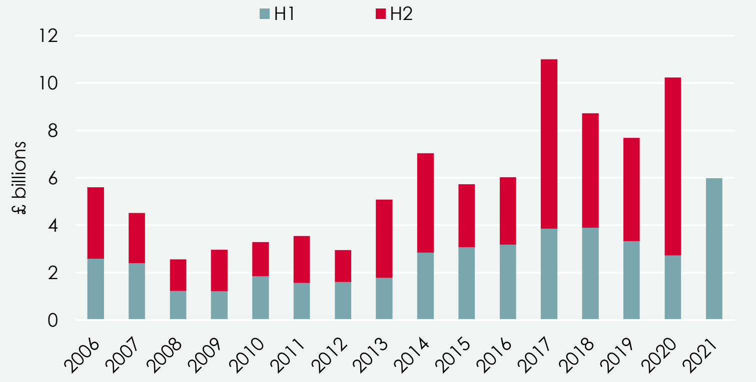
Portfolios have also been an important part of the investment market of late, accounting for a third of the total transacted in H1 2021, on a par with the level recorded in 2020 and up from 21% of the total in 2019.

Most individual industrial and logistics assets lack the scale required by institutional investors who look to deploy large amounts of capital through a single transaction. Bundling assets into a portfolio can provide institutional investors with the required lot size. One of the largest portfolio deals so far this year is the BentallGreenOak acquisition of seven assets located across the UK, for £303 million in February 2021.

Blackstone have been highly acquisitive in the first half of 2021. They are currently in the process of finalising a c.£1.27 billion take over bid of property development company St Modwens. Half its portfolio by value is focused on industrial and logistics assets, while the remainder is dedicated to housebuilding and regeneration projects.

Blackstone also acquired the Albion Portfolio from Westbrook Partners for £283 million in May 2021, and purchased the Vantage Portfolio from Infrared Capital Partners for £187 million for Mileway their European last mile logistics platform. Blackstone are currently in talks to acquire Asda's logistics portfolio for around £1.7 billion, the assets are to be sold on a sale-and-leaseback basis, on a 25-year full repairing and insuring lease (FRI) lease, yielding 4%.

Industrial & logistics - Investment total



Source: Knight Frank, Property Data

Key Investment Deals – H1 2021

Property	Price (£ million)	Purchaser	Vendor	Yield
Logistics Portfolio (seven assets)	303.00	BentallGreenOak	Morgan Stanley Real Estate & Thor Equities	5.50%
Jaguar Land Rover, Solihull	132.50	W.P Carey	Prologis	5.12%
Waitrose & Crown Records, Enfield	87.25	British Land	M&G	2.18%
Amazon, Bardon	160.00	Savills Investment Management	Vestas Investment Management	3.94%
Amazon, Hinkley	104.50	Aberdeen Standard	IM Properties	3.10%
John Lewis, Milton Keynes	109.85	Deka Investments	Lime Property Fund	3.75%

Source: Knight Frank

INVESTOR COMPETITION DRIVING UP PRICING

- Returns for UK industrial and logistics are forecast to outpace those on offer in other real estate sectors and investors are eager to increase their allocations to the sector.
- Industrial and logistics yields have compressed 25-100 bps over the past year. Prime distribution assets offering 15-year income are currently yielding just 4%, on a par with City Prime offices (offering 10-year income).

COMPETITION DRIVING UP PRICING

The investor base targeting industrial and logistics assets is broadening, demonstrating the wide appeal of the sector. Investors seeking secure long income continue to be drawn to prime assets underpinned by strong covenant tenants. There is strong competition amongst core-plus and value-add investors however, which is driving up demand and pricing on secondary assets.

Prime distribution assets offering 15-year income with open market rent reviews are yielding 4.00% (down from 4.25% a year ago). Yields for prime distribution providing 20-year income (with fixed uplifts or indexation) are now just 3.25%, down from 4.00% a year ago.

Competition for secondary assets has led to yields narrowing over the past year, secondary distribution yields are now 4.50% having recorded 100bps compression over the past year and secondary estates have come in 75bps to 5.50%.

TARGET LOT SIZE

The average lot size transacted in the first half of 2021 was £20.2 million, an increase from £17.9m in 2020 and £11.9m in 2019. The increase in activity from overseas investors as well as acquisitions from UK Institutional investors pushed up the average lot size transacted.

40% of the investment total in H1 2021 was in the £100m+ size band, demonstrating the appetite for transactions offering scale. There has also been an increase in activity in the £30-40m lot size band and the £20-30m lot size band. A rising number of funds are targeting opportunities of this size.

IS THE FLIGHT TO CORE OVER?

The attractive risk/return profile of the sector continues to draw investors seeking core assets. Despite yield compression, core logistics assets offer an income and risk profile that is difficult to match in other real estate sectors and continues to deliver a premium over gilts.

Underpinned by structural trends in the e-commerce market, a limited supply of high quality assets and robust occupier demand, the logistics sector continues to offer strong appeal to long income investors. High quality distribution facilities can offer secure and often inflation-linked income through strong covenants on long leases.

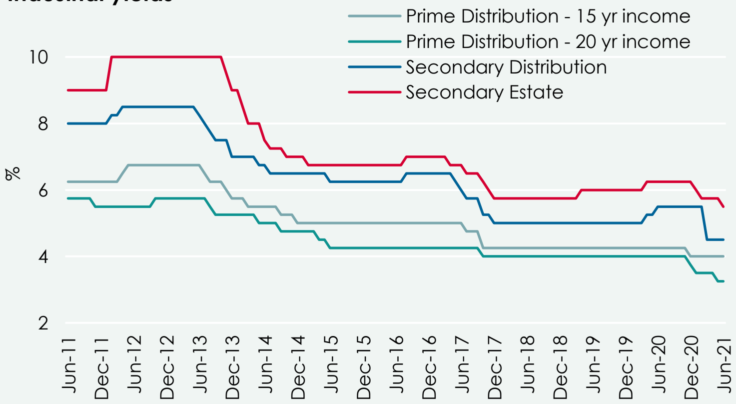
ADDING THE PLUS TO CORE+

As pricing at the prime end of the market sharpens, an increasing number of investors are seeking returns further up the risk curve. The average weighted yield for distribution assets transacted in H1 2021 was 5.0%, up slightly from 4.8% in 2020.

There is rising competition for assets fitting a core+ investment profile. However, how investors perceive risk will influence how they add the plus to a core strategy and thus drive their asset selection.

Investors are looking to assets that have some level of risk, whether that is location risk, leasing risk or a need for improvement/refurbishment in order to drive higher returns. Some investors will favour strong locations with assets that offer potential for improvement/refurbishment or short lease lengths. Other investors may seek out locations where they anticipate rising demand and future rental growth.

Industrial yields



Source: Knight Frank

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