MULTI-LET INSIGHT SERIES

The definitive guide to the
UK's multi-let industrial property market

ISSUE 2 – INCOME

Summer 2020

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INTRODUCTION

Multi-let is Gerald Eve's unique and market-leading syndicated study that provides detailed industry-reference insight into this rapidly changing commercial property segment.

The results are built from the bottom up, using individual tenancy information from 22 leading multi-let industrial institutional property investors. The information spans 11 years, covering over 30,000 individual assets with a sample size in 2019 of 131 million sq ft, valued at £18bn.

This report covers industrial units of over 500 sq ft with a maximum lease length of 30 years.

Units between 500 sq ft and 50,000 sq ft in size are collectively referred to as the multi-let dataset and comprise of:

Micro units
500-5,000 sq ft

Small box units
5,001-25,000 sq ft

Mid box units
25,001-50,000 sq ft

Units larger than 50,000 sq ft are also included in this edition for the first time as a point of comparison to multi-let.

This is Issue 2 of a series of five reports:

Issue 1
Occupiers

Issue 2
Income

Issue 3
Risk

Issue 4
Investment

Issue 5
Outlook

CONTRIBUTORS


dpd
YJ65 WWE

EXECUTIVE SUMMARY

Valuer appraisals of multi-let continued to be strong in 2019 and ERVs increased year-on-year across all geographies. The average ERV in London & the South East is now valued at £11.28 per sq ft, over twice as much as the £5.59 per sq ft average in the rest of the UK.

Inner London ERVs are not only the highest valued multi-let space but also have the strongest 5-year average annual growth rate – almost double that in the South East. This is particularly the case for the highest value Inner London micro units, which have increased by over 12% on average per year and were valued at £18.72 per sq ft in 2019. This reflects the rapid change of use to high value food and retail direct to densely populated urban households.

Outside of the South East, the regions can be split into three groups in terms of ERV growth. The Midlands and the South West have been the strongest, with over 5% growth per year on average. Wales, Scotland and the North East have been the weakest, with between 2% and 4% growth per year on average.

The breakdown of unit size shows that progressively larger units are valued at progressively lower ERVs. Consequently, the lowest valued space is for the larger 50,000 sq ft+ units in Wales, which have an average ERV of only £2.64 per sq ft.

The highest valued micro unit ERVs in London & the South East have pulled away from the lower valued small box and, particularly, the mid box units over the past five years. In contrast, outside of the South East mid box unit ERVs have increased the most strongly. Regional micro units contain many low value Individuals occupiers, contributing to lower ERV growth, bringing the range of values across unit size brackets here closer together.

The value of incentives across all geographies continued to trend downwards in 2019 and are generally in low single digit percentages of ERVs. Underrentedness is where there are differences. Inner London units may have the highest ERVs, but they were also the most underrented in 2019, at 19%. At 12%, London & the South East underrentedness edged down and may have reached a turning point. Multi-let outside of the South East has an underrentedness of only 6.6% but continued to trend upwards.

By business activity, food-related activity and logistics used for last mile parcel and post in London & the South East occupy the highest valued multi-let space. Regions outside of the South East are lower income and less densely populated so this is less of a factor. In-house logistics and quasi-office-occupied multi-let space commands the highest ERVs. Leisure operators, general manufacturing tenants and individuals tend to occupy the lowest-valued multi-let space across all UK regions.

Food-related tenants and logistics operators in London & the South East received the greatest discounts to ERV in 2019. Outside of the South East, the on-site servicing tenants (overwhelmingly automotive) get a relatively high discount to ERV – potentially through tenant collusion. Leisure operators and food manufacturers get more upfront rent concessions as a discount, potentially for fit out reasons. Individuals with no bargaining power are far more ubiquitous in the regions and get the lowest rental discounts in multi-let.

Tenancy lengths and the time to break continued to trend downwards in London & the South East in 2019 and were 7.3 years and 4.4 years, respectively. In the regions the length of income is lower but continues to be stable at around 6 years. Leisure operators commit to the longest income, potentially due to their degree of fitout.

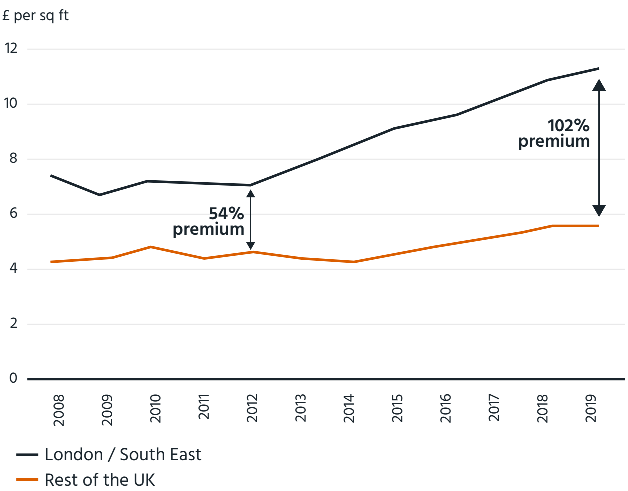
ERVS BY REGION

Valuer appraisals of multi-let continued to be strong in 2019 and ERVs increased year-on-year across all geographies. In London & the South East the rental increase was sufficient to push the average premium over the Rest of the UK to over 100% for the first time on record. The average ERV in London & the South East is now valued at £11.28 per sq ft, over twice as much as the £5.59 per sq ft average in the Rest of the UK.

The split by specific region below shows the significantly higher valuations for Greater and Inner London, which were valued at an average of £12.91 and £15.50 per sq ft at the end of 2019, respectively.

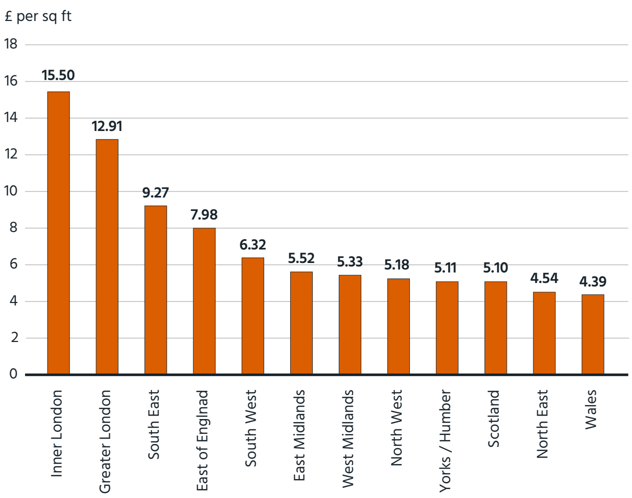
ERVs by major UK region

Source: Gerald Eve



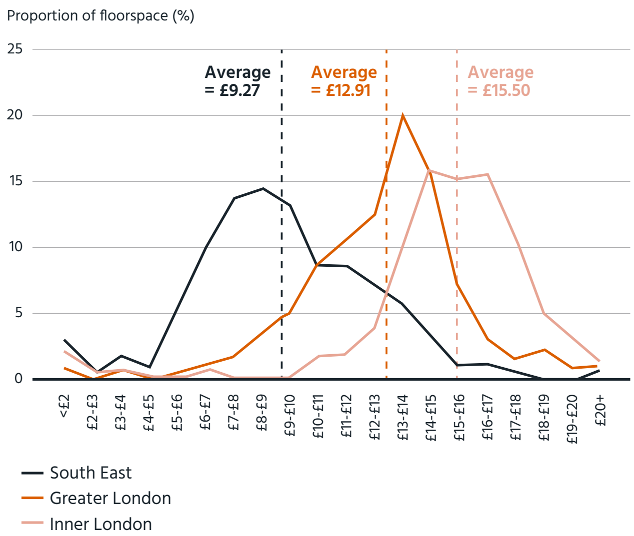
Multi-let ERVs by region

Source: Gerald Eve

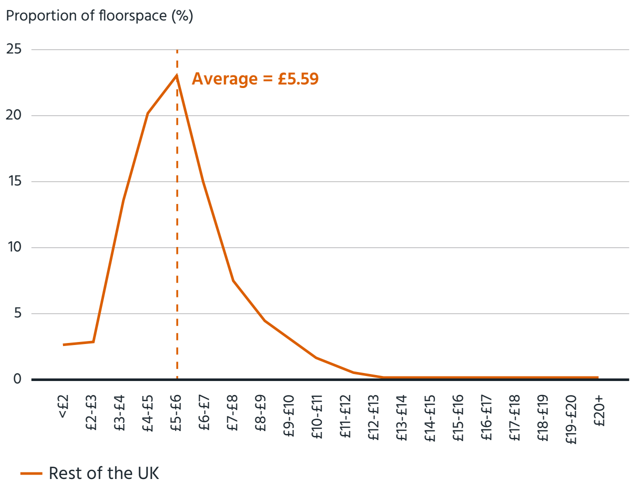


The distribution of ERV by floorspace shows that the London & South East markets cover a broad range of valuations, whereas in the rest of the UK the variation is narrower, with a large majority of ERVs between £3 and £8 per sq ft.

ERV distribution by South East region
Source: Gerald Eve



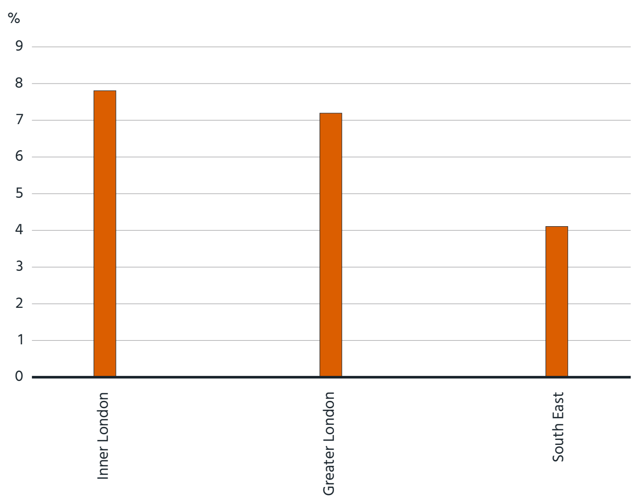
ERV distribution – Rest of the UK
Source: Gerald Eve



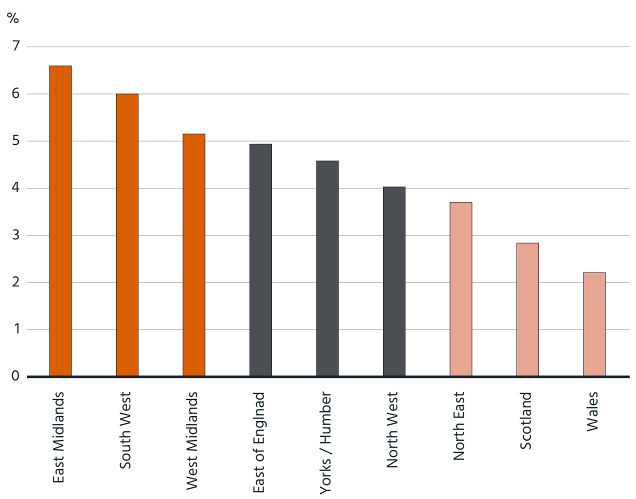
Inner London ERVs have the strongest 5-year average annual ERV growth rate in multi-let, at 7.8%. Rental growth in the South East has been only just over half as strong over this period.

Outside of the South East, the regions can be split into three groups. The Midlands and the South West have been the strongest, with over 5% growth per year on average over the past five years. Wales, Scotland and the North east have been the weakest, with between 2% and 4% growth per year on average.

ERV average annual growth rate, 2014-19
Source: Gerald Eve



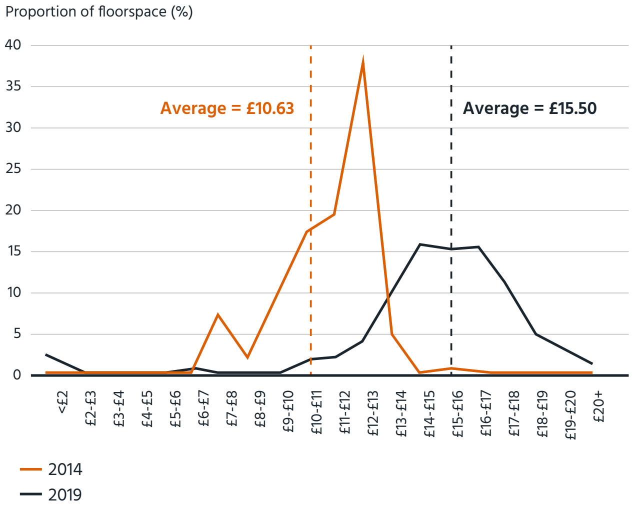
ERV average annual growth rate, 2014-19
Source: Gerald Eve



The ERV distribution charts show the changes from 2014 to 2019. The London markets stand out as not only having the strongest growth, but also the most significant change to the shape of the distribution. ERVs at the higher end have pulled away and have stretched the distribution to account for the newer, most gentrified high value purposes such as direct retail, artisan food & drink and last mile logistics.

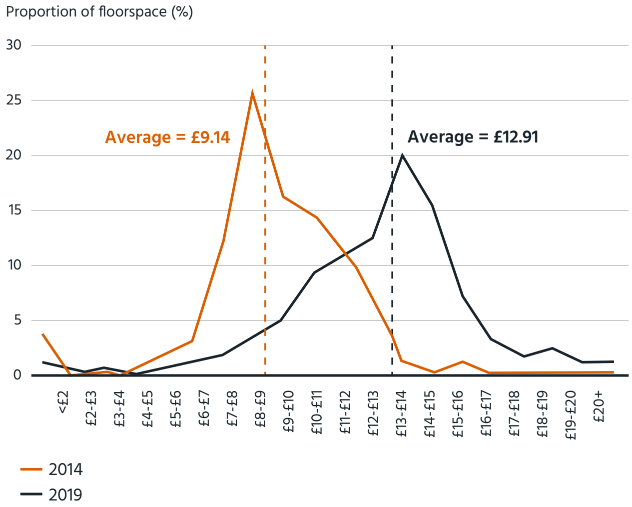
Inner London ERV distribution

Source: Gerald Eve



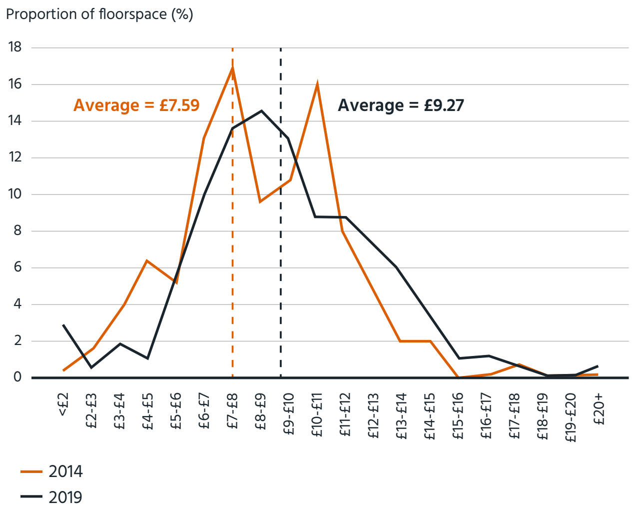
Greater London ERV distribution

Source: Gerald Eve



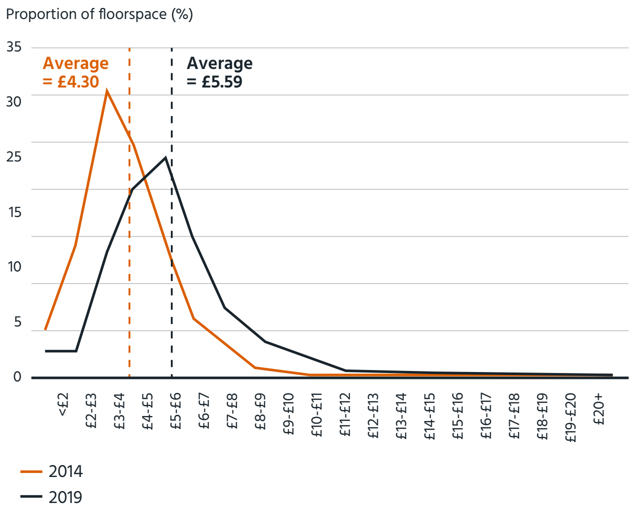
South East ERV distribution

Source: Gerald Eve



Rest of the UK ERV distribution

Source: Gerald Eve




jensen
HIVER BEERS
Hiver.
AND FRIENDS
HIVER BEERS
BERMONDSEY ST BEES
ALL GOOD BEER
jensen's
LONDON'S BEST GIN
ALL DRINKS MUST BE CONSUMED INSIDE!

ERVS BY UNIT SIZE

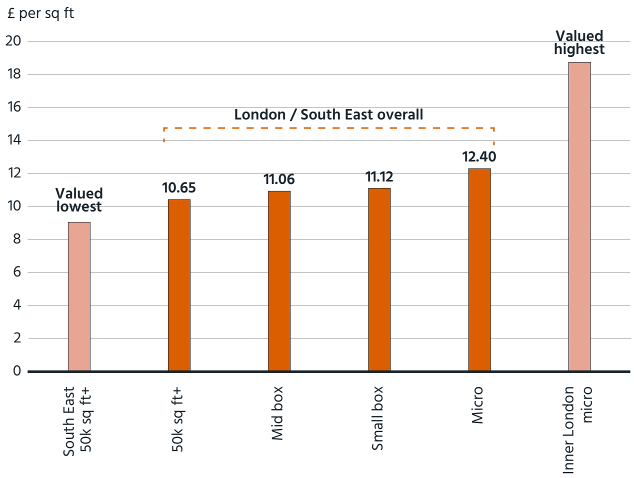
The breakdown of unit size shows that the smallest micro units have the highest ERVs and progressively larger units are valued at progressively lower ERVs.

Unsurprisingly then, the very highest valued multi-let space is by far is for the micro units in Inner London, at £18.72 per sq ft.

The dynamics for the different unit sizes in London & the South East and in the Rest of the UK are not the same. In London & the South East ERVs on the expensive micro units have pulled away from the others, with an average 7% growth per year. The ERV growth for mid box units has been significantly lower, at 3.9%.

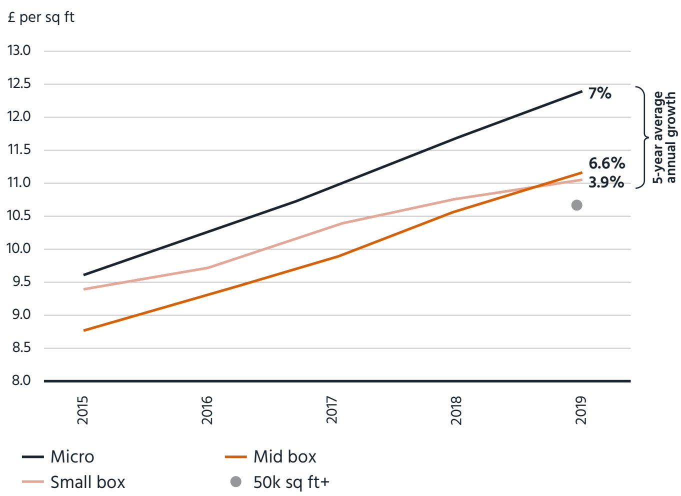
London / South East ERVs

Source: Gerald Eve



ERVs in London / South East by size of unit

Source: Gerald Eve

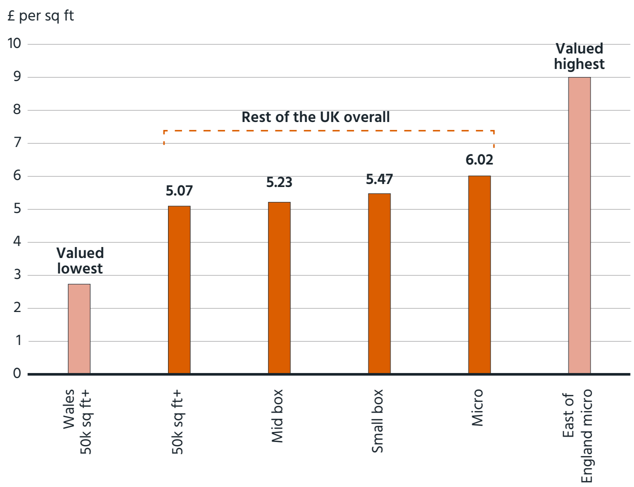


The highest ERVs in the Rest of the UK are the micro units in the East of England, at £8.99 per sq ft, though it is worth noting that the government office region for the East of England includes many locations directly north of London that may colloquially be considered South East in the industrial market. The lowest valued space is for the larger 50,000 sq ft+ units in Wales, which is an average of only £2.64 per sq ft.

In the Rest of the UK the growth rate hierarchy is the reverse - the larger units have had a stronger average ERV growth rate over the past five years, causing the various valuations to move closer together somewhat. Issue 1 showed how regional micro units contain a high proportion of Individuals – the very smallest and most vulnerable multi-let occupiers that potentially have not driven as much value for the smaller units.

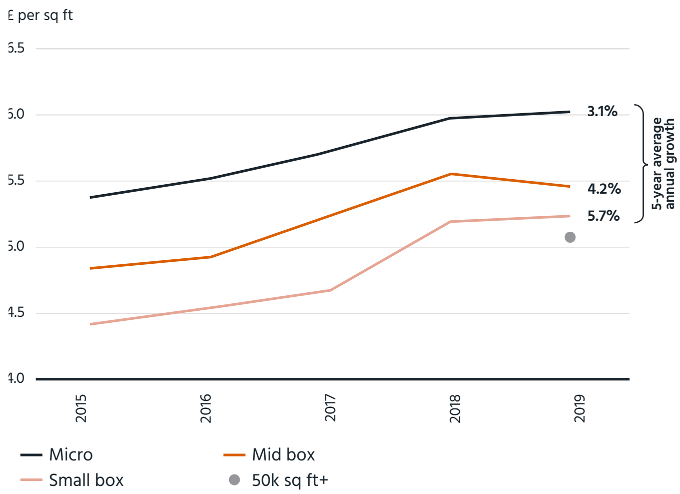
Rest of the UK ERVs

Source: Gerald Eve



ERVs in the Rest of the UK by size of unit

Source: Gerald Eve

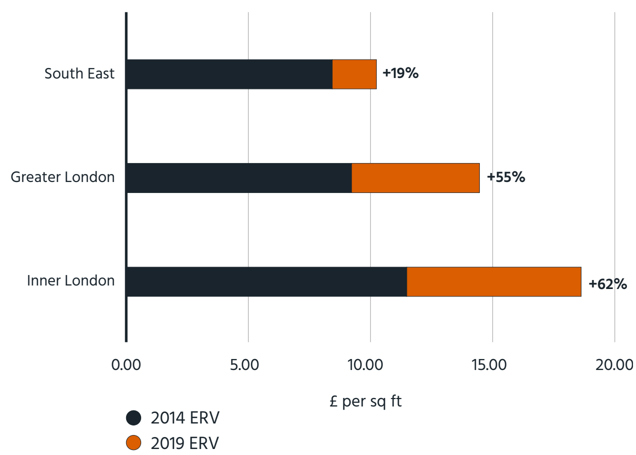


The strongest ERV growth over the past five years was achieved in that combination of the most expensive area – Inner London – and the most expensive micro unit size. Inner micro unit ERVs increased by an enormous 62% between 2014 and 2019, compared with 55% in Greater London and only 19% over the same time period in the South East.

As multi-let has gentrified over the last several years, it appears that it is the micro Inner London units in particular that have been able to capture the increase in high value uses – namely the food and retailing operations direct to the densely-populated high income urban households identified in Issue 1.

Micro unit ERVs and cumulative growth 2014-19

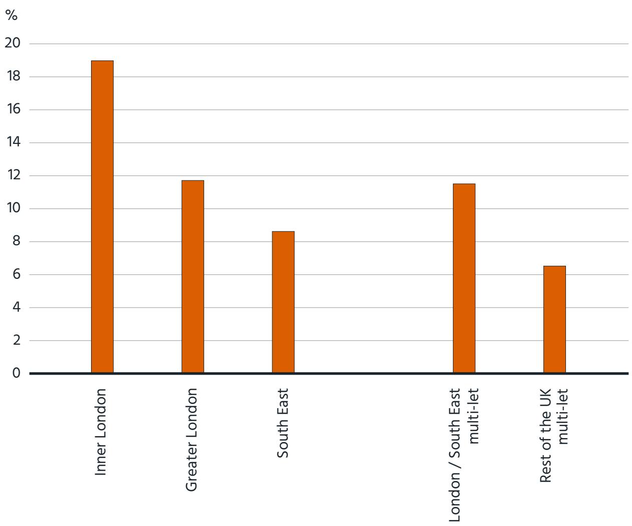
Source: Gerald Eve



UNDERRENTEDNESS AND INCENTIVES

Market valuations is one aspect of the multi-let rental growth story, but how are these achieved in practice? Comparing average ERVs and average contracted rents shows that Inner London units may be valued the highest, but they were also the most underrented in 2019, with a 19% difference between ERV and contracted rents. At the other end of the spectrum, the relatively lower valued Rest of UK multi-let has an underrentedness of only 6.6%.

Underrentedness by geography (contracted rent discount to ERV)
Source: Gerald Eve

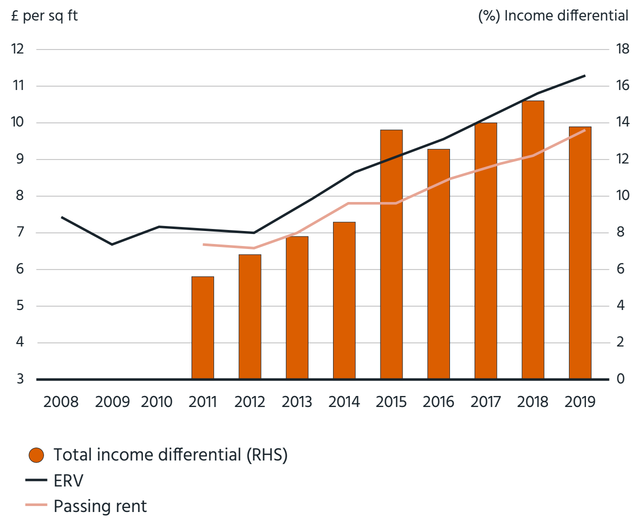


In terms of dynamics, the charts opposite show ERVs and passing rents, and the percentage spreads between the two. This shows the discount – or reversion – to ERV and the proportion that is due to either underrentedness or the use of rental incentives.

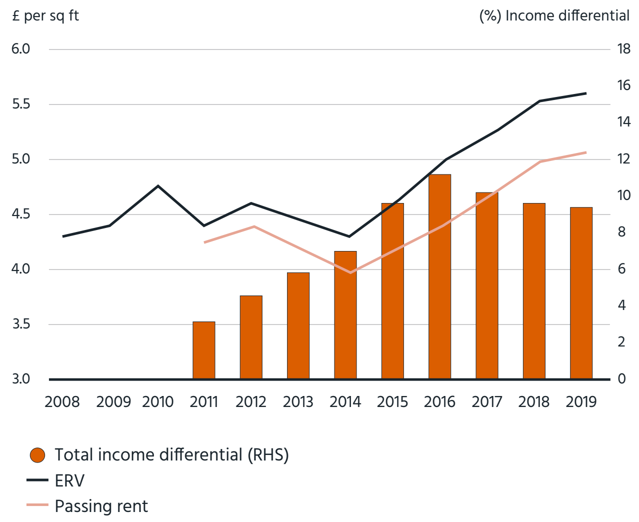
From the columns it is evident that London & the South East has a much larger total spread between ERVs and passing rents – in the mid teens percent as opposed to below 10% for the UK regions. The further breakdown into the types of discount show that the discount from incentives have been trending downwards and are relatively small – in the order of 2%-3% of ERVs.

The real difference between the two major geographies is due to underrentedness. In the Rest of the UK underrentedness is lower and but continued to trend upwards. In London & the South East underrentedness is higher but may possibly have reached a turning point as it actually fell in 2019, helping to bring the overall average passing rent slightly closer to the average ERV.

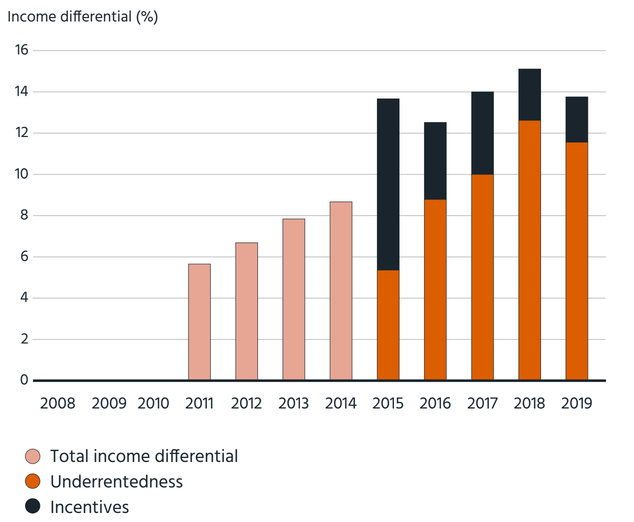
London / South East ERV vs passing rent
Source: Gerald Eve



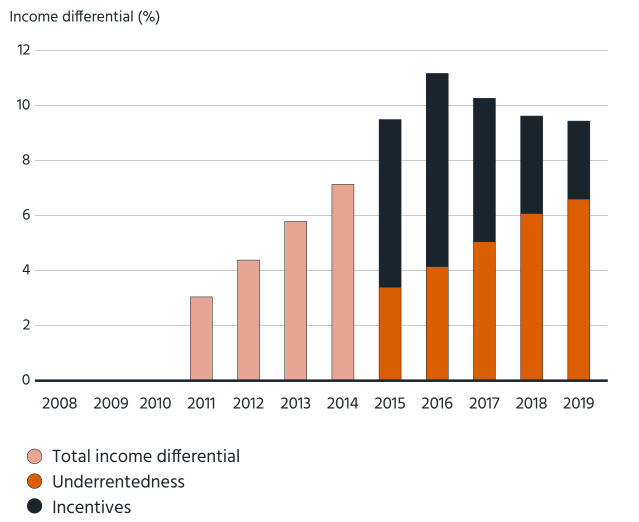
Rest of the UK ERV vs passing rent
Source: Gerald Eve



London / South East breakdown of income differential
Source: Gerald Eve



Rest of the UK breakdown of income differential
Source: Gerald Eve



ERVS BY OCCUPIER TYPE

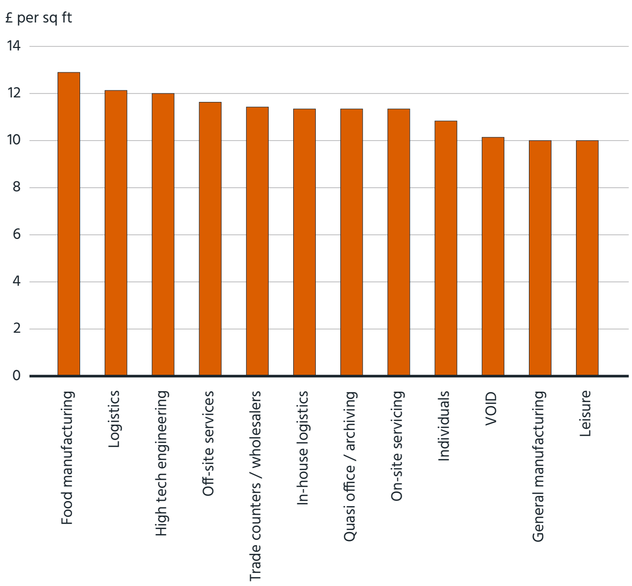
By business activity, the high proportion of food-related activity in the micro units of Inner London show up here as occupying the highest valued multi-let space. Logistics used for last mile parcel and post are closely behind.

In the lower income and less densely populated Rest of the UK, the food and third party logistics activity is not so high value and it is the in-house logistics and the quasi-office occupied space that is valued the highest. Outside of the South East voids are on average valued notably lower than the occupied space, which suggests some of this is more structural void in some of the more disadvantageous locations.

Leisure operators, general manufacturing tenants and individuals tend to occupy the lowest-valued multi-let space across all regions in the UK.

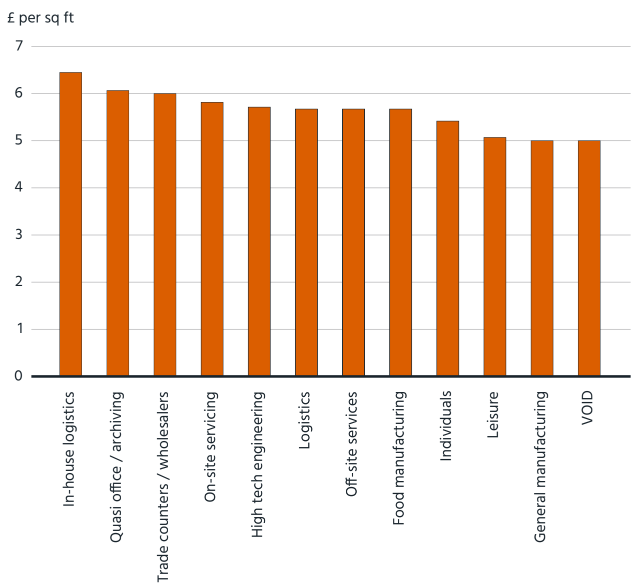
London / South East ERVs by business activity

Source: Gerald Eve



Rest of the UK ERVs by business activity

Source: Gerald Eve



UNDERRENTEDNESS AND INCENTIVES BY OCCUPIER TYPE

The breakdown of discount – or reversion – by occupier business activity reveals that the food-related tenants and logistics operators in London & the South East had the largest discounts and were paying the smallest proportion of their ERV in 2019.

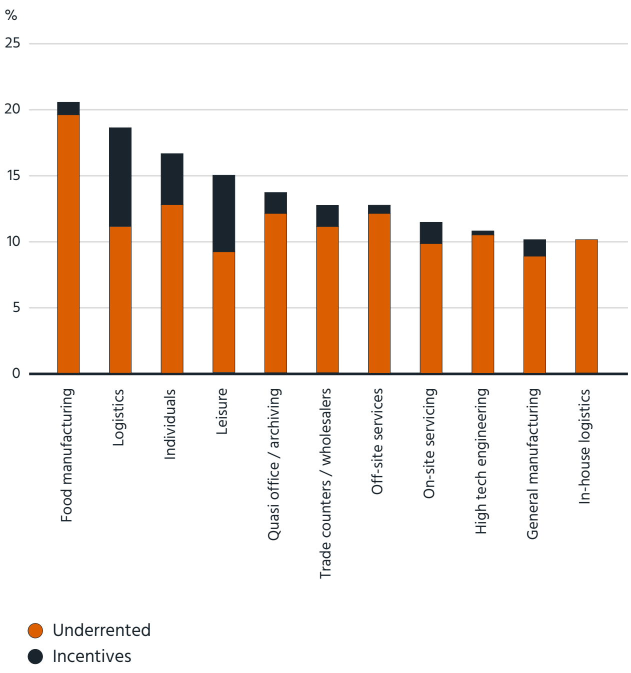
The Logistics firms obtained a relatively large proportion of the discount through incentives, shown in black. This is also the case for leisure operators across the UK and food manufacturers outside of the South East. This reflects the relatively small number of well represented large firms across multiple multi-let sites that can negotiate portfolio deals. In the case of the food manufacturers and leisure operators the upfront rent concessions could likely be tied to some of the upfront costs of fit out also.

As shown in Issue 1, Individuals are far more ubiquitous outside of the South East and ERV data show that the units they occupy have had the lowest growth. These tenants have no real bargaining power and get the lowest discounts in multi-let. The footprint of general manufacturers and the in-house logistics continue to be very much in decline in London & the South East, and these tenants also get some of the lowest discounts. The reverse is true for in-house logistics outside of the South East and these tenants get the greatest average discount.

Outside of the South East, the on-site servicing tenants (overwhelmingly automotive) also have a relatively high percentage discount to ERV. In previous research we proved that when these types of occupiers cluster together they tend to drive a lower passing rent and this has been confirmed by landlord anecdote that these types of occupiers more often tend to collude with each other to maximise discounts.

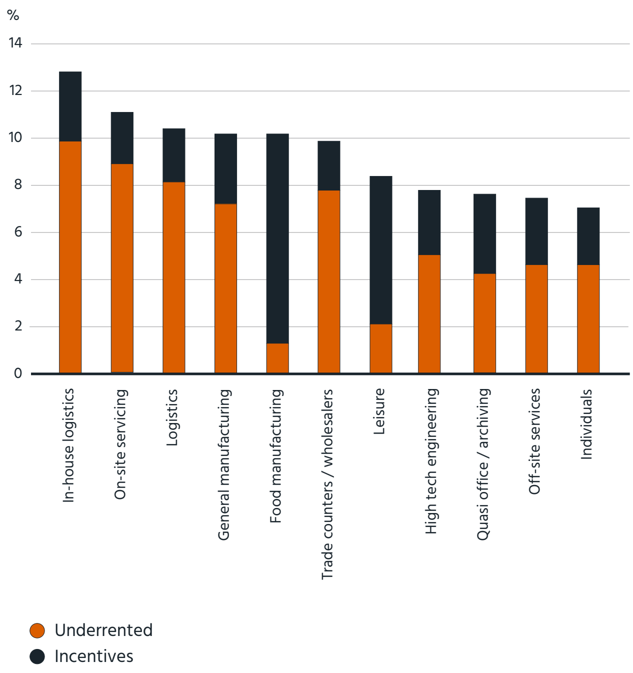
London / South East spreads to ERV by business activity

Source: Gerald Eve



Rest of the UK spreads to ERV by business activity

Source: Gerald Eve



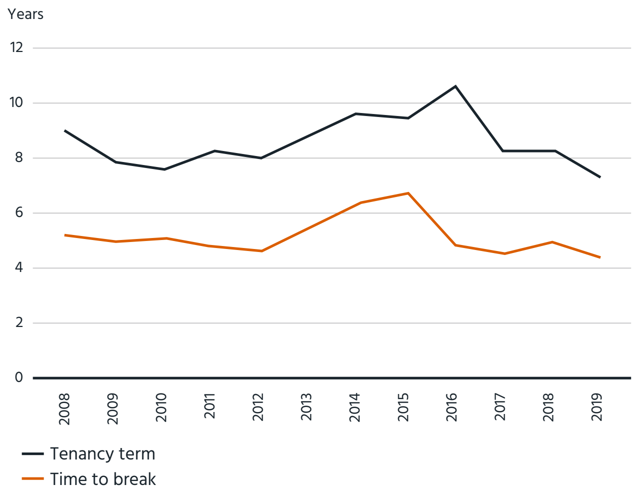
LENGTH OF INCOME BY REGION

In terms of length of income, both newly-signed tenancy lengths and the time to break continued to trend downwards in London & the South East in 2019, from a recent peak in 2015/16.

In the regions outside the South East the length of income is shorter than in the South East and the dynamic has been different. Income has been relatively stable at 6 years full term and around 3.6 years to break.

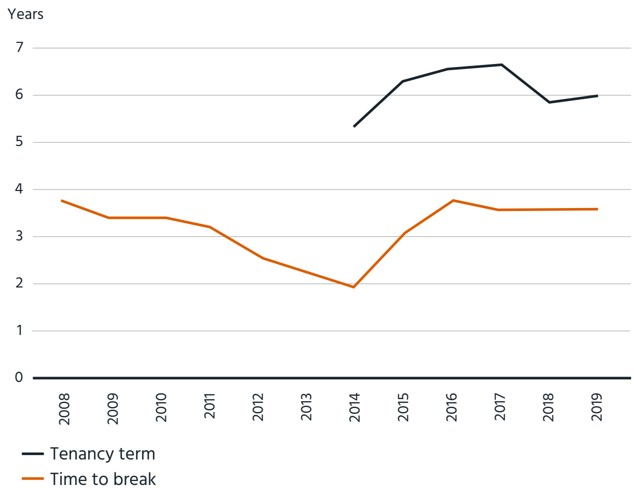
London / South East newly-signed income length

Source: Gerald Eve



Rest of the UK newly-signed income length

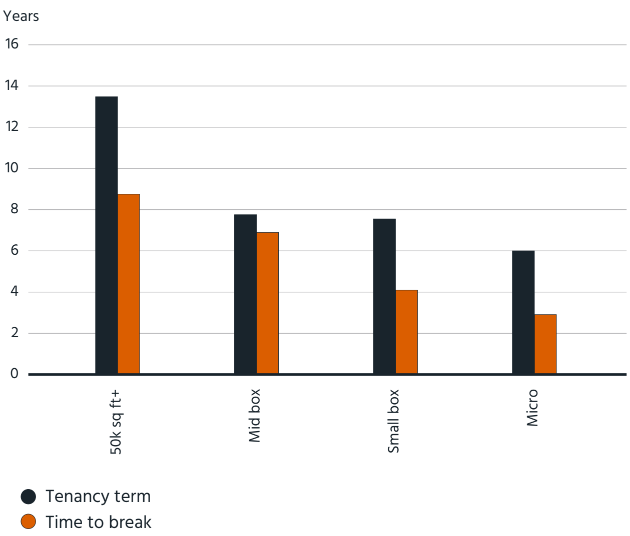
Source: Gerald Eve



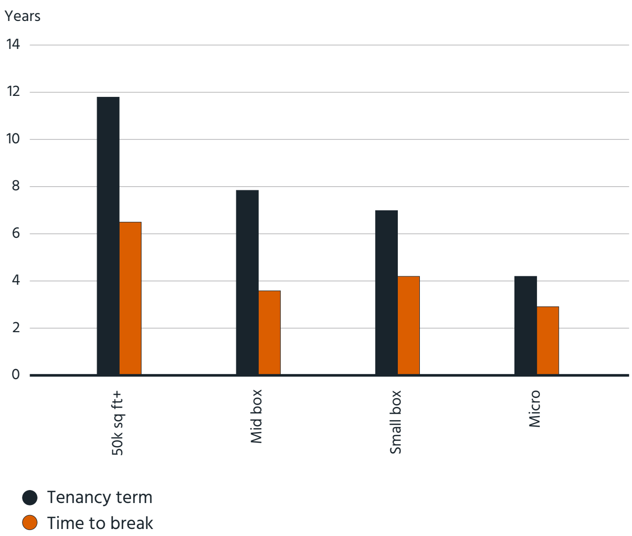
LENGTH OF INCOME BY UNIT SIZE

Across both geographies the larger units typically have a longer income. This is noticeably the case for the 50,000 sq ft+ units, with an average of over 13 years full tenancy term. Within multi-let, the mid box units in London & the South East have a relatively long time to break.

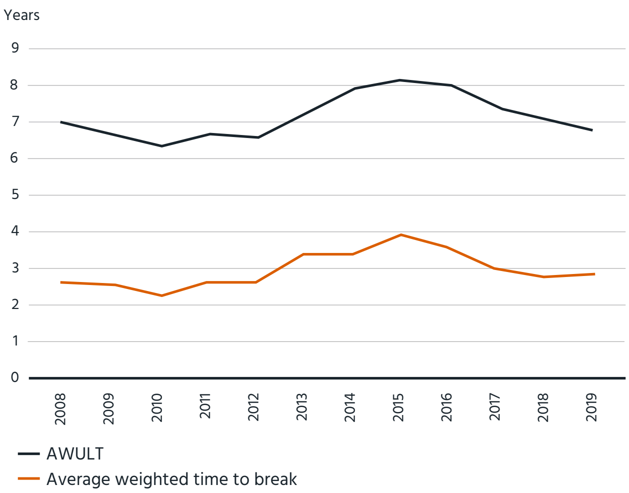
London / South East length of income by unit size
Source: Gerald Eve



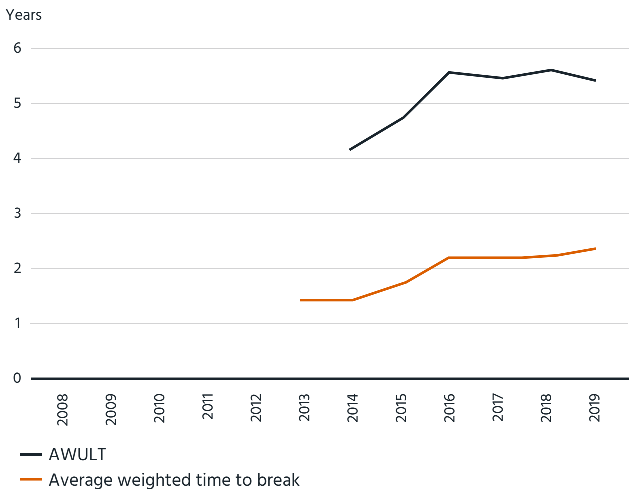
Rest of the UK length of income by unit size
Source: Gerald Eve



London / South East length of unexpired income
Source: Gerald Eve

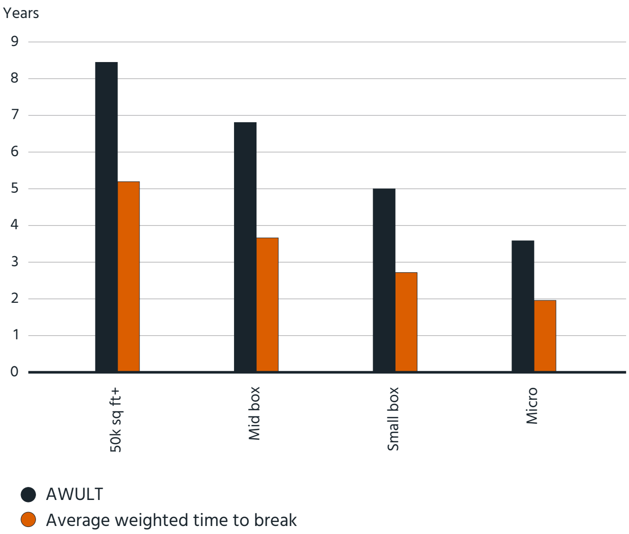


Rest of the UK length of unexpired income
Source: Gerald Eve



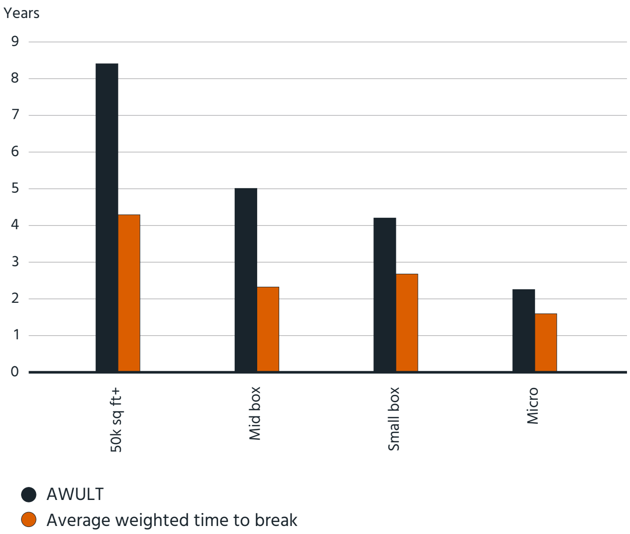
London / South East length of unexpired income by size of unit

Source: Gerald Eve



Rest of the UK length of unexpired income by size of unit

Source: Gerald Eve



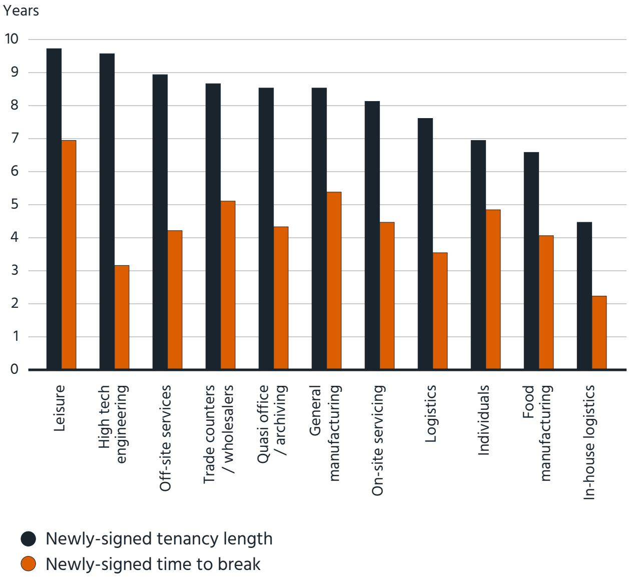
LENGTH OF INCOME BY OCCUPIER TYPE

The length of income breakdown by business type shows that leisure operators commit to the longest income – potentially in part due to the degree of fitout for some types of gym or trampoline centre operations. This business type also appears to prefer discounts to ERV in the form of upfront rent concessions rather than underrentedness so the longer lease could help accommodate that.

With regards to food – the differences in occupier activity in the two major UK regions are also reflected in the lease length. In London & the South East the income is relatively short – the proportion of direct-to-consumer completed meals is high and there is a more fragmented occupier base across many smaller units. The relatively long unexpired income suggests the relatively recent change to this kind of food activity and the length of income has come down. In contrast, outside of the South East the newly-signed income continues to be relatively long since these tenants occupy larger units for producing more staple foodstuffs.

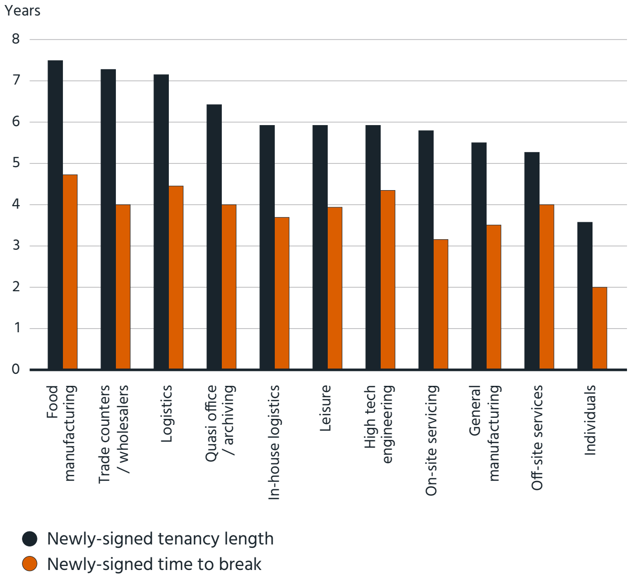
London / South East length of income by occupier type

Source: Gerald Eve



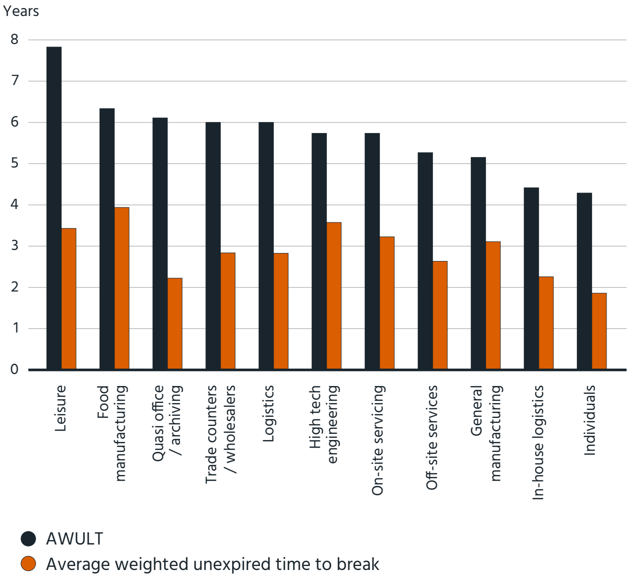
Rest of the UK length of income by occupier type

Source: Gerald Eve



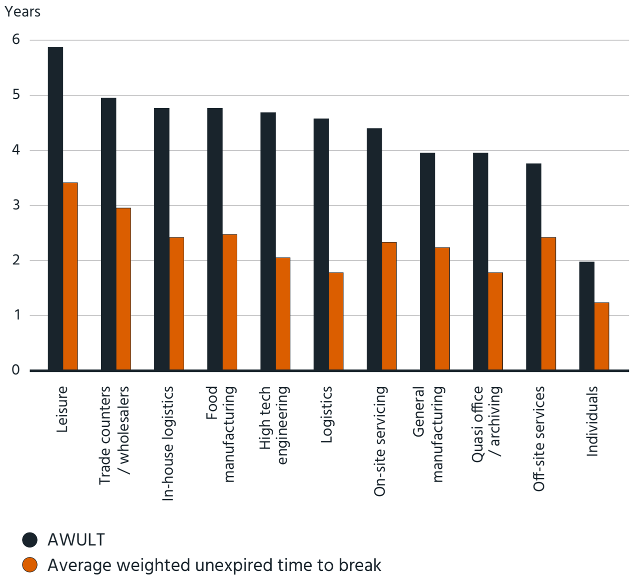
London / South East length of unexpired income by occupier type

Source: Gerald Eve



Rest of the UK length of unexpired income by occupier type

Source: Gerald Eve



GLOSSARY

STUDY DEFINITIONS

Multi-let industrial
For the purposes of this report, multi-let industrial covers industrial units between 500 and 50,000 sq ft in size on a lease up to 30 years in length located in the UK.

Multi-let industrial estate
An industrial estate usually under single ownership and comprised of different sized units let to multiple occupiers.

Multi-let industrial unit
An individual industrial unit situated in an industrial estate, usually let to one tenant.

Contributor
For the purposes of this report, reference to 'contributor' refers to the landlords or companies who have provided tenancy and valuation information which forms the basis of this study.

Regions
The location of each unit in the multi-let sample is assessed by individual postcode. This report aggregates up these individual postcodes into standard UK Government Office Regions, including Scotland and Wales. "Inner London" includes only the inner London postcodes (E, EC, N, NE, NW, SE, SW, W, WC).

OCCUPIERS

	Description	Examples
Trade counters/ wholesalers	Goods are stored and there is also some kind of on-site sales/retail function for visiting trade and/or the public.	Sellers of windows, doors, carpets, tiles, garden, tools, building supplies.
Retail & in-house logistics	Goods or equipment are stored but solely for the purpose of onward business (such as a retail store, sold remotely to an off-site location or for carrying out business operations). Non-public facing.	Internet retailers, department stores, utilities companies.
Logistics	Dedicated storage and distribution for a third party. Non-public facing.	Parcel and post/3PL
Food manufacturing	Production or processing of foodstuffs for humans or animals occurs on-site. Non-public facing.	Abattoirs, bakeries, breweries, cheese making, coffee roasting, dairies, meat/fish smoking/curing
General manufacturing	Production of relatively basic physical components or products occurs on-site. Non-public facing.	Fabricators, moulders. Includes waste/recycling.
High-tech engineering	Complex construction/ testing. Research and development. Non-public facing.	Incl. electronic, biomedical, nuclear, aerospace industries.
On-site servicing	Third party items are brought on-site by trade or the public for testing/repairing.	M.O.T./servicing, valeting, tyres and other vehicle/machine/ goods repair.
Off-site services	Services to business or residential offered off-site. Potentially a public facing element/small office on-site.	Shopfitters, joiners, builders, plumbers, electricians, scaffolders, machine/car hire.
Leisure	On-site offer of leisure goods and services to the public - typically fitness or play.	Gyms, sports training/ rehabilitation, soft play, trampoline warehouses.
Quasi office/ archiving	Ranges from storage of documents/data to full office or training centre functions.	Public sector bodies, data centres, designers, finance, solicitors, estate agents, employment agencies, call centres.
Individuals	Lease in the name of an individual and a company cannot be traced.	Potentially any of the above.

KEY TERMS

AWULT
Average Weighted Unexpired Lease Term. The product of currently contracted rental income between now (or, in this study case, the end of 2019) and the time the leases expire for any given tenant, summed across tenants, and then divided by the total annual income of the property or portfolio.

Capital value
The market value of an asset that could be reasonably expected to be paid in an open market.

Capital growth
The annual percentage increase in value of an asset.

Churn rate
Proportion of units where there is a change in occupancy between one year and the next (such as a unit let following vacancy, becoming vacant following a let, or a change of tenant). Measured as a % of OMRV.

Contracted rent
The annual rent stipulated in the lease contract. This might be above or below the OMRV if it is over or underrented.

Default rate
Leases in default are calculated by assessing whether a tenant under a contractual lease obligation is no longer in occupation. Expressed as a % of the OMRV total.

Econometrics
Mathematical and statistical analysis aimed to give empirical content to economic relationships. Seeks to exclude all other factors other than the issue at hand to try to isolate and quantify relationships.

ERV
Estimated rental value. A valuation estimate of what could be charged if the unit were let in the open market on the valuation date. This data has been provided by the contributing investors and funds for all units within the sample.

Incentives
This refers to the level of passing rent discount offered to occupiers as part of the lease agreement. Incentives in this report are measured as the differences between the contracted rent agreed and the actual passing rent received.

Income return
The annual compounded rate of net income receivable per year expressed as a percentage of the capital employed over the year.

MSCI
MSCI produce research-based indexes and analytics on the UK property market and are an independent benchmark of property investment market performance. MSCI data used in this report is the 2019 Annual Digest and reference to Standard Industrial refers to all industrials excluding distribution warehouse centres.

Overrented
A term used to describe when the contracted rent is above the open market rental value, which implies a negative reversion.

Passing rent
The annual rent actually paid, which may be more or less than the OMRV and equal to or less than the contracted rent.

Rack rented
Where the contracted rent (and potentially the passing rent) is equal to the OMRV. In a practical sense here, it is within 95%-105% of OMRV to rule out conversion and rounding errors, etc.

Rental growth
The annual percentage change in either the open market rental value, passing or contracted rent, as expressly defined.

Reversionary yield
A valuations-based yield estimate assuming a fully-let property with a rent equal to the ERV and capital value at the market rate at that point in time.

Time to first break
The time duration in months between the start date of a lease contract and the contract expiry or a break that a tenant can exercise, whichever is sooner.

Total return
The annual compounded rate of monthly capital appreciation, net of capital expenditure, plus monthly net income received expressed as a percentage of monthly capital employed.

Transacted yield
Average yields (weighted by capital value) recorded to have actually taken place in a transaction. This is in contrast to the valuations-based reversionary yield.

Underrented
A term used to describe when the contracted rent is below the open market rental value, which implies a positive reversion.

Void rate
The proportion of vacant floorspace, expressed as a percentage of the total.

CONTACTS

Agency

London
Mark Trowell
Tel. +44 (0)20 7333 6323
mtrowell@geraldeve.com

David Moule
Tel. +44 (0)20 7333 6231
dmoule@geraldeve.com

Josh Pater
Tel. +44 (0)20 3486 3473
jpater@geraldeve.com

Midlands
Jon Ryan-Gill
Tel. +44 (0)121 616 4803
jryan-gill@geraldeve.com

John Sambrooks
Tel. +44(0)121 616 4841
jsambrooks@geraldeve.com

Sam Skinner
Tel. +44(0)121 616 4843
sskinner@geraldeve.com

North West
Jason Print
Tel. +44 (0)161 830 7095
jprint@geraldeve.com

South West & Wales
Richard Gatehouse
Tel. +44 (0)29 2038 1863
rgatehouse@geraldeve.com

Scotland
Sven Macaulay
Tel. +44 (0)141 227 2364
smacaulay@geraldeve.com

Investment
John Rodgers
Tel. +44 (0)20 3486 3467
jrodgers@geraldeve.com

Nick Ogden
Tel. +44 (0)20 3486 3469
nogden@geraldeve.com

Callum Robertson
Tel. +44 (0)161 259 0480
crobertson@geraldeve.com

Lease Consultancy
Chris Long
Tel. +44 (0)20 7333 6444
clong@geraldeve.com

Ian Gascoigne
Tel. +44 (0)121 616 4812
igascoigne@geraldeve.com

Rating
Keith Norman
Tel. +44 (0)20 7333 6346
knorman@geraldeve.com

Valuation
Richard Glenwright
Tel. +44 (0)20 7333 6342
rglenwright@geraldeve.com

Research
Steve Sharman
Tel. +44 (0)20 7333 6271
ssharman@geraldeve.com

Ben Clarke
Tel. +44 (0)20 7333 6288
bclarke@geraldeve.com

Offices

London (West End)
72 Welbeck Street
London W1G 0AY
Tel. +44 (0)20 7493 3338

London (City)
Bow Bells House
1 Bread Street
London EC4M 9BE
Tel. +44 (0)20 7489 8900

Birmingham
45 Church Street
Birmingham B3 2RT
Tel. +44 (0)121 616 4800

Cardiff
32 Windsor Place
Cardiff CF10 3BZ
Tel. +44 (0)29 2038 8044

Glasgow
140 West George Street
Glasgow G2 2HG
Tel. +44 (0)141 221 6397

Leeds
1 York Place
Leeds LS1 2DR
Tel. +44 (0)113 204 8419

Manchester
No1 Marsden Street
Manchester M2 1HW
Tel. +44 (0)161 259 0450

Milton Keynes
Avebury House
201-249 Avebury Boulevard
Milton Keynes MK9 1AU
Tel. +44 (0)1908 685950

West Malling
35 Kings Hill Avenue
West Malling
Kent ME19 4DN
Tel. +44 (0)1732 229423