GERALDEVE

PRIME LOGISTICS

The definitive guide to the UK's distribution property market

Q2 2021 Bulletin

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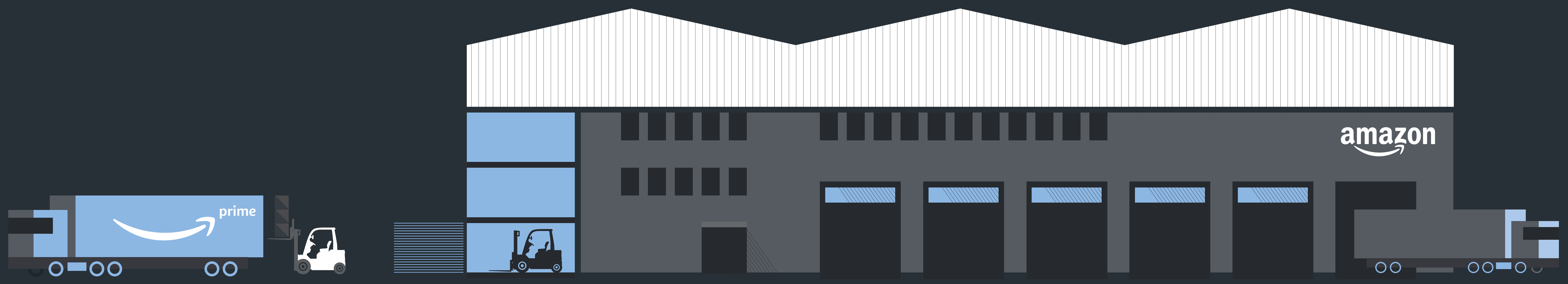


Q2 2021: MARKET OVERVIEW

Occupier demand for UK logistics is at a record high and supply is at an all-time low. Since the onset of the pandemic, speculative developers have responded, but any extra space has so far been absorbed by occupiers. Despite high land values and increased development costs, there is renewed emphasis on securing development land and planning activity is elevated. Rents are growing stronger than previously expected and we have upgraded our forecasts to reflect these acute market conditions.

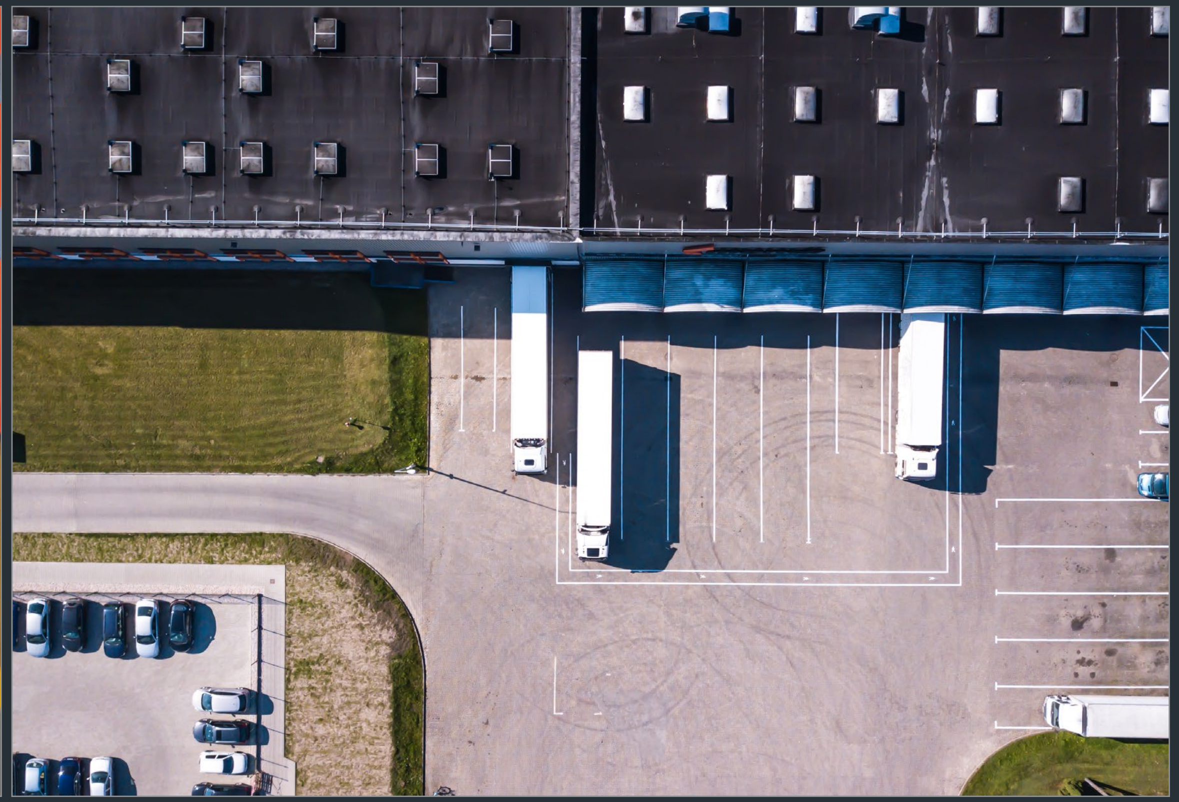
22.3m sq ft ▲
take-up in Q2 2021

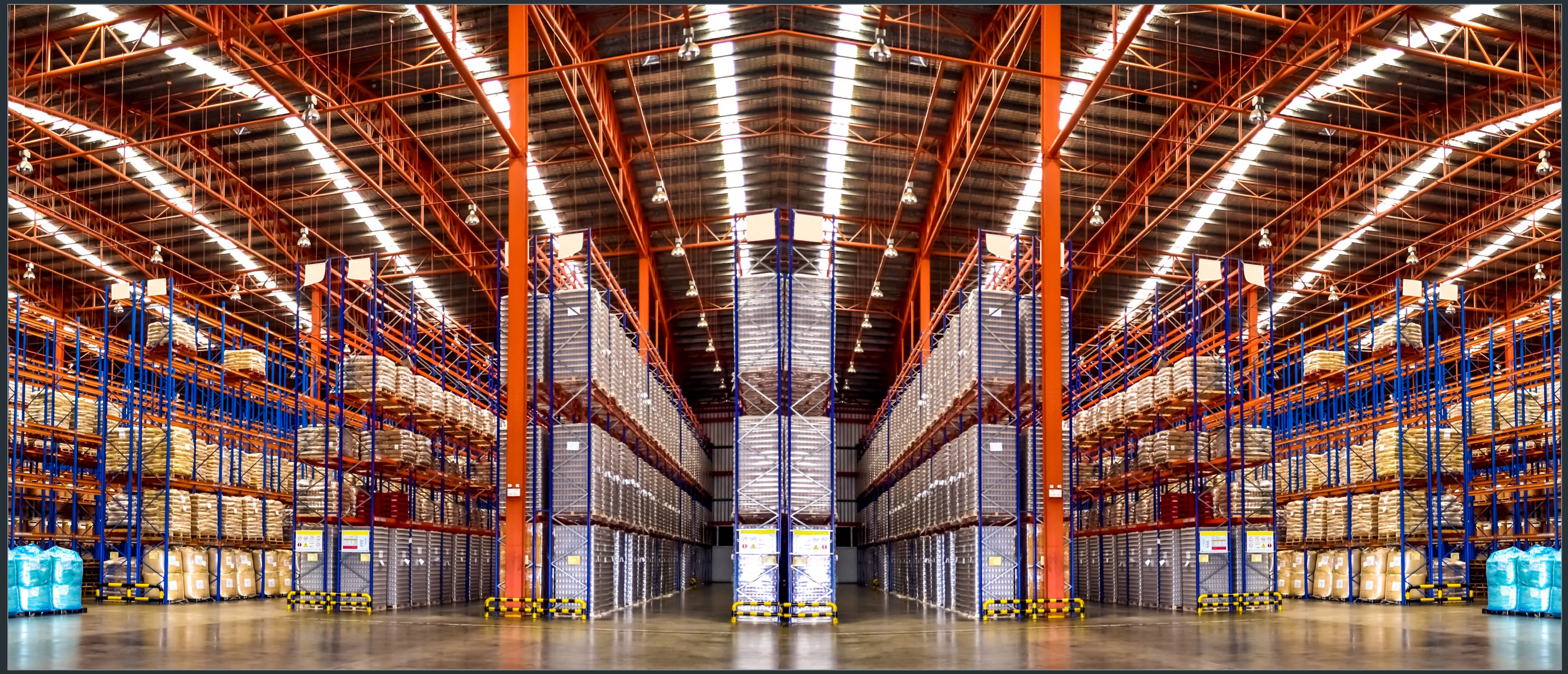
5.2% ▼
UK availability rate

2.2% ▲
quarterly prime rental growth, Q2 2021

3.4m sq ft ▼
of spec development starts in Q2 2021

26% ▲
annual logistics total return, June 2021





OCCUPIER DEMAND

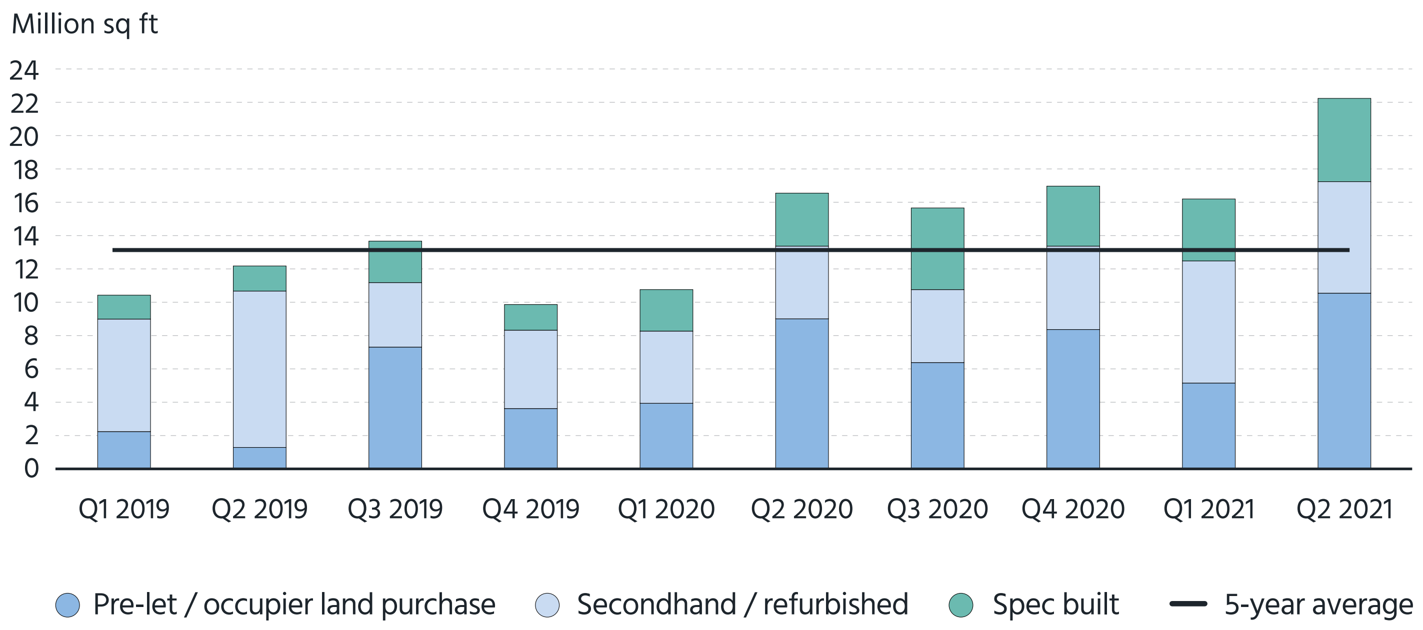
RECORD HIGH TAKE-UP IN Q2

Occupier take-up was 22.3 million sq ft in Q2 2021 - a third higher than in Q1 and over two-thirds above the 5-year quarterly average. This record-breaking quarter brings take-up over the last 12 months to an incredible 71.1 m sq ft. The sea-change in consumer behaviour accelerated by covid lockdowns continues to put pressure on logistics and online retailer supply chains to meet intense demand for home delivery. These occupiers have been decisive in expanding their logistics property footprints by taking up-and-built space for immediate occupation and signing pre-lets for long term growth plans. Securing logistics accommodation is now business critical for many occupiers, but remains an ongoing challenge given the chronic supply shortage.

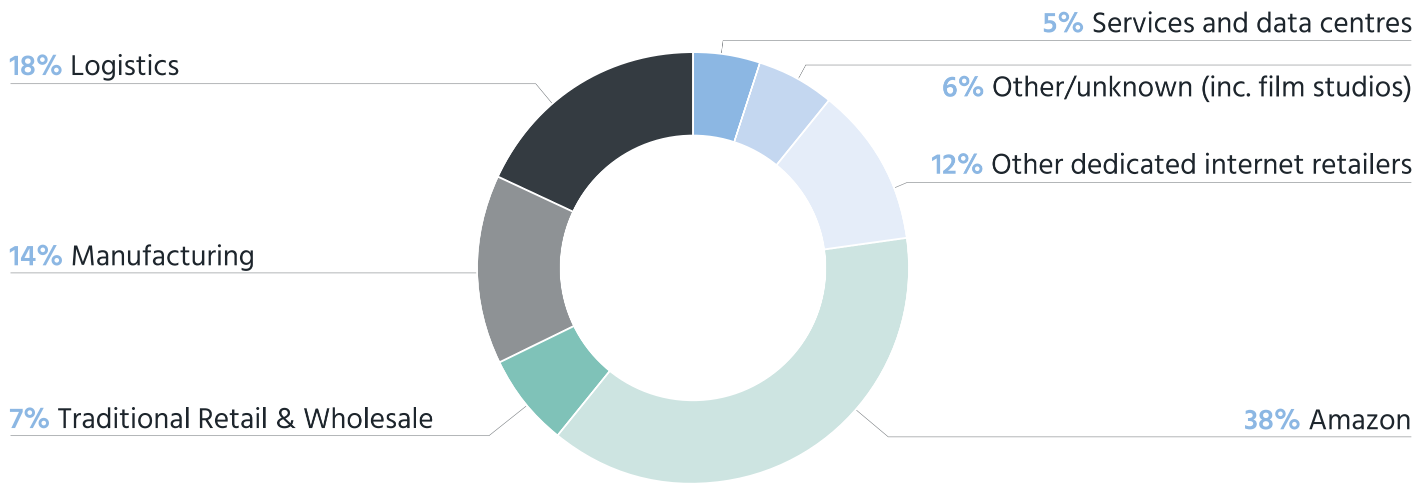
AMAZON ACCOUNTED FOR 38% OF Q2 DEMAND

Amazon let or received planning permission on over 8m sq ft of new accommodation in Q2. This includes planning permission on 2m sq ft buildings in Tees Valley, Wakefield and Basingstoke, and the take up of speculative buildings such as Wakefield 515 and MP411 in Lutterworth. It also committed to several smaller facilities closer to London in Q2, taking buildings in Orpington, Kent and Harlow.

Take-up by building quality and 5-year average
Source: Gerald Eve



Q2 take-up by occupier sector
Source: Gerald Eve



BROAD-BASED OCCUPIER DEMAND

Following a weak year of take-up from manufacturers in 2020, demand from the sector has been buoyed this year by the need to hold additional stock due to the new Brexit arrangements. Lagging impacts from covid on the R&D and pharma sectors have also given a boost. Home retail and house-related manufacturing remained an active sub-segment of demand in Q2 also, with deals agreed by Riva Home, Made.com, the Symphony Group, Dunelm and DUSK. There has also been an increase in occupier activity relating to large scale battery production and energy plants in response to the sustainability agenda and clean energy generation, which will be a theme throughout 2021 and beyond.

71.1m sq ft
rolling annual logistics take-up, Q2 2021

48%
of Q2 take-up was pre-let

22%
of Q2 take-up was spec-built

216,000sq ft
average building size taken-up in Q2

SUPPLY AND DEVELOPMENT

SUPPLY AT AN ALL-TIME LOW

The overall availability rate fell for the third consecutive quarter in Q2 to 5.2%, the lowest since our records began in 2006. The availability rate for new or modern stock fell sharply to 2.2% in Q2, down from 2.8% in Q1 and 4.5% a year earlier. The availability of up-and-built new or refurbished stock is now at a record low in nearly all UK markets, especially in London and the South East, and prime locations in the Midlands.

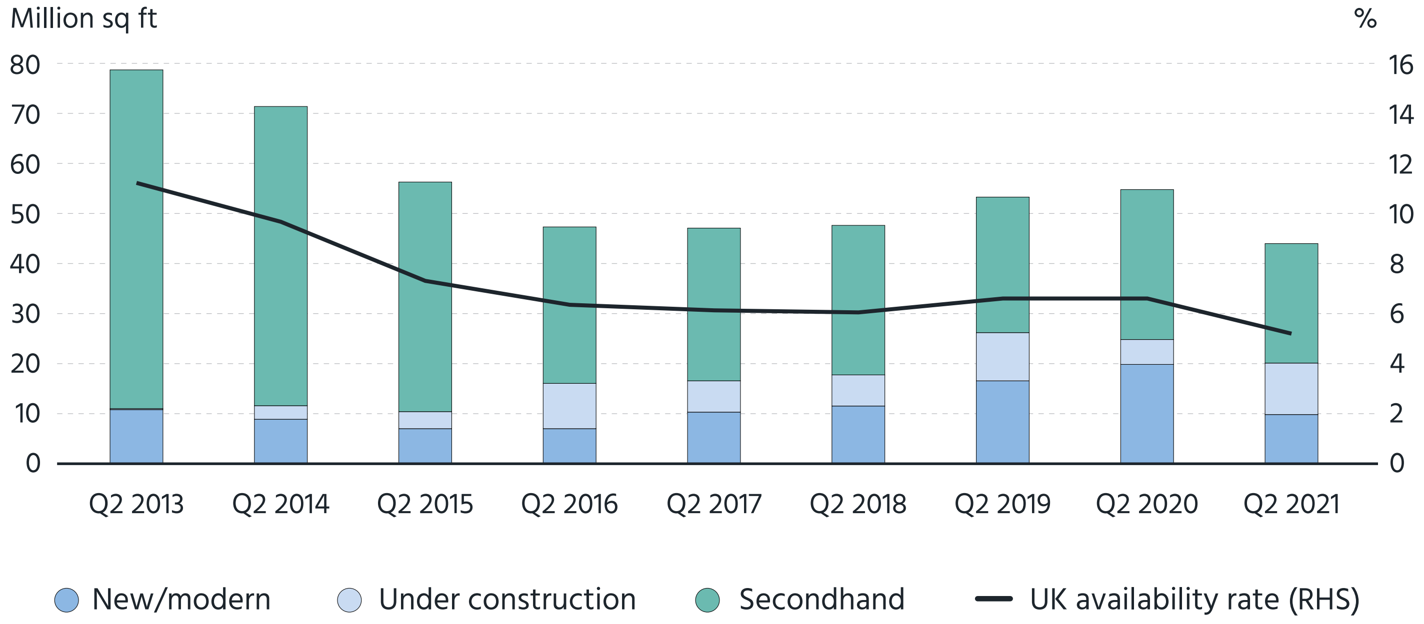
SPECULATIVE DEVELOPMENT NOT YET HELPING WITH SUPPLY CRUNCH

At end-Q2 2021 there was over 41m sq ft of space under construction across the UK and a third of it was speculative. The average building size under speculative construction remains around 145,000 sq ft and regionally the majority was in the Southern East Midlands, Bucks & Beds, London East, Merseyside & Cheshire and the Southern West Midlands. There was 4.6 million sq ft of development completions in Q2, 72% of which was speculative. Many of these speculative schemes have already been let or are under offer – including Wakefield 515 and Icon Manchester.

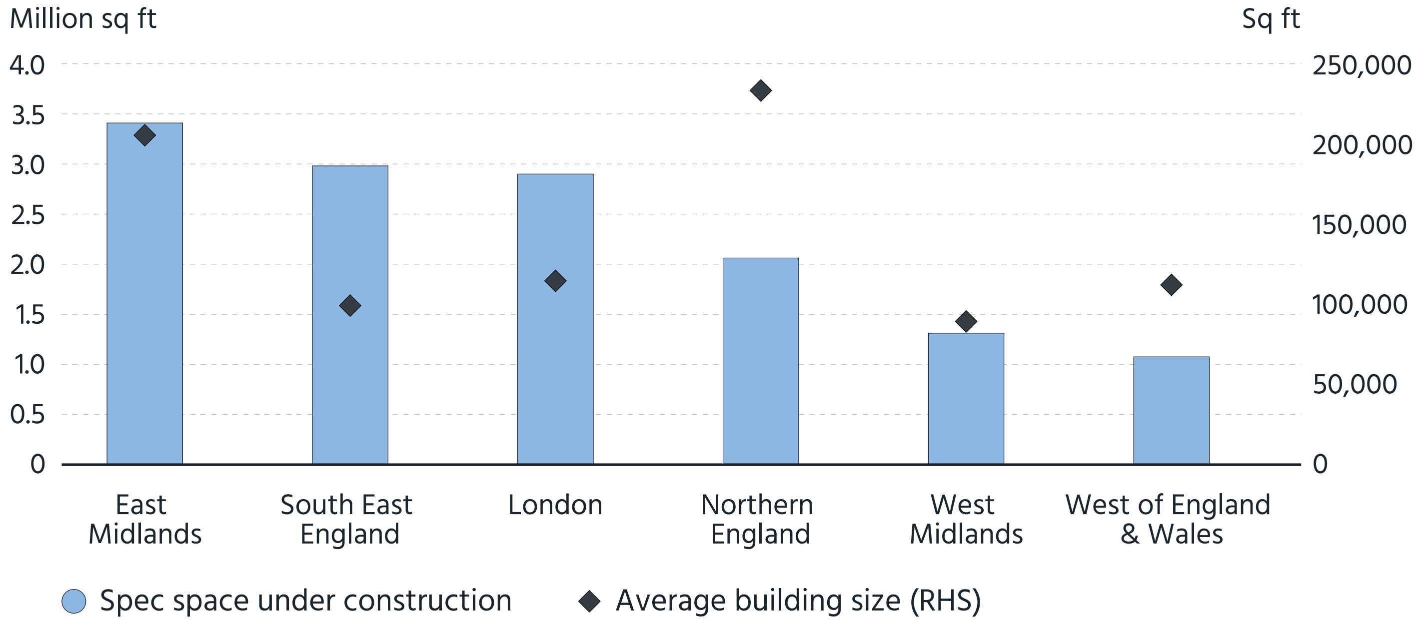
LARGE SECONDHAND BUILDINGS HOTLY CONTESTED BY OCCUPIERS

The volume of secondhand space on the market fell for the third consecutive quarter in Q2. Secondhand buildings from the likes of Debenhams, DHL (Next), Comfy Quilts and the Co-Op were made available in Q2, but marketed buildings, especially the larger ones, saw fierce levels of occupier interest and many are now under offer.

Annual availability by building quality and national availability rate (2013 - 2021)
Source: Gerald Eve



Speculative space under construction and average building size as at the end of Q2 2021 by region
Source: Gerald Eve



145,500 sq ft
average size of building under construction speculatively at the end of Q2 2021

5.2%
UK availability rate (Q2 2021)

515,000 sq ft
largest spec building under construction (Panattoni, Derby Commercial Park)

Let to JD Sports in July

RENTS

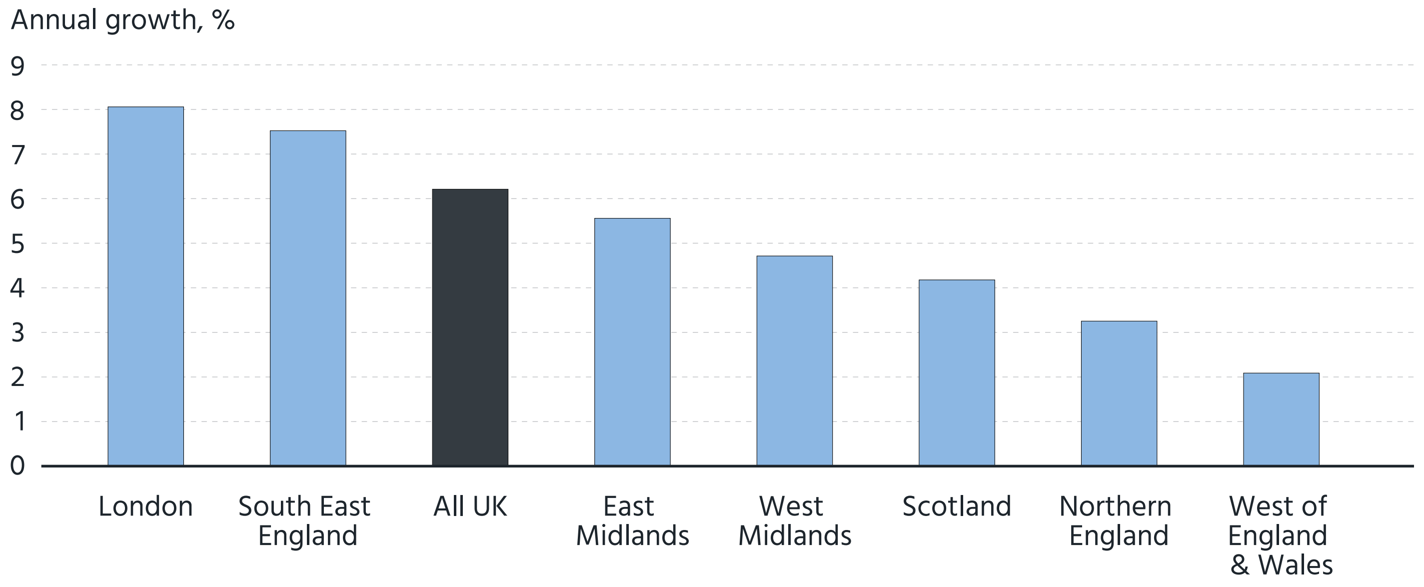
STRONG RENTAL GROWTH ON THE BACK OF INTENSE MARKET CONDITIONS

Prime headline rents increased in over half of our 53 Gerald Eve centres in Q2, aggregating to 2.2% UK quarterly rental growth and 4.3% for the first half of 2021. Since the onset of the pandemic in Q2 2020, UK prime rents have grown 6.2%, with the strongest growth in London and the South East. However, sharp increases have also been recorded more recently in locations benefitting from the occupier 'ripple effect' out from the established supply-constrained core markets.

RIPPLE EFFECT OUT FROM 'PRIME' MARKETS

With rents high in most core prime markets, occupiers - principally internet retailers and logistics operators - are increasingly looking to less-established markets to house their highly-automated facilities. As well as access to 'chimney pots', sites in such locations are more readily available and still often meet modern occupational requirements, such as the availability of sufficient power along with access to a diverse and skilled workforce. This has been a significant boost to certain regions in the South East since covid, including markets in Suffolk and Oxfordshire, as well as markets to the south and east of the Golden Triangle.

Regional annual growth in prime headline logistics rents, Q2 2021
Source: Gerald Eve



LANDLORDS HARDEN THEIR POSITION

Quoting rents on schemes have increased markedly in 2021 and some landlords have taken a harder position in negotiations on some of the more in-demand buildings. Rising property costs plus increased operational and labour costs in the light of staff shortages has put pressure on already-tight margins for some occupiers. However, the need for additional space is undeniable and occupiers have been willing to pay the required rent to secure space, even on a rental 'best bids' arrangement for the more in-demand assets. Incentives remained flat in Q2 but are above the five-year average, which seems counterintuitive in this market. But such is the strength of investor interest in the sector at present that a few months additional rent free to secure a tenant with a strong covenant is an agreeable trade-off for some landlords given the potential for increased headline rents and several bps on the investment yield.

There is strong demand from online retailers and logistics operators, especially in London and the SE. But we are also seeing other growth sectors such as film studios, data centres and battery plants eating into logistics supply. This will continue to drive land values and rents in the sector.

Mark Trowell, Partner

INVESTMENT

INSATIABLE INVESTOR APPETITE FOR LOGISTICS

Competition for industrial and logistics assets is fierce and the weight of capital continues to drive down yields. This positive yield impact drove annual total returns to over 26% in June. Around £6bn of industrial and logistics assets has been traded at the halfway point of the year, which is one of the strongest recorded half-yearly totals, and 2021 looks set to be another record year for investment.

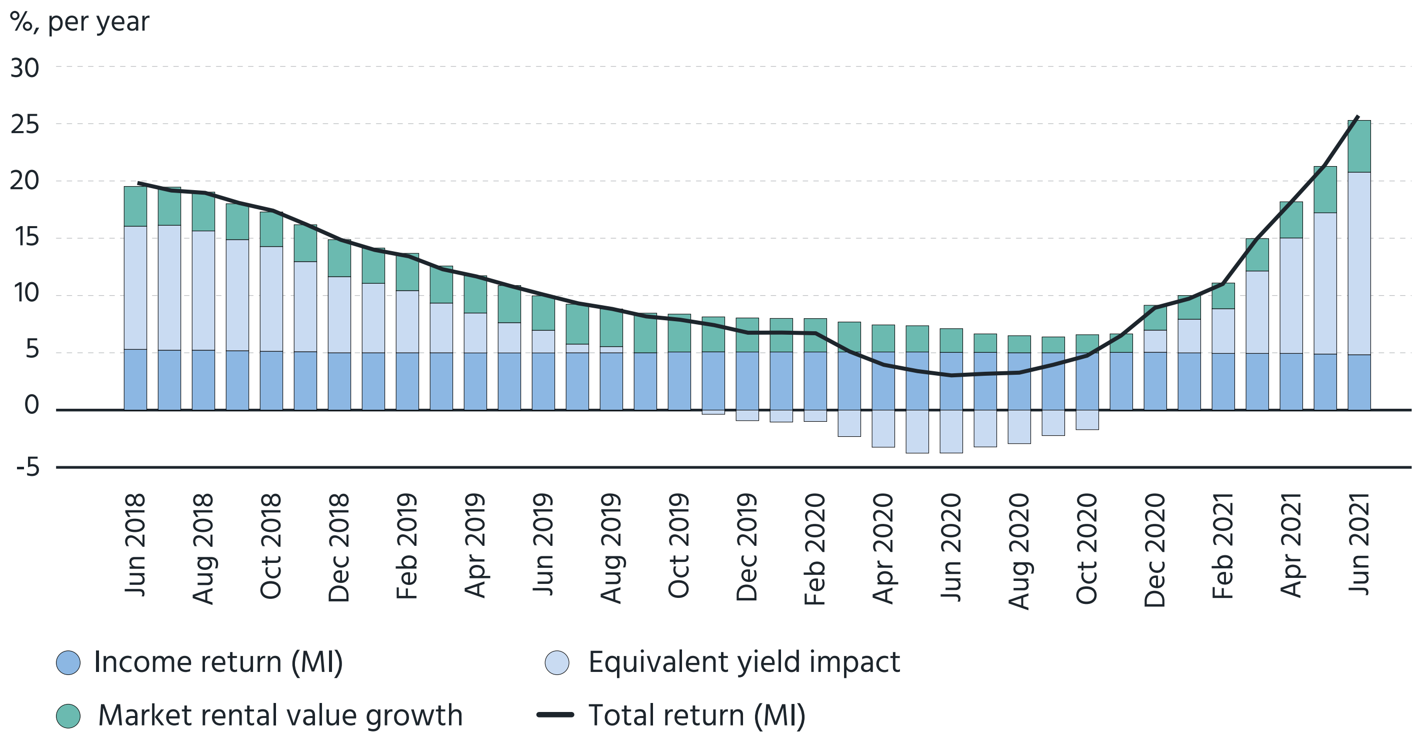
SHARP REBOUND IN VALUES IN 2021 FOR ALL QUALITIES OF SPACE

Investor interest remains focused on the most valuable and densely populated markets in London, the South East and the West Midlands, where rental growth expectations are strongest. However, all qualities of logistics space recorded significant improvement in returns in 2021. Even tertiary logistics stock, which recorded the sharpest falls in capital growth in the months immediately following the onset of the pandemic, are now recording growth more than that being achieved pre-pandemic.

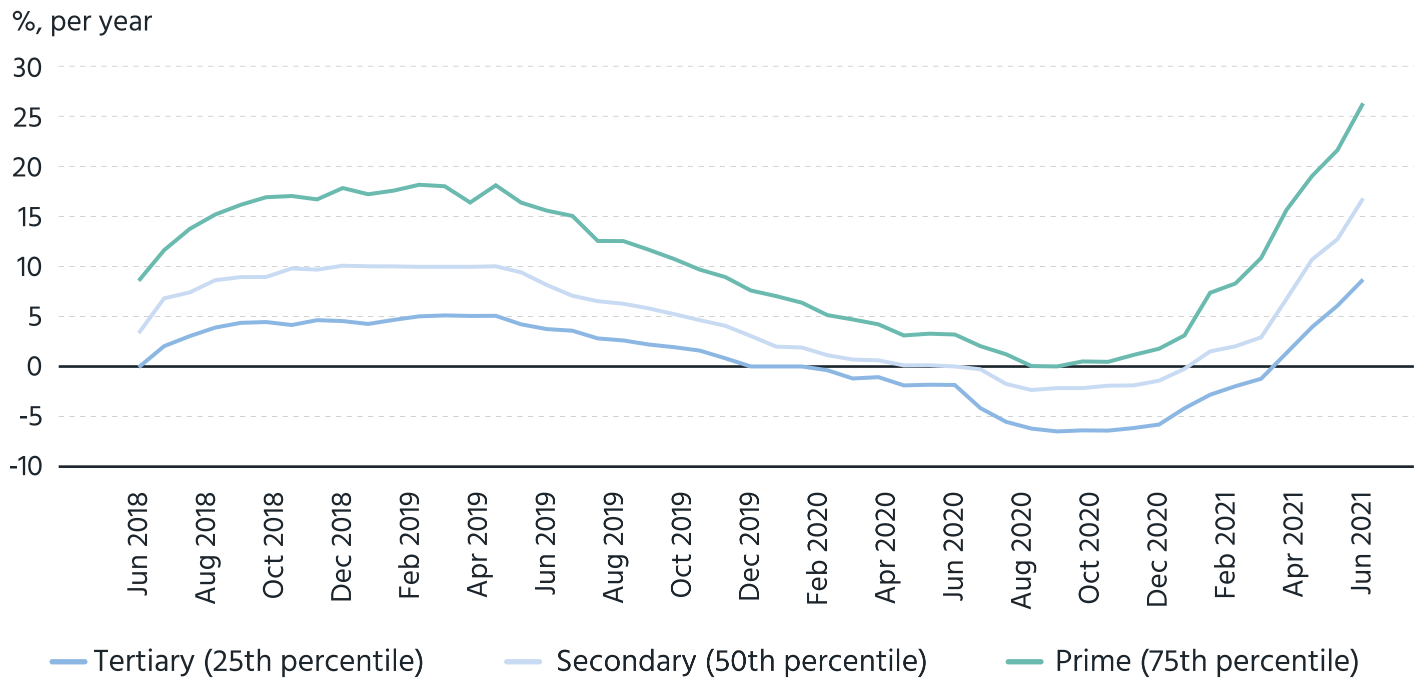
OCCUPIER AND DEVELOPER ACTIVITY PROVIDES SOME MUCH-NEEDED INVESTMENT STOCK

In Q2, single-let distribution warehouses made up 78% of the industrial investment volume, which is an unusually high proportion given the segments typically accounts for less than half of all activity. This reflects the completion of a number of logistics portfolios but also the increased number of large-scale funding opportunities provided by the occupier and speculative development markets. These include Aberdeen Standard Investment's forward-purchase of Next's new facility in Yorkshire and Amazon's warehouse in Hinckley.

Distribution warehouse annual total return and components
Sources: MSCI, Gerald Eve



Distribution warehouse annual capital value growth by yield quartile
Sources: MSCI, Gerald Eve




Amazon's new facility in Hinckley

OUTLOOK

OCCUPIER ACTIVITY TO REMAIN ELEVATED IN 2021

There is over 7 million sq ft of up-and-built space under offer across the country and over 8 million sq ft in the pipeline awaiting planning permission. MPS1, a 747,000 sq ft speculatively developed building in Magna Park Lutterworth is rumoured to be under offer to Amazon, as is the largest available secondhand building in the UK – the 736,000 sq ft former Debenhams unit in Peterborough. The relatively short void periods on these buildings represents the urgency of occupier requirements, even for the largest of buildings.

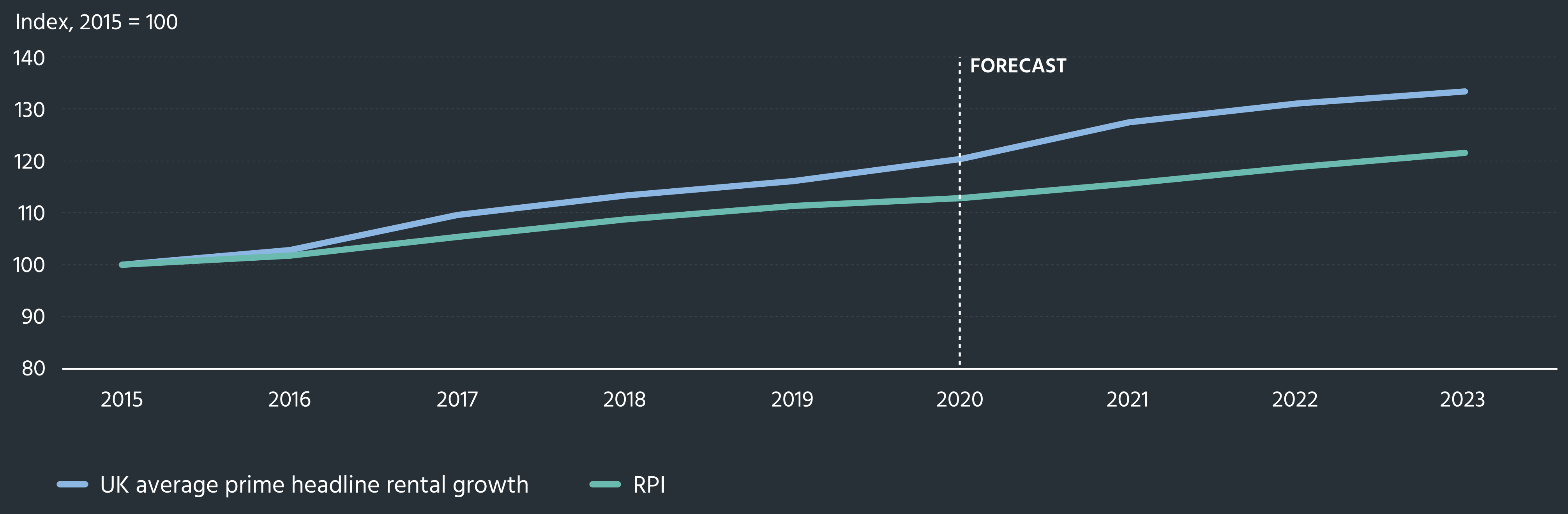
RENTAL GROWTH FORECASTS UPGRADED

Such intense occupier market conditions have meant that we have upgraded our national prime logistics rental growth forecasts. The base case outlook for UK prime logistics headline rents is for an above-inflation average annual growth of 4.3% per year over the next three years. This is above the long term average and even stronger than the average 4% per year recorded over 2016-20. Rental growth is forecast to be frontloaded in 2021, increasing by 7% while market conditions are the most acute.

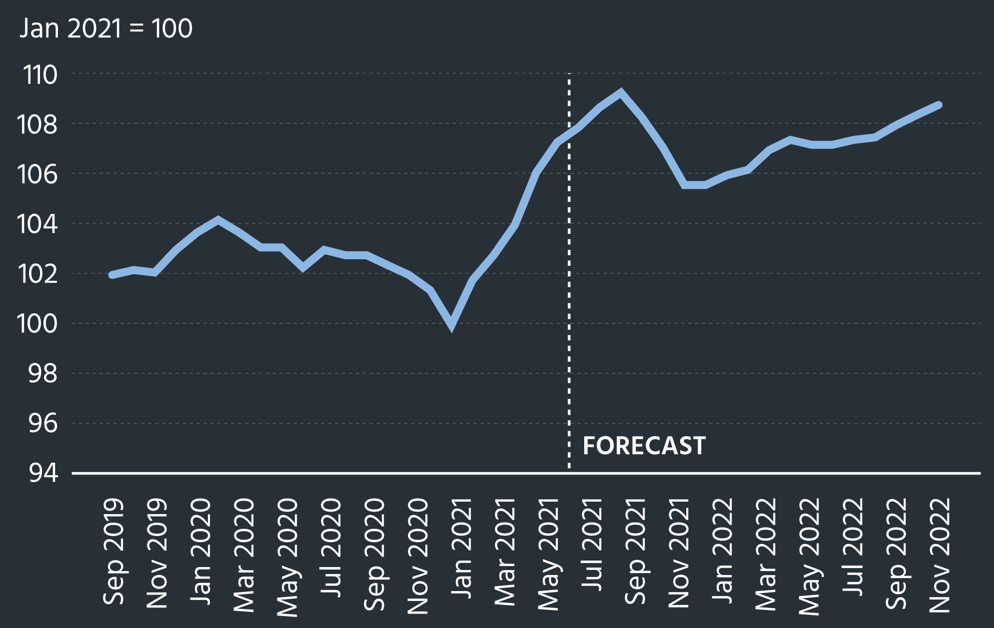
DEVELOPER CONFIDENCE IS HIGH, BUT CONSTRUCTION COSTS ARE RISING

Looking to the second half of 2021, well capitalised developers will likely continue to start speculative developments and plans have been submitted on several schemes in Q2. Activity is likely to be strongest in the North West, Yorkshire and the East Midlands, where several sites linked to established developers have recently received planning permission and forward-fundings are in progress. Construction costs – both in terms of materials and labour – are high and rising, which in turn will put further upward pressure on rents on these schemes.

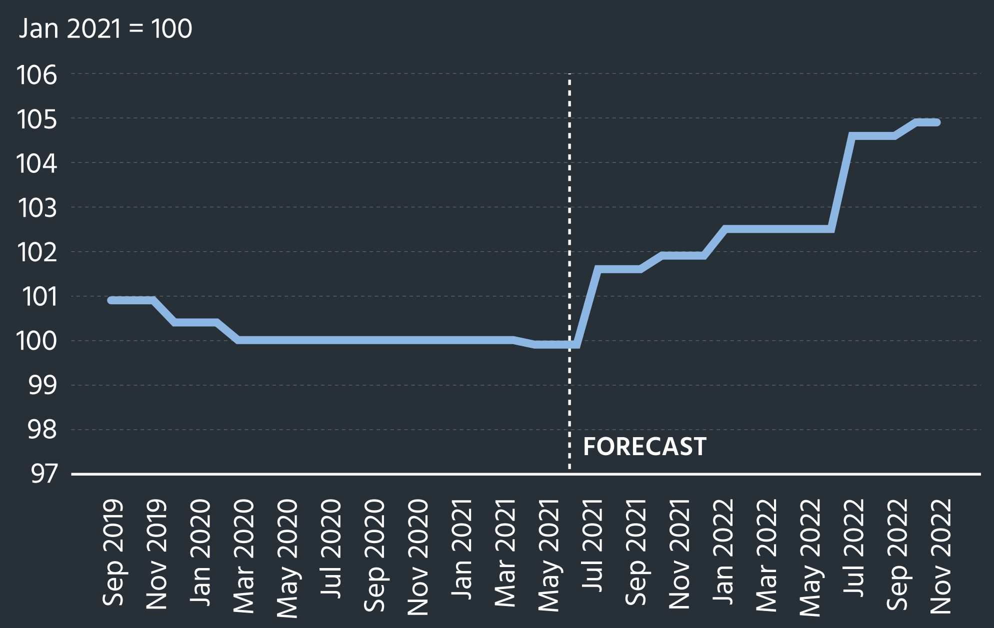
Annual growth in prime headline rents and RPI inflation
Sources: Gerald Eve, Oxford Economics



Construction cost index: Materials
Source: BCIS



Construction cost index: Labour
Source: BCIS



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GERALD EVE IN THE MARKET

Gerald Eve is well-established in the logistics property market and covers the full range of property services, from national occupational and investment agency through to lease consultancy and valuation. Our specialists have been involved in several high profile transactions during the quarter. Please contact them directly for more information.

Jon Ryan-Gill advised AEW on the letting of EMDC525, a speculatively built 523,404 sq ft unit in Castle Donington to online retailer Buy it Direct.

Email **Jon** to find out more +44 (0)7961 820757

Freddie John is advising Mirastar on the disposal of Unit B, Circular 13, Gascoigne Road in Barking, a 98,500 sq ft unit situated to the north of Alfreds Way on the A13.

Email **Freddie** to find out more +44 (0)7788 394341

Jason Print advised Aberdeen Standard Investments on the funding and letting of Kingsway 216, a 216,777 sq ft speculatively-built building in Rochdale to a global internet retailer.

Email **Jason** to find out more +44 (0)7833 170680

Josh Pater advised Ocado on the off-market acquisition from a previous occupier of Origin in Park Royal for the creation of a new urban logistics campus to service London.

Email **Josh** to find out more +44 (0)7782 271355

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Find out how we can help

Prime Logistics is the definitive guide to the UK's distribution property market. Dealing with logistics units of 50,000 sq ft and above, this research report gives detailed analysis and statistics for 26 key distribution areas – from take-up, stock and development statistics to drivers of occupier demand, growth forecasts and regional outlooks. All previous editions can be downloaded from our website.