GERALDEVE

MULTI-LET

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

December 2022

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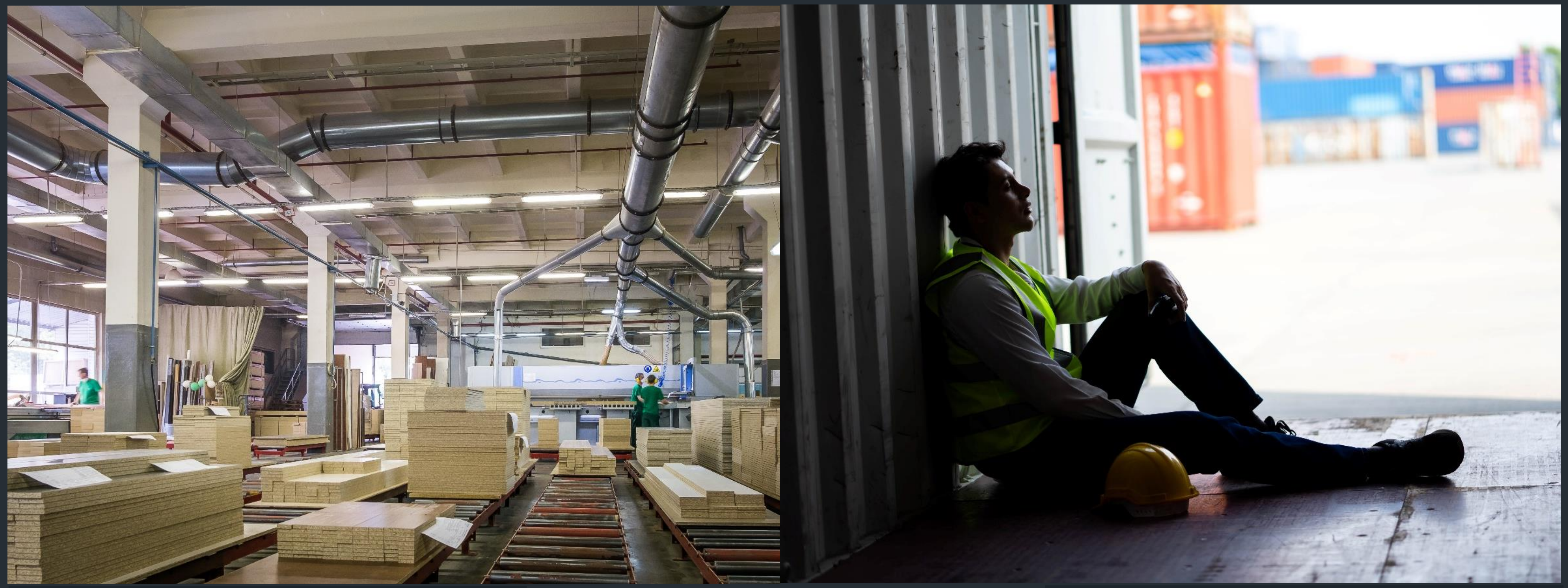
MARKET OVERVIEW

The UK is in recession and high frequency indicators suggest that almost all consumer and business sectors and geographies are in retrenchment. Insolvencies are back up to around 80% of the peak last seen during the global financial crisis. The financial markets may have settled but the current trajectory for interest rates is still markedly higher than only a few months ago. Prime multi-let yields took another significant step up in Q3 and are now typically 150bps above their Q1 lows. Valuations data are now also rapidly catching up with the direct investment market, which cumulated to an astonishing -9.1% monthly total return in October – the most negative on record.

Lettings activity and exceptional prime rental growth over recent years have taken a pause. However, the direct investment market is showing some signs of stabilisation. There are more potential buyers than a month ago after the period of so-called "price discovery". Investors remain buoyed by the fundamental robustness of the multi-let income stream, borne out of the diversity and resilience of the occupier base set against an effectively neutralised development supply.

Our "equilibrium yield" modelling points to a peak multi-let equivalent yield of 5.9% in 2023, which will drive a short sharp correction in values. Yield movement is set to take around 34% from multi-let capital value peak-to-trough and contribute to a -13.9% total return in 2022. More encouragingly, UK multi-let capital values should regain momentum and return to the 2021 nominal baseline by 2026. And after a subdued period over 2022-24 multi-let total return is forecast to outperform the other property segments over 2025-27.



£14.65 ▲
PER SQ FT Q3 LONDON & THE SOUTH EAST ERV

20% ▲
Q3 LONDON & THE SOUTH EAST RENTAL REVERSION

£1.6bn ▼
Q3 MULTI-LET INVESTMENT

£7.24 ▲
PER SQ FT Q3 REST OF UK ERV

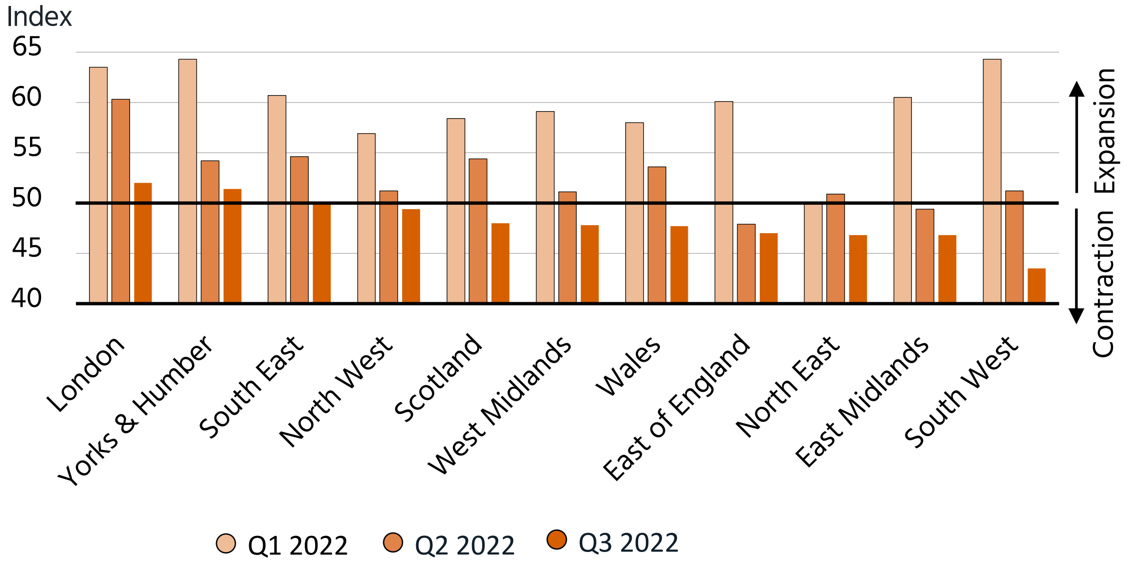
2.8m sq ft
TOTAL UK FLOORSPACE UNDER CONSTRUCTION

-13.9% ▼
FORECAST 2022 MULTI-LET TOTAL RETURN

ECONOMY

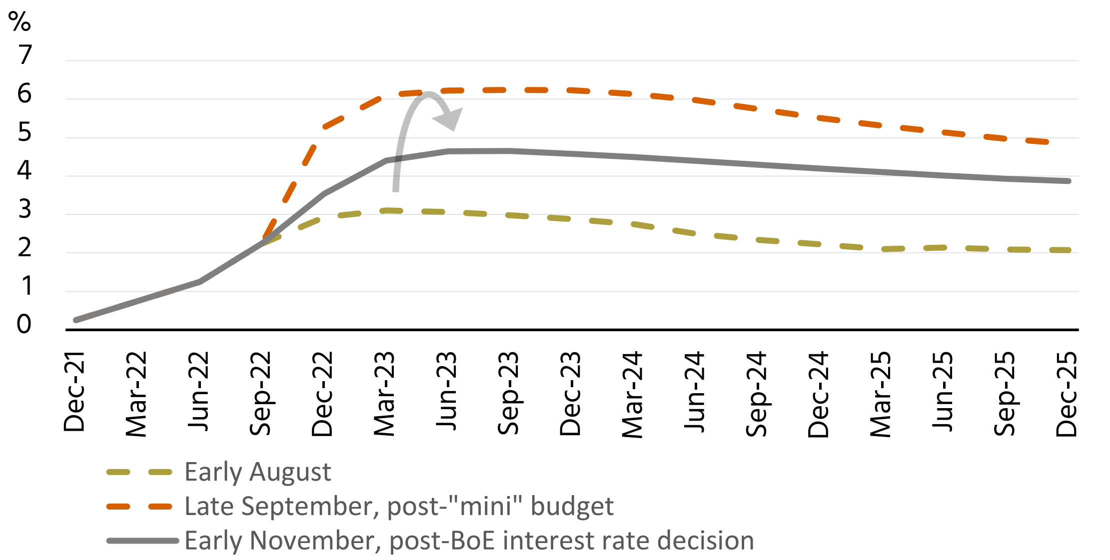
Business activity index by region

Source: Natwest regional PMI



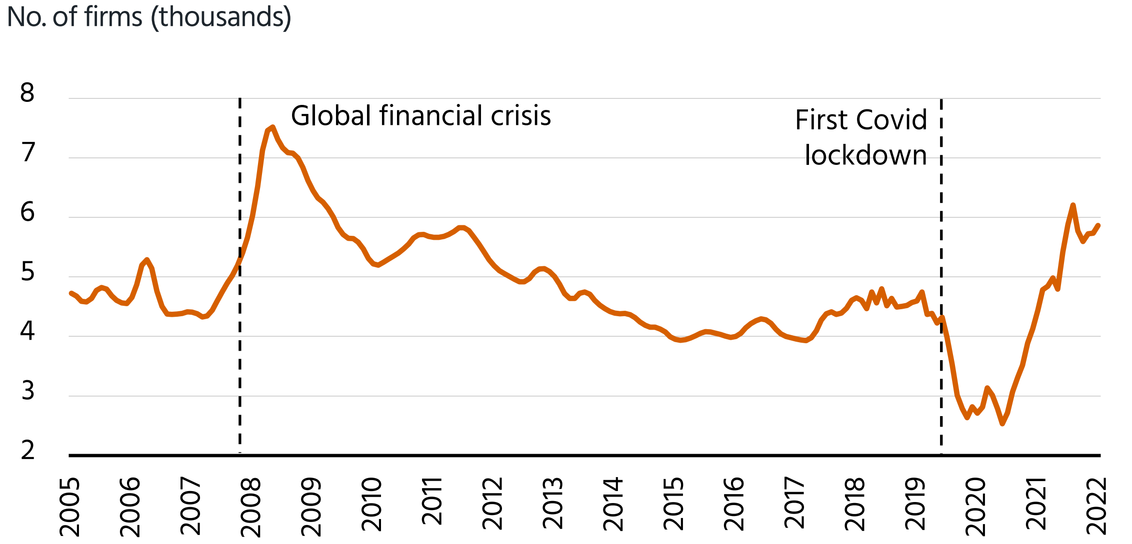
Bank base interest rate

Source: Bank of England, Chatham Financial



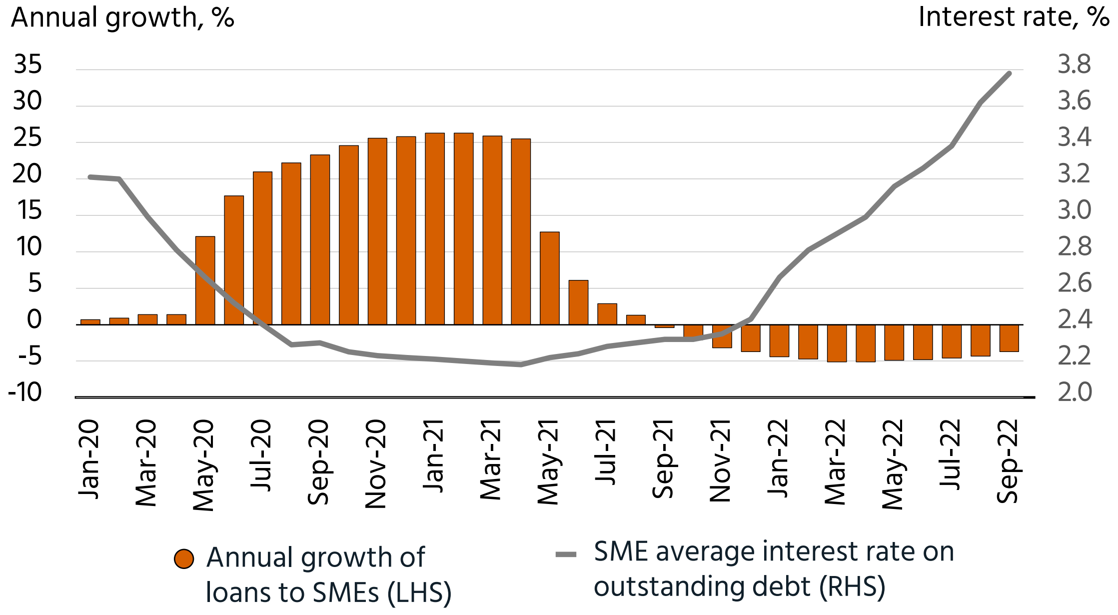
UK rolling quarterly business insolvencies to Oct 2022

Source: ONS, The Insolvencies Service



Lending volume to and interest rate for SMEs

Source: Bank of England



GDP fell 0.2% in Q3 and most commentators expect this to be the first quarter of a long recession that could last through the whole of 2023. November's PMI business sentiment surveys again suggest that services and manufacturing output are falling, with a broad-based slowdown in recruitment activity and a sharp fall in new orders for both consumer and business-facing firms. Regionally, business activity fell in all but three of the UK's 12 monitored regions in Q3. London was the best-performing, despite seeing growth slow to a 20-month low.

The change at the top of government leading to the recent Autumn Statement has eased the volatility in financial markets. The 10-year bond yield fell from 4.4% in late September/early October to 3.1% currently and market expectations for future base interest rates has lowered. However, given that much of the proposed £55bn fiscal tightening is backloaded to the medium term through 'fiscal drag', considerably higher interest rates are still anticipated in the short term than was expected in August.. This will continue to pass through to outstanding debt for SME's, which took on a significant amount of extra debt over covid compared with their larger counterparts.

UK insolvencies have been trending sharply upwards since the period of maximum government support over covid and are now running at around 80% of the peak of the financial crisis. This will inevitably feed through to multi-let defaults and void rates, but the strength and diversity of the modern occupier base makes it unlikely that they will be of the magnitude of previous downturns.

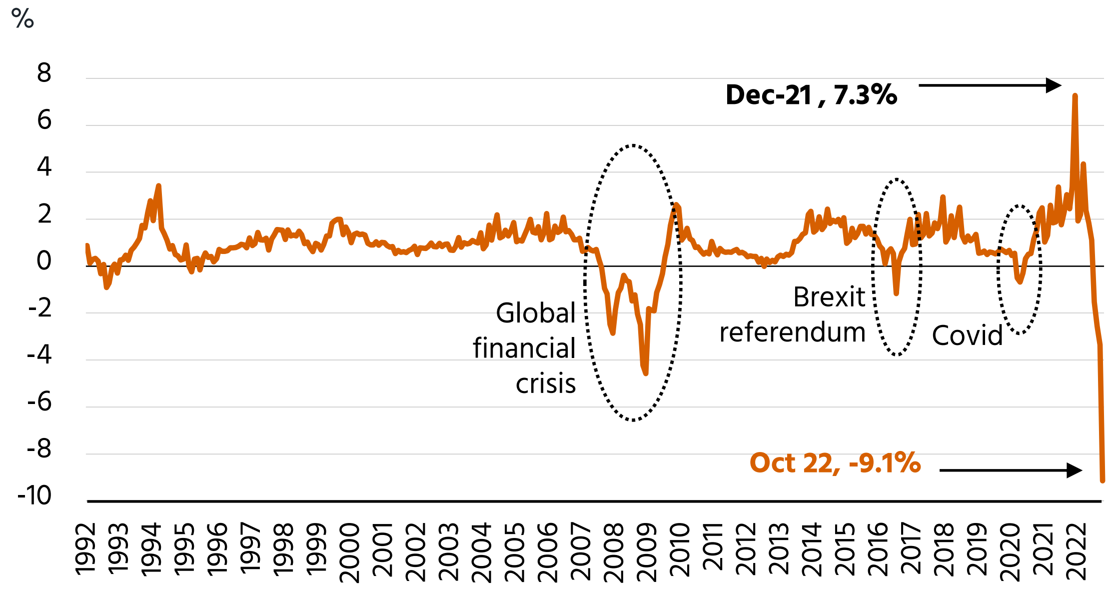
INVESTMENT MARKET

YIELD SHIFT GENERATES MOST NEGATIVE RETURN ON RECORD

Prime multi-let yields took another significant step up in Q3, notably after the disastrous Truss/Kwarteng "mini" budget, and are now typically 150bps above their Q1 lows. Valuations data are now also rapidly catching up with the direct investment market. According to MSCI data, the UK multi-let average equivalent yield moved out 52bps in a single month in October, which contributed to an astonishing -9.1% monthly total return. This is the most negative multi-let figure on record, greater even than any individual month during the global financial crisis. The current data are all the more remarkable given that only 10 months ago in December 2021 the multi-let monthly total return was the highest ever recorded at +7.3%.

UK multi-let monthly total return to Oct 2022

Source: MSCI

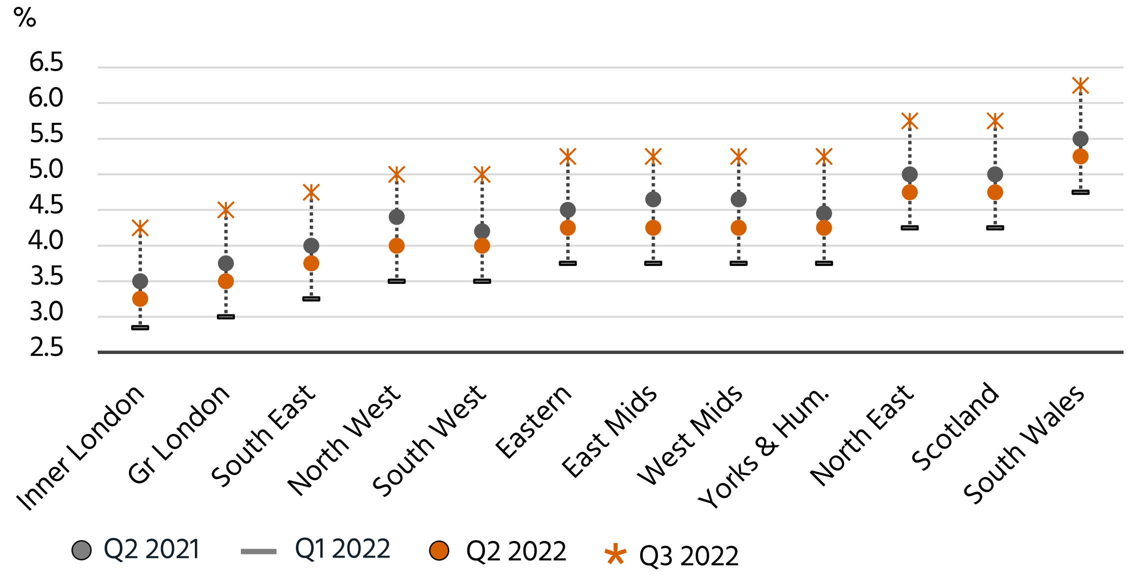


SOME RETURN OF STABILITY AND BASIS TO INVEST

Ironically, now that the valuations data are at their most acutely negative the direct market is showing some signs of stabilisation. There are more potential buyers than a month ago after the period of so-called "price discovery" and now that the more extreme financial market volatility has eased. The fund sell-off driven by redemptions continues, but so far this has been orderly. The pension funds are also selling and there is likely to be more refinance-led distressed sales. However, diversity and resilience in the multi-let occupier market will help give potential buyers with appropriate finance that have been waiting on the sidelines the confidence to act. We expect this to drive a UK yield trajectory that peaks next year, as shown overleaf.

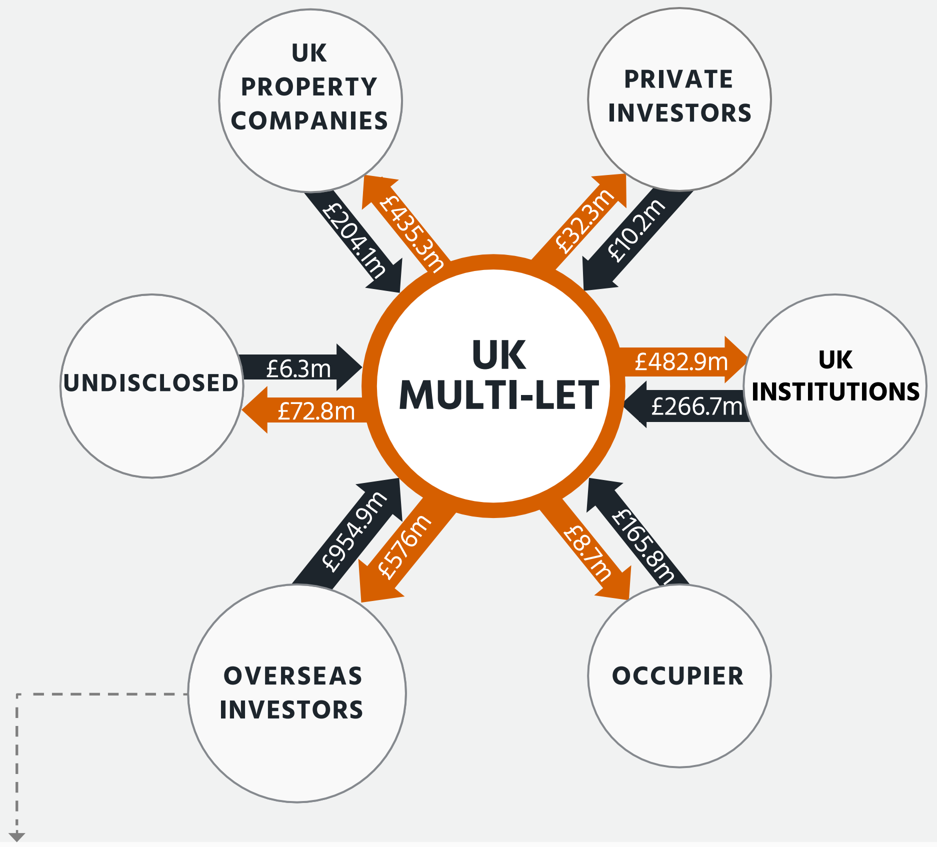
Prime multi-let yields by region

Source: Gerald Eve



UK MULTI-LET CAPITAL FLOWS, Q3 2022

Source: Gerald Eve, Property Data



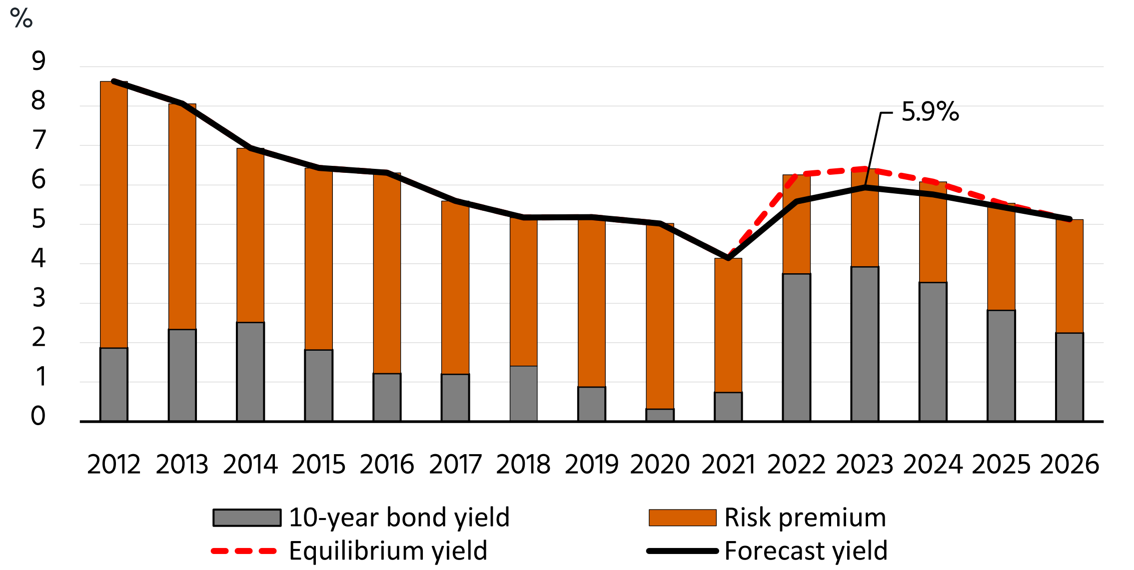
INVESTMENT VOLUME BY INVESTOR SUB-DOMICILE

£425m	£289m	£180m	£61m
FAR EASTERN	NORTH AMERICAN	OTHER	EUROPEAN
45% OF OVERSEAS INVESTMENT	30% OF OVERSEAS INVESTMENT	19% OF OVERSEAS INVESTMENT	6% OF OVERSEAS INVESTMENT

PERFORMANCE AND OUTLOOK

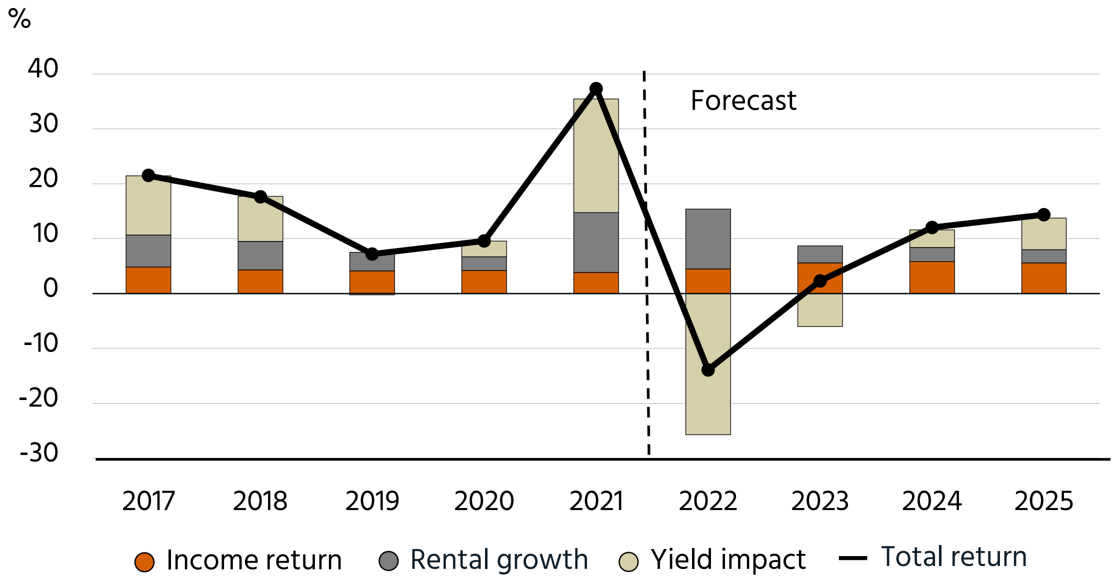
Multi-let equilibrium and forecast yield

Source: Gerald Eve, MSCI



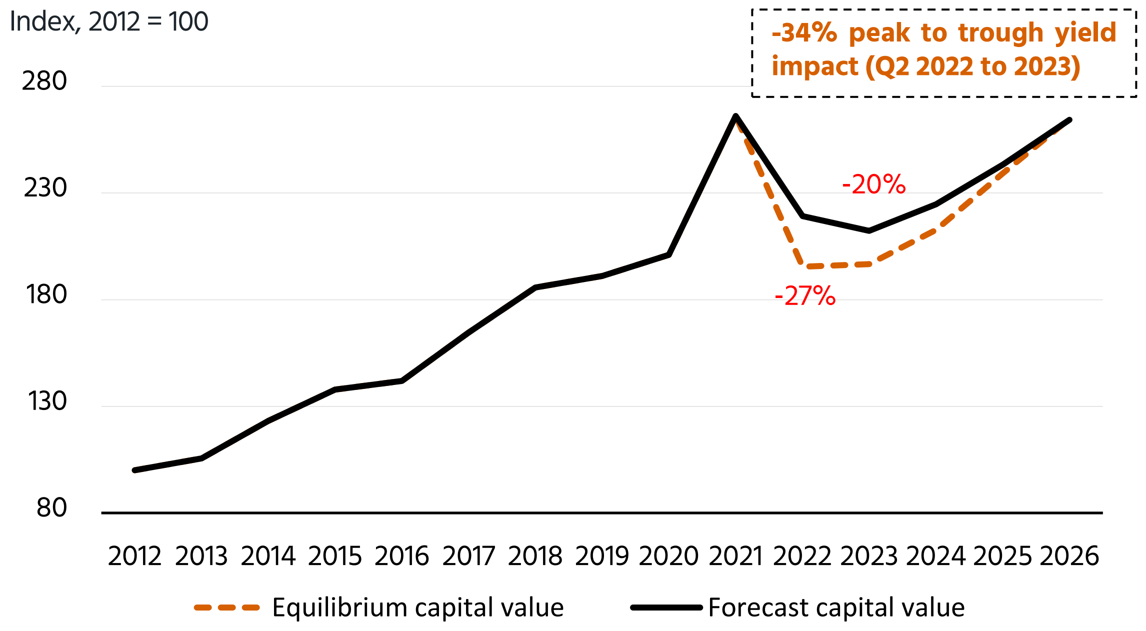
UK multi-let annual total return and components

Source: MSCI, Gerald Eve



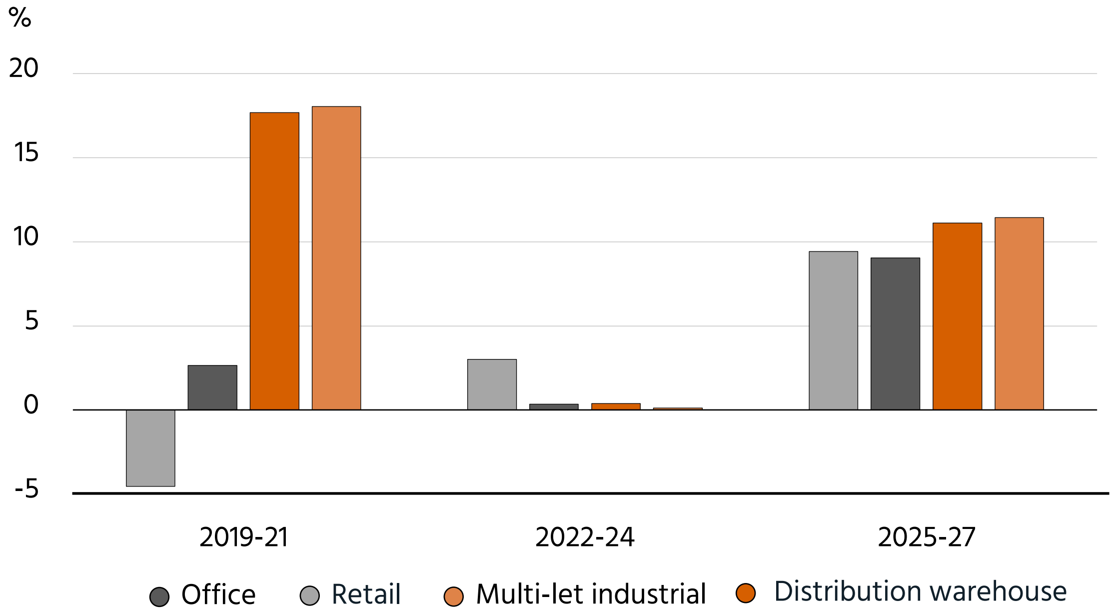
Multi-let equilibrium and forecast capital value

Source: Gerald Eve, MSCI



Average annual total return by sector

Source: MSCI, Gerald Eve



In the wake of the step-change in the interest rate environment and knock on effect on the investment market, Gerald Eve has developed the Equilibrium Yield forecast model. See more detail here in a special extended Spotlight section of our monthly *In Brief* report.

The UK multi-let yield is forecast to peak at 5.9% in 2023. The risk free rate component of the projected yield is proxied by the UK 10-year government bond yield and is forecast to rise to 3.75% by end-2022 and 3.9% in 2023. The multi-let risk premium over the risk free rate is forecast to narrow from 2022 onwards, in keeping with the historic inverse relationship with bond yields. The equilibrium yield peaks at over 6.4% in 2023 and is where the multi-let equivalent yield "should" be for the given market conditions. However, the sheer rate of change means that the actual forecast yield is expected to undershoot this as the market catches up with a new equilibrium.

The outward yield shift will be moderated by some low single-digit positive market rental growth but is projected to take 20% off the value of UK multi-let overall between end-2021 and 2023. In terms of pure yield impact this increases to -34% peak to trough from Q2 2022. More encouragingly, after the short, sharp correction in 2022/23, UK multi-let capital value should return to the 2021 nominal baseline by 2026.

After dominating the other property segments over 2019-22, multi-let and distribution warehouses returns are set for a subdued period over 2022-24. More moderate outperformance is set to return over 2025-27.

OCCUPIER MARKETS - RENTS

EASING IN MULTI-LET LEASING ACTIVITY

Multi-let leasing activity has broadly slowed down as the UK enters recession. Occupiers have understandably paused somewhat to take stock of the impact on their future operating markets. The trade counter occupiers are still robust in their need for space, and ability and willingness to pay. Improving ESG credentials and maintaining access to densely populated areas is still centre stage, but there has been a hiatus until the consumer sector response becomes clearer. New demand from Q-commerce has dropped back now that the sector has become more established and continues to mature. Most key urban centres and university towns are appropriately covered now, with even some redundant depots being remarketed.

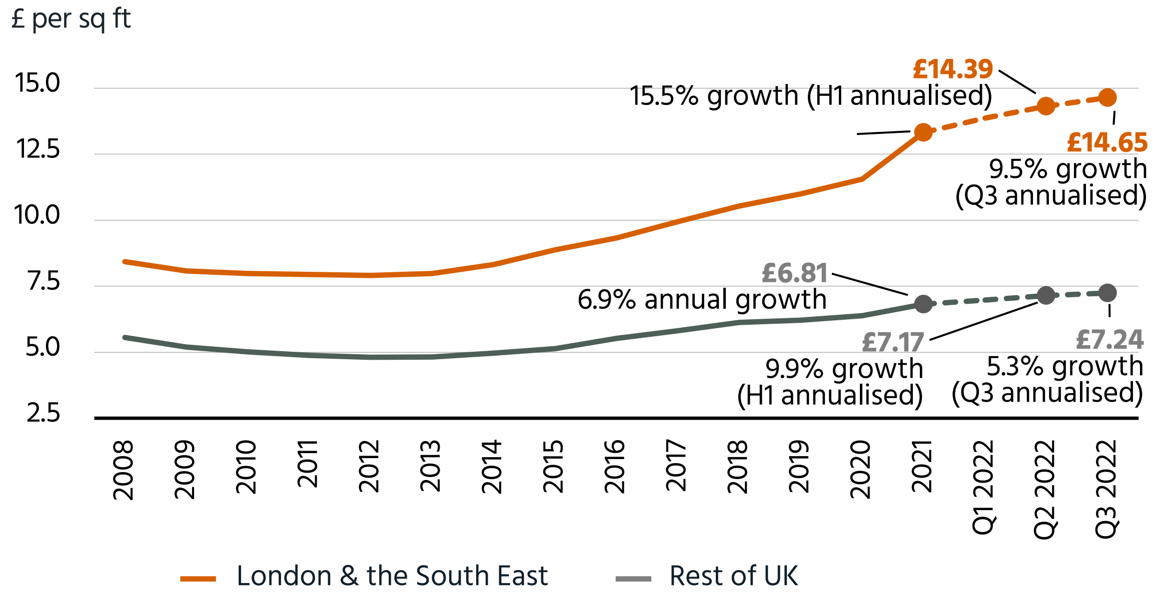
HEADLINE RENTAL GROWTH PAUSED IN H2

There remains some inertia for the smaller support services to the streaming media companies in smaller industrial units. Meanwhile data centre and parcel & post demand is holding up, notwithstanding availability of power limitations and some instances of the larger logistics space coming back to the market. Prime headline rents in the direct market have undergone some historic step changes in recent quarters but this paused in Q3 as anticipated while the market absorbs the changes. Across all grades on a valuation estimate, the rate of annualised growth slowed from around 15% in London & the South East and 10% in the regions in H1 to under 10% and around 5% respectively in Q3.

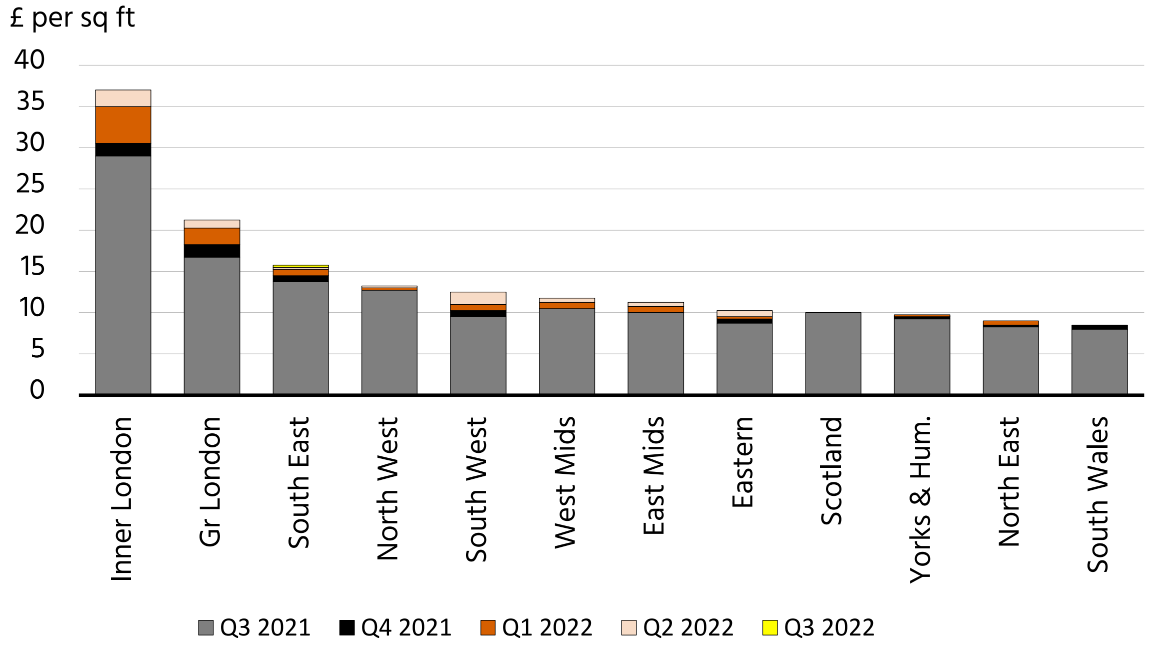
LANDLORDS SUPPORT HEADLINE RENTS THROUGH INCENTIVES, MAINTING HIGH MARKET REVERSION

Landlords are keen to maintain headline rents and where necessary might give away more generous incentives in the form of rent frees, capex/fit-out, breaks or inclusion in the 1954 Act in order to achieve this. The recent surge in ERVs means that the spread over contracted rents remains historically high. Rental reversion was estimated to be around 20% in London & the South East in Q3, though in London this could be far higher – as much as 35%. Even in the regions outside of the South East reversion is likely to have gone into double figures for the first time. Consequently occupiers on the ground will still see significant passing rental growth for a number of years.

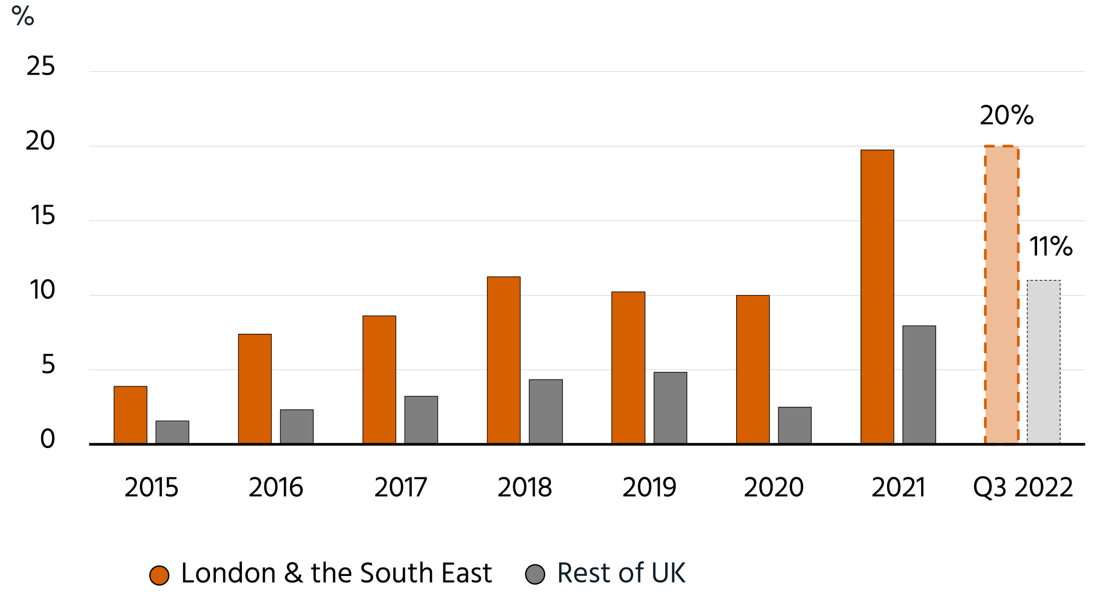
All-grades multi-let ERVs
Source: Gerald Eve



Prime multi-let ERVs
Sources: Gerald Eve



All-grades multi-let reversion
Source: Gerald Eve



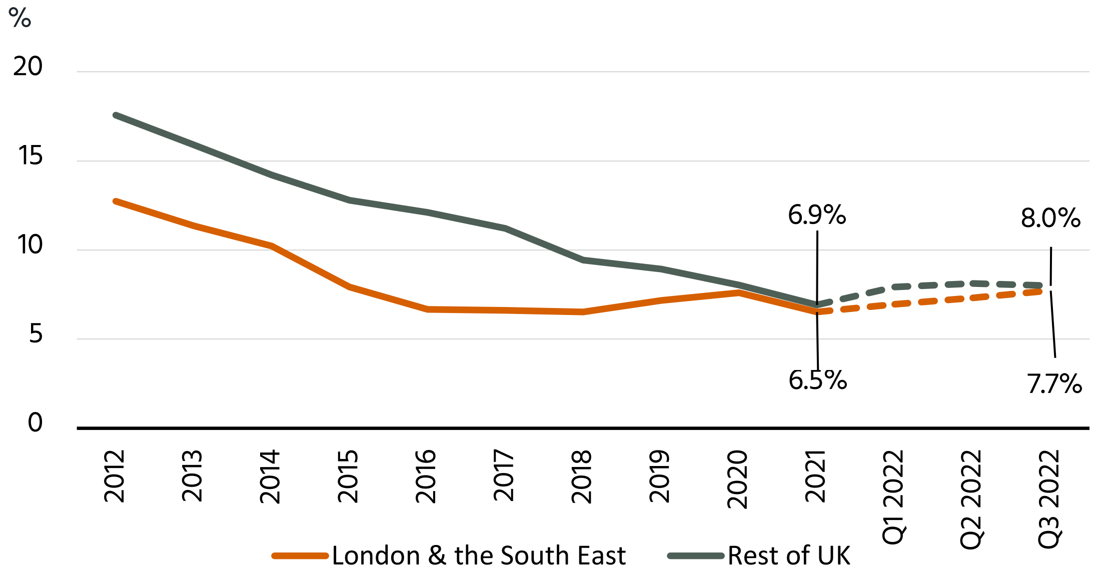
OCCUPIER MARKETS – SUPPLY AND DEVELOPMENT

The vacancy rates for both London & the South east and the Rest of the UK have converged but remain near historic lows. High frequency estimates are that vacancy ticked up to 7.7% and 8% respectively in Q3. However, this is still relatively contained and does not bear a resemblance to the sharp increases in UK company insolvencies shown on page 3.

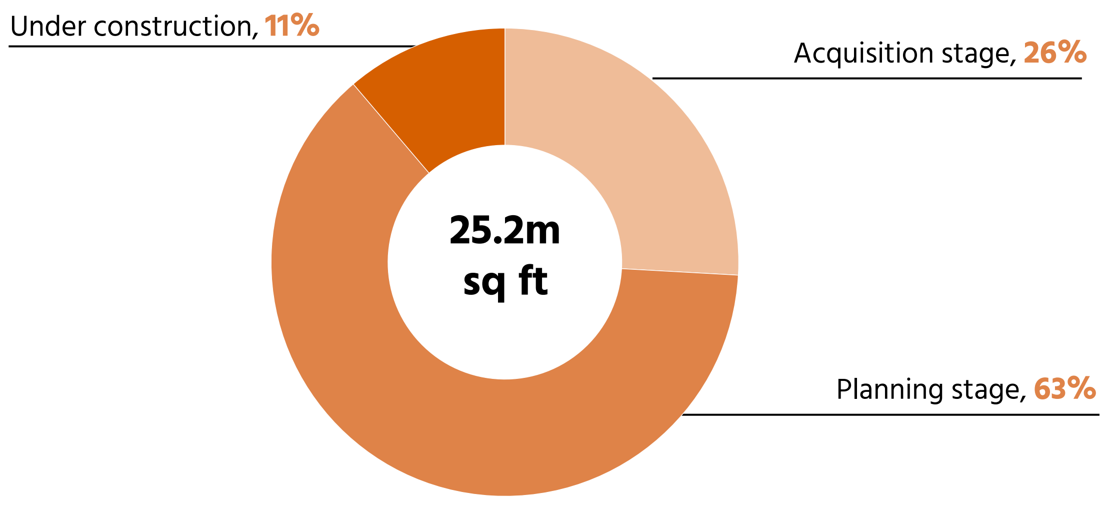
With the exception of some logistics operations, the relationship between the downturn in economic activity and future multi-let voids will likely be mediated mostly via defaults rather than planned lease events, such as breaks or expiries, or sublet 'grey' space. Such planned options on fitted out space tends to be expensive, and rent is a relatively small component of overall cost in a world of high inflation for goods, energy, shipping, labour, currency, and increasing business rates. Typically either a firm using multi-let space can trade and needs that space or it cannot and it will default. The default rate in 2021 was a record low 2.4%, and while this will rise, intelligence from the market suggests it has not increased as much as the insolvencies data suggest, thus demonstrating the relative diversity and resilience of the modern multi-let occupier base.

Development pipeline records suggest that in total there are 289 multi-let schemes at various stages across the UK, totalling a potential 25.2 million sq ft. However, this is very much notional since only around a tenth of this is actually under construction, with the remainder at the site acquisition or planning stages. The softening of multi-let yields and inflated development costs makes these schemes effectively infeasible over the medium term. Activity is greatest in the North West, but the construction pipeline is in the hundreds of thousands of sq ft, which will have a minimal impact on an entire region.

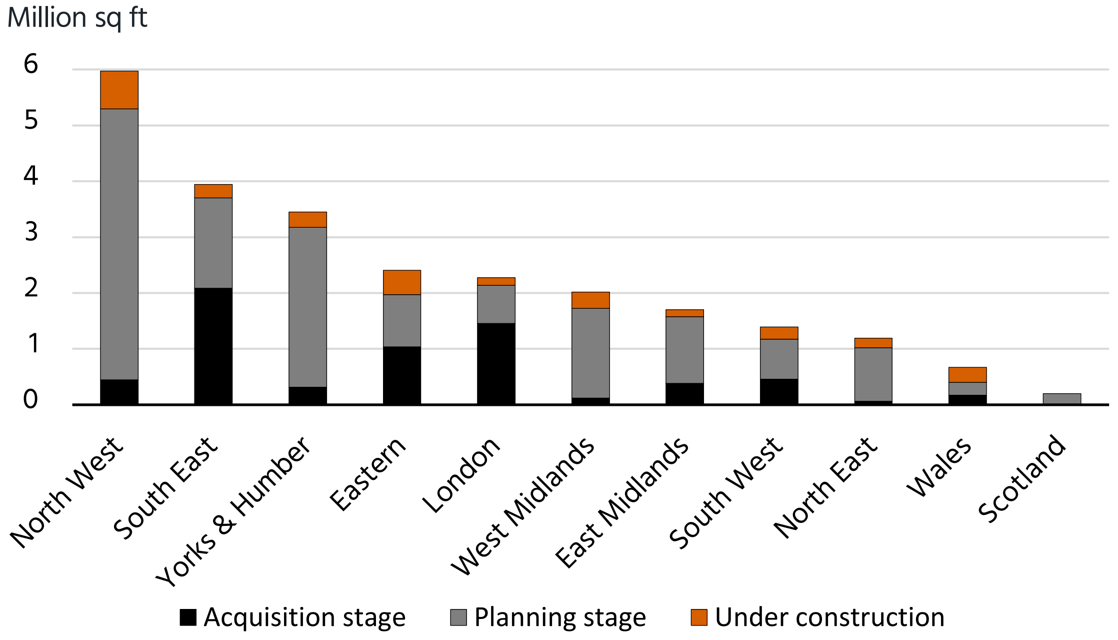
Vacancy rate by major UK region
Source: Gerald Eve



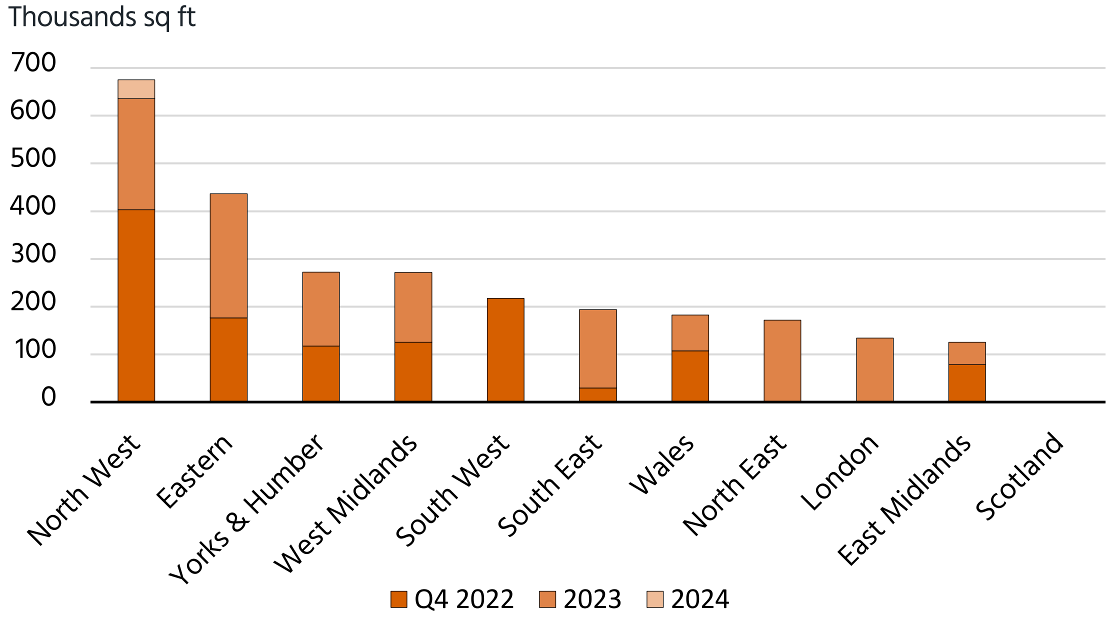
Multi-let development pipeline by status
Source: Gerald Eve, Property Data



Multi-let development pipeline by region
Source: Gerald Eve, Property Data



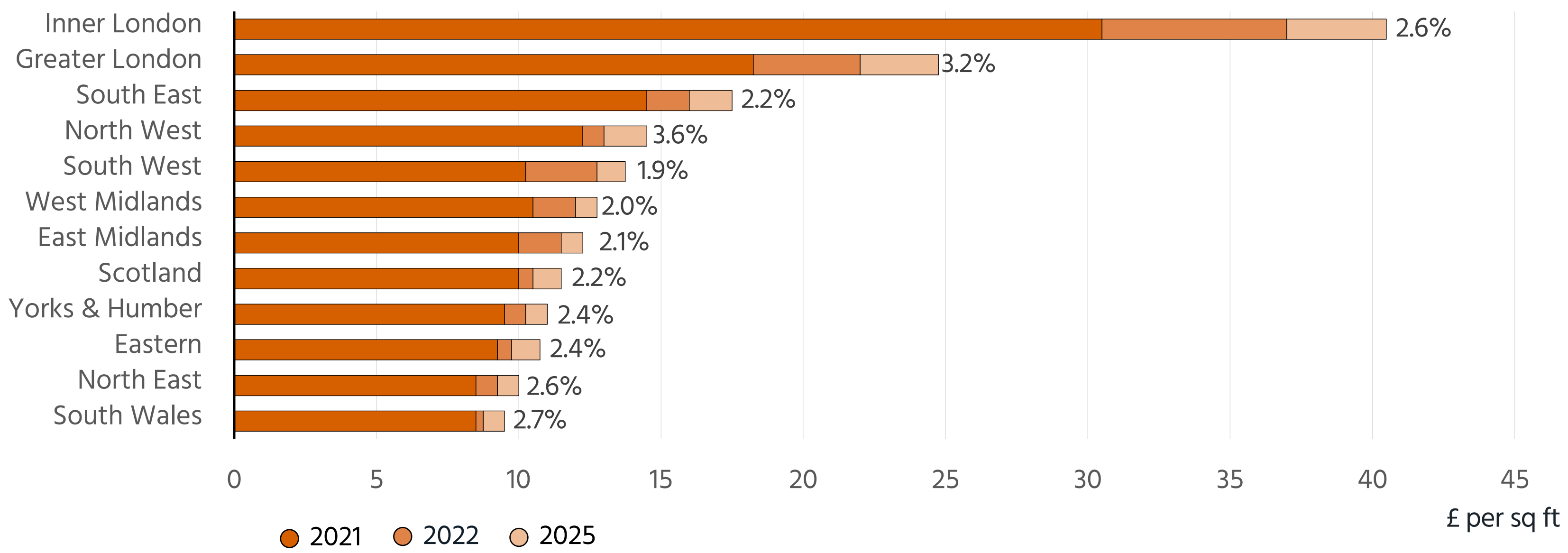
Expected completion dates of schemes under construction
Source: Gerald Eve, Property Data



RENTAL OUTLOOK

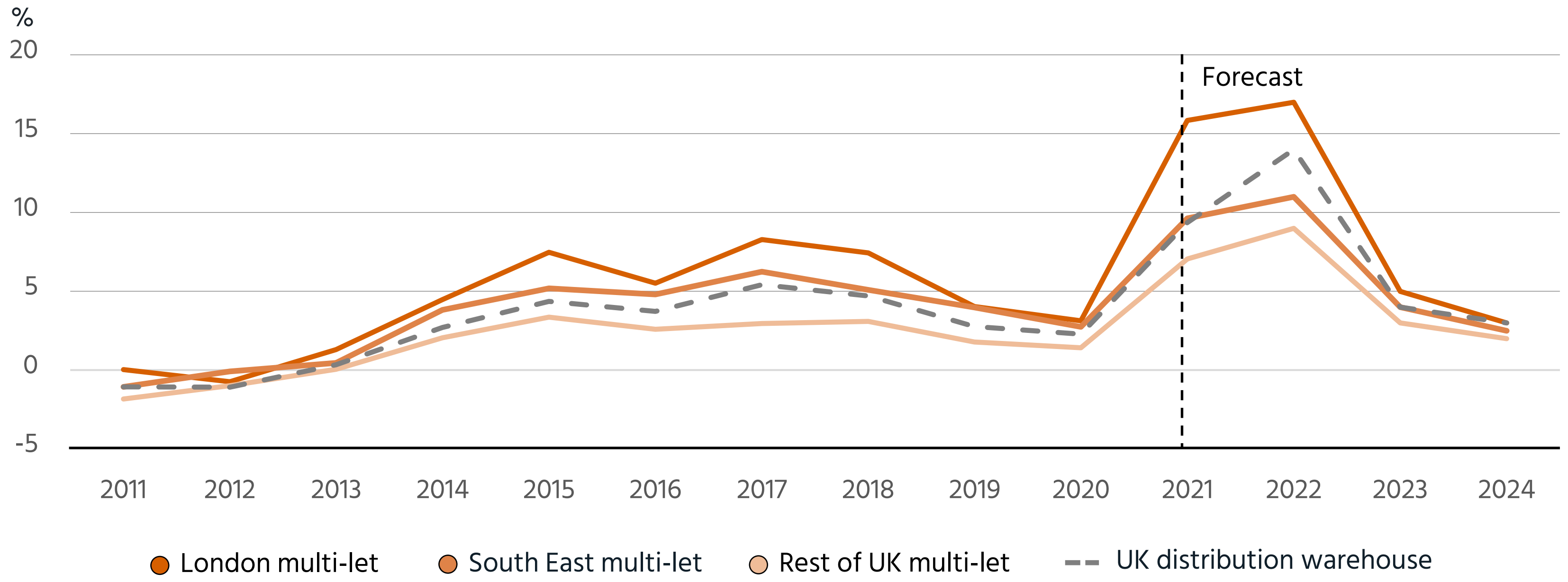
Prime multi-let rents and average annual growth 2023-25

Source: Gerald Eve



All-grades multi-let rental growth

Source: MSCI, Gerald Eve



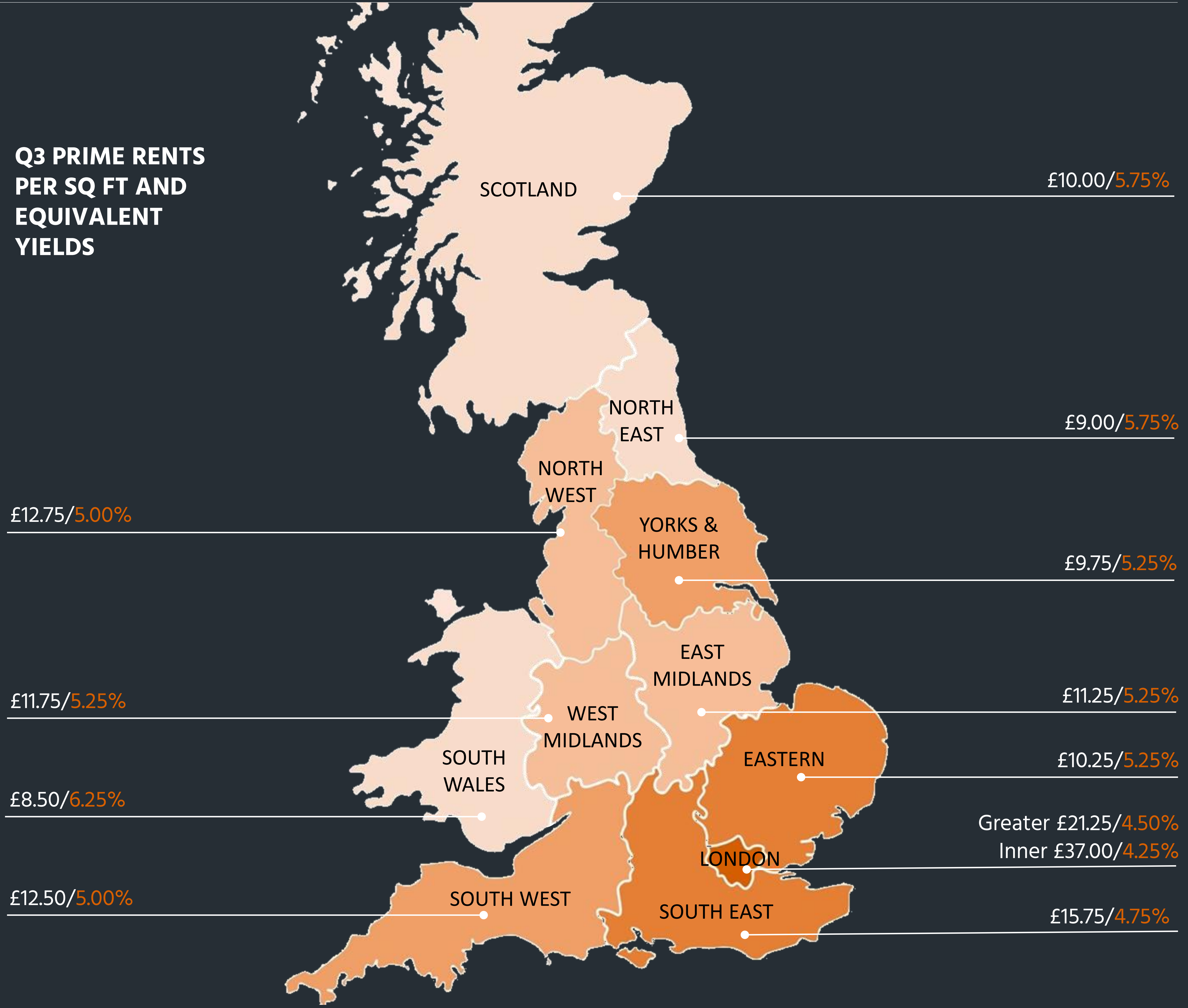
We've entered recession and this is set to be the first real test for the modern multi-let market. Pressure on occupiers is coming from a variety of directions, not just in slowing demand but in the form of increased costs on energy, materials, labour, shipping, currency and add to that a 20-40% hike in business rates in 2023. There's currently an understandable pause for breath in the lettings market while the new trading conditions continue to make themselves known. But we remain upbeat on the sector's diversity and resilience that will see it through this challenging period.

Mark Trowell, Partner

MULTI-LET REGIONS

Click on a region to jump to the page for more detailed breakdown and insight.

Q3 PRIME RENTS PER SQ FT AND EQUIVALENT YIELDS

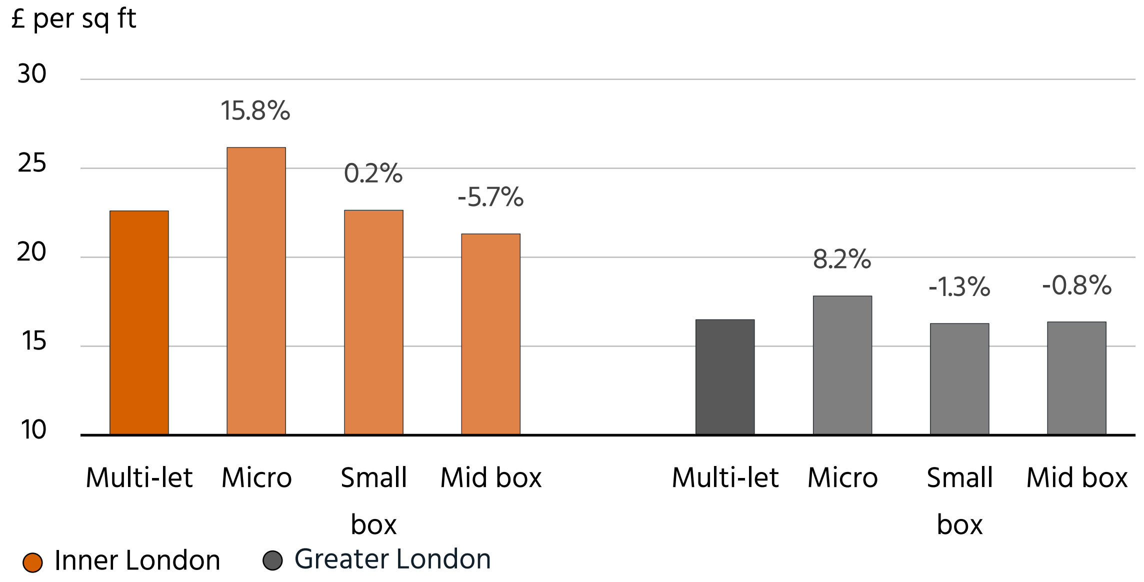


LONDON

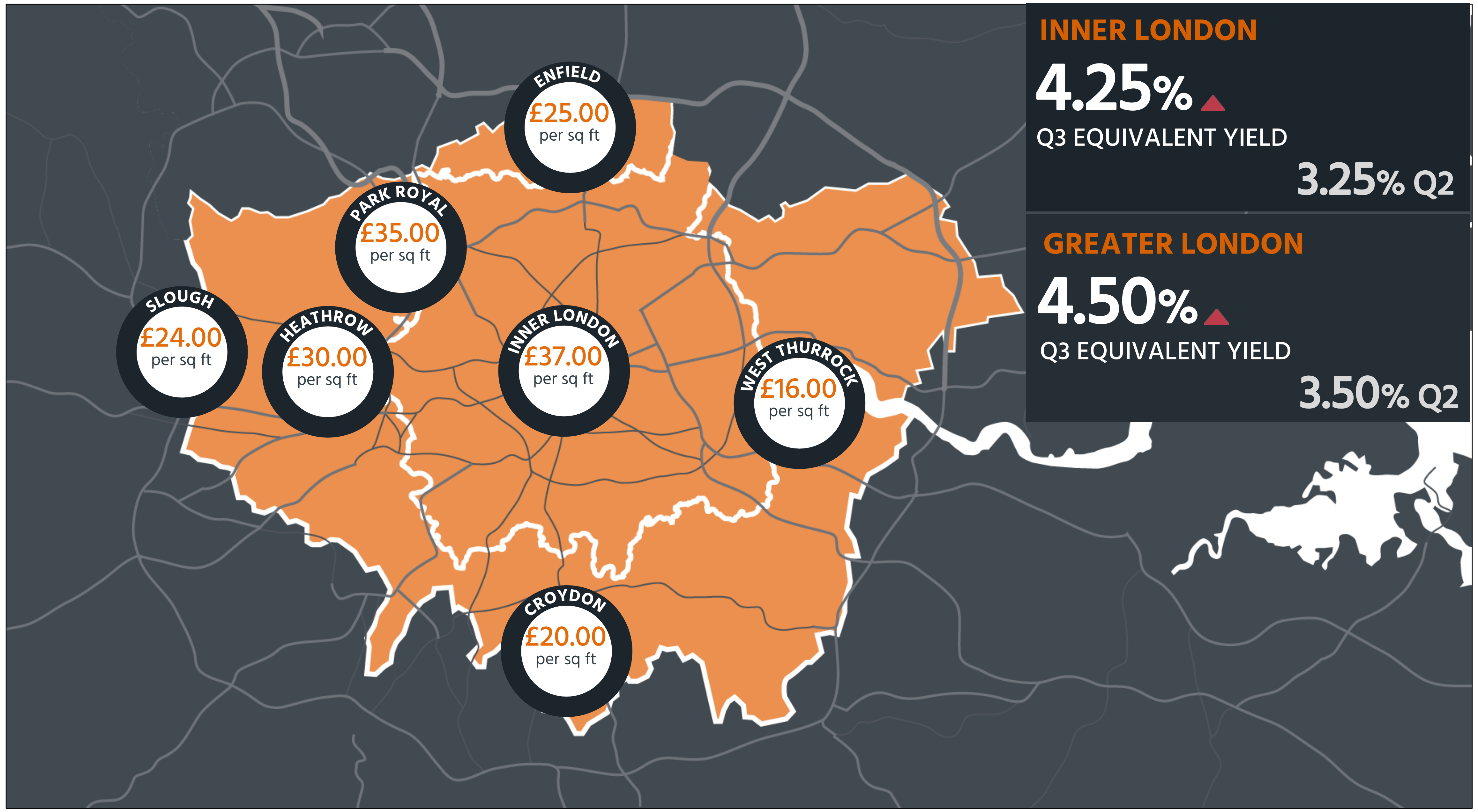
Continue with this region

All-grades ERV by area
Source: Gerald Eve

Q3 all-grades ERV by unit size and % premium/discount
Source: Gerald Eve

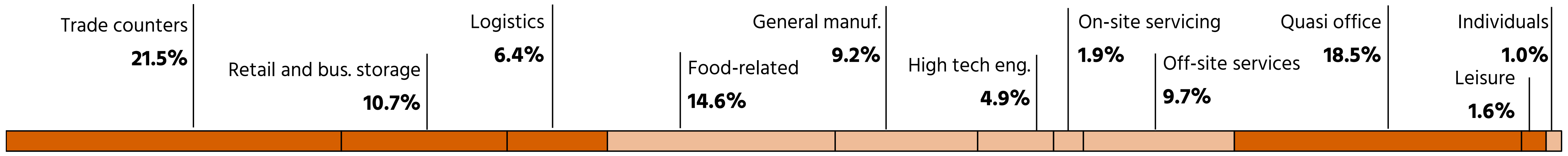


Q3 prime rents and equivalent yields
Source: Gerald Eve

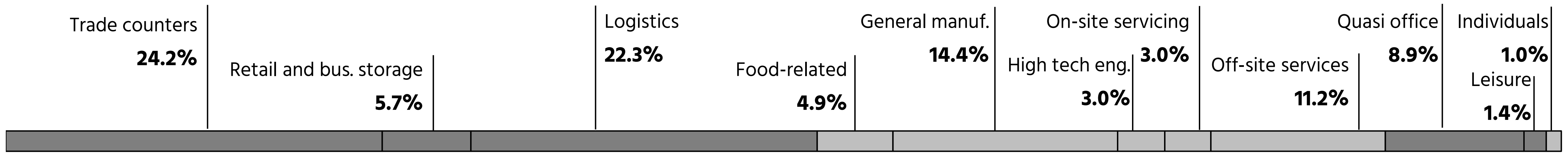


LONDON

Inner London



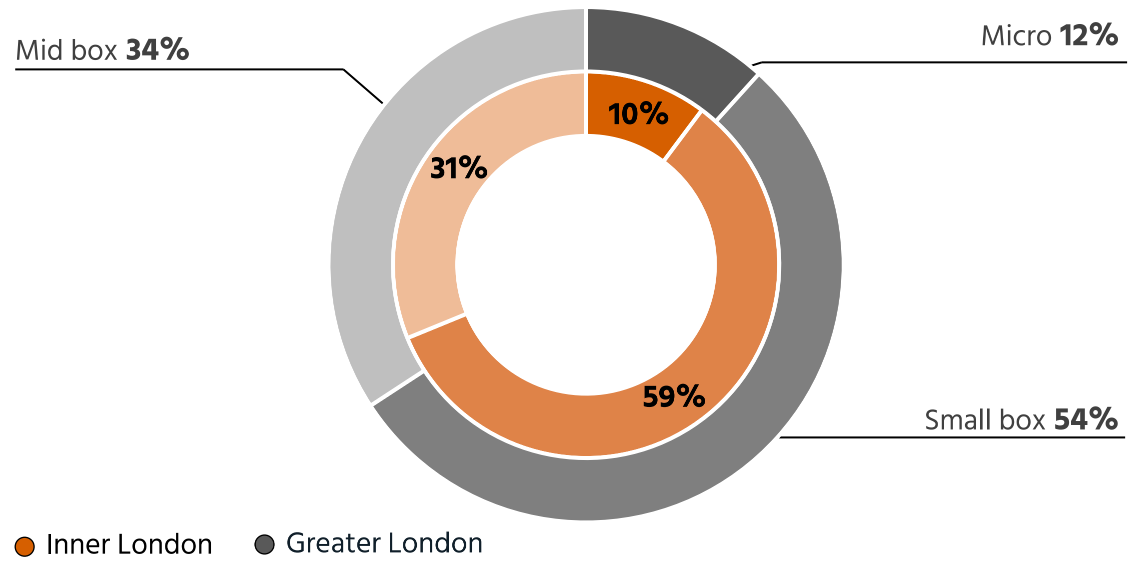
Greater London



London has the largest prime multi-let market in the UK, where headline rents have successively pushed through record highs. Rental reversion is the highest in the country at as much as 35%. Inner London is the most expensive submarket of course, at £37.00 per sq ft, while West Thurrock to the east is the cheapest at £16.00 per sq ft. The market is characterised by a notably oversized proportion of food-related occupiers in Inner London and logistics operators in Greater London, notably in the mid box units. The EPC credentials are the best in the country, with a tiny proportion of F&G units and a majority in the A-C range. There are potentially 24 schemes in the development pipeline, totalling 2.3m sq ft. However, only the 135,000 sq ft multi-storey SEGRO V-Park is under construction and due in 2023.

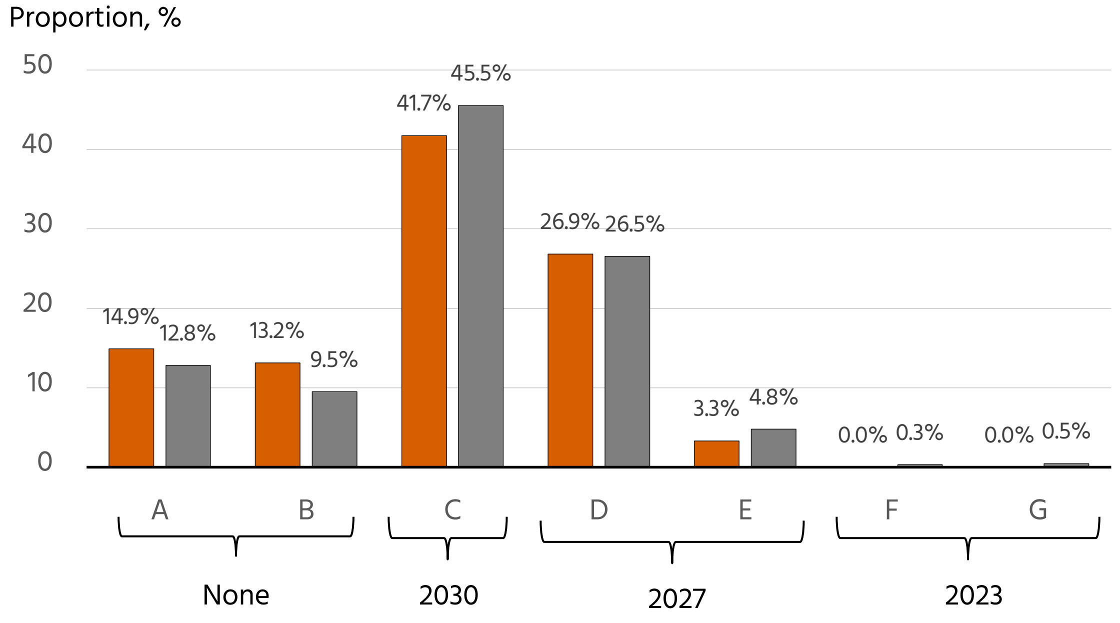
Proportion of floorspace by unit size

Source: Gerald Eve



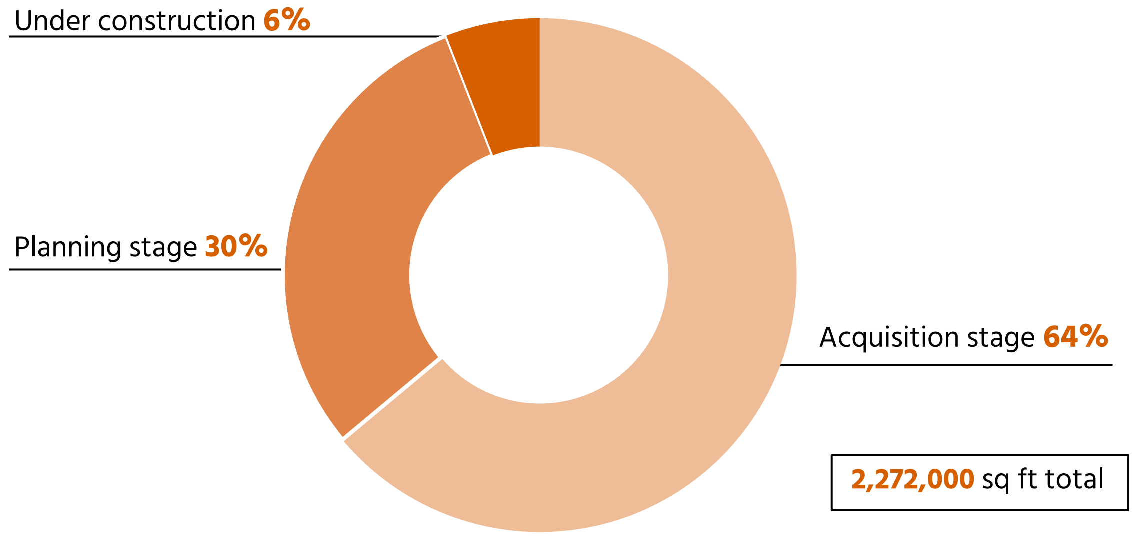
Floorspace by EPC grade (& deadline to non-compliance)

Source: Gerald Eve



Development pipeline

Source: Gerald Eve, Property Data

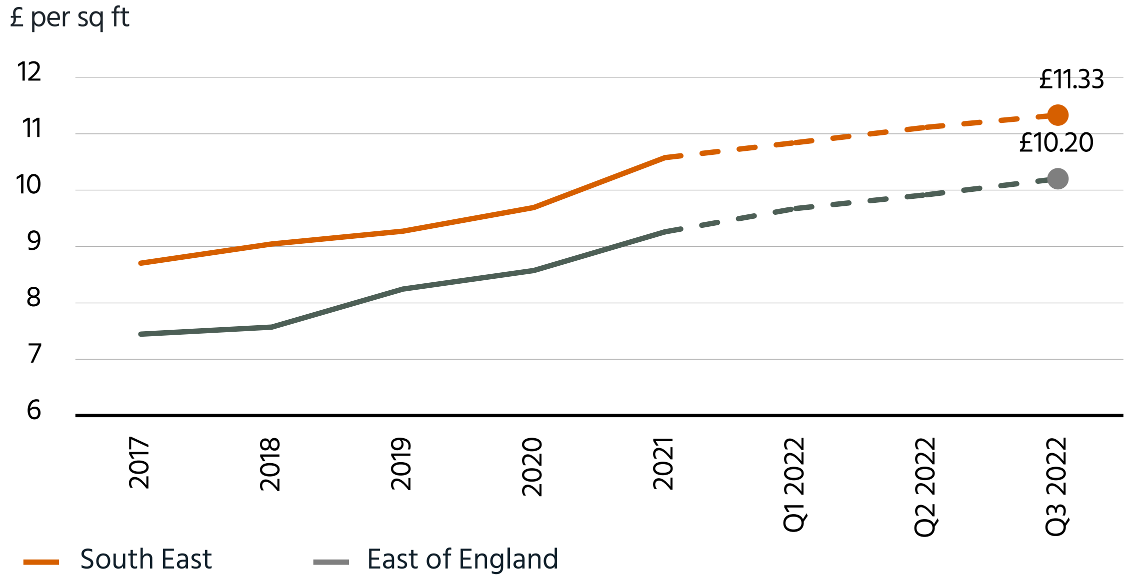


THE SOUTH AND EAST

Continue with this region

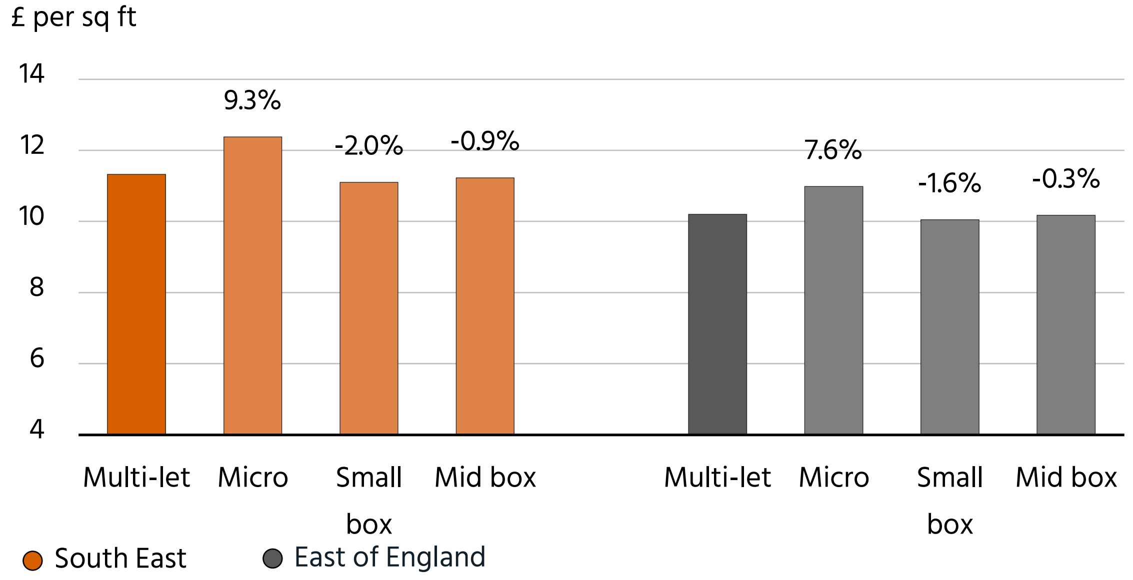
All-grades ERV by area

Source: Gerald Eve



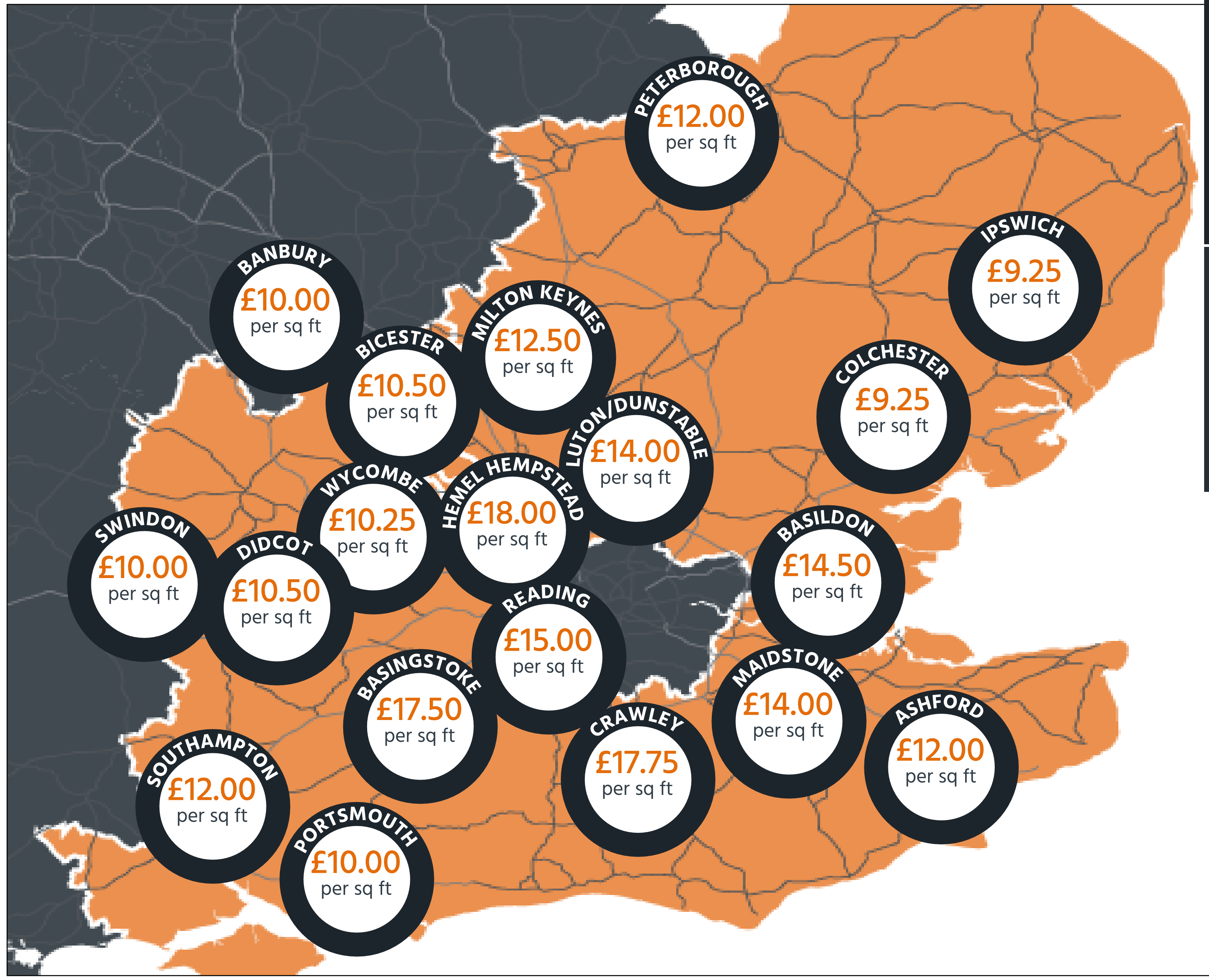
Q3 all-grades ERV by unit size and % premium/discount

Source: Gerald Eve



Q3 prime rents and equivalent yields

Source: Gerald Eve



SOUTH EAST

4.75% ▲

Q3 EQUIVALENT YIELD

3.75% Q2

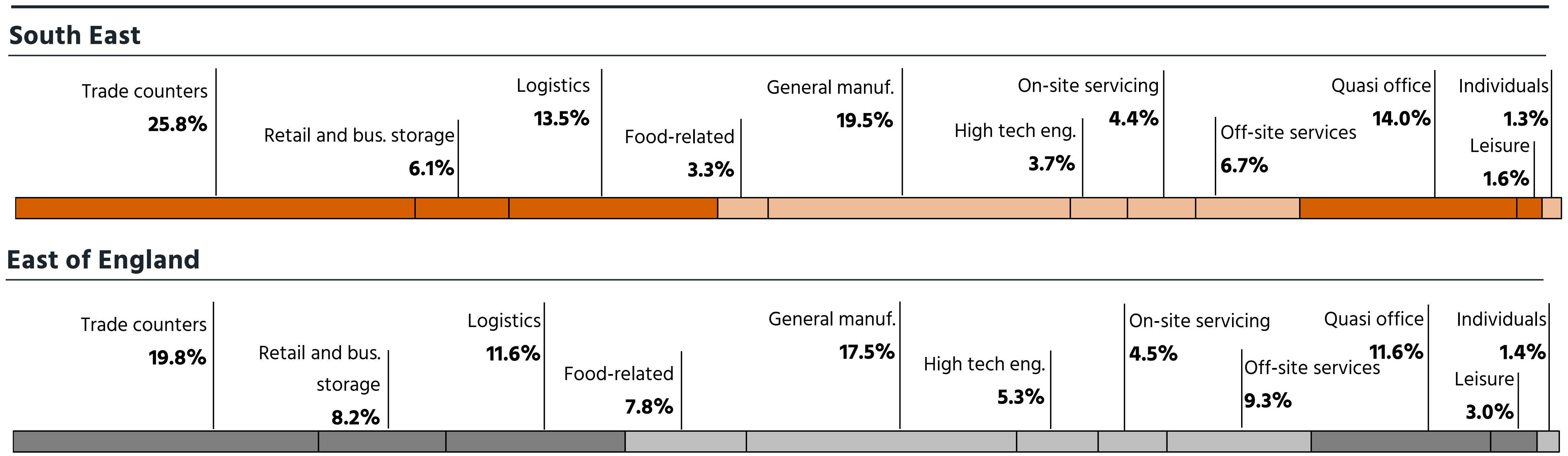
EAST OF ENGLAND

5.25% ▲

Q3 EQUIVALENT YIELD

4.25% Q2

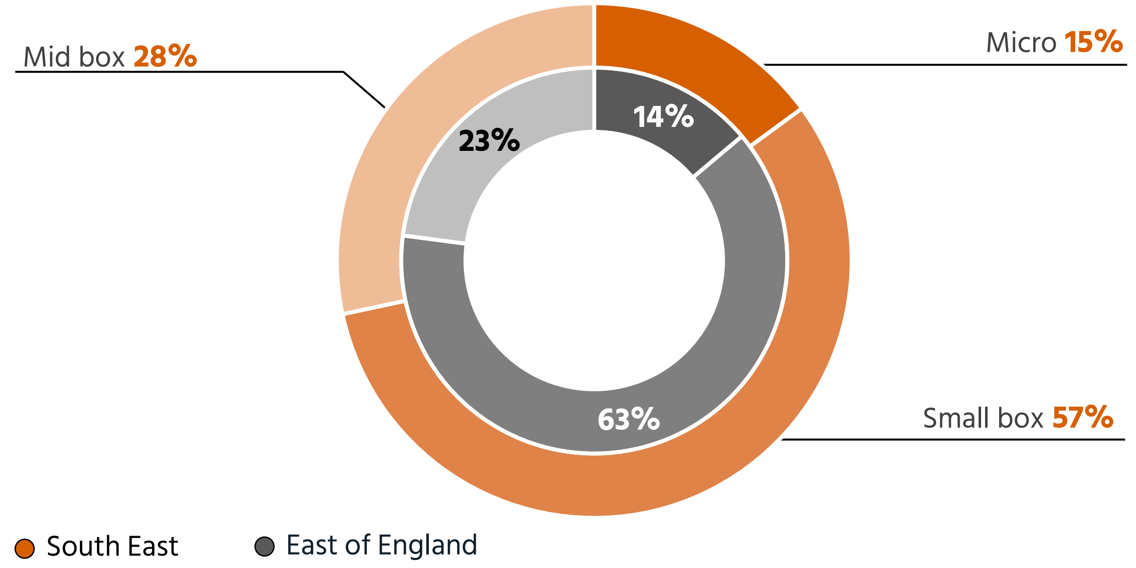
THE SOUTH AND EAST



The South and East covers a wide range of multi-let markets, from £18.00 per sq ft in Hemel Hempstead to only £9.25 per sq ft in Ipswich. There is a more moderate amount of multi-let logistics operations here than in Greater London, and a notably smaller proportion of trade counters in the East of England in favour of food and traditional manufacturing. Well over a third of multi-let space is EPC grade D or below and will need refurbishment before 2027. There are 60 schemes in the pipeline, two-thirds of which are in the South East where the average scheme size is an above-average 104,000 sq ft. Though a smaller total, 18% of the East of England pipeline is under construction. The largest scheme is Red Brick Farm in Peterborough, which is set to deliver five multi-let units in Q4 as part of a larger 25 acre development.

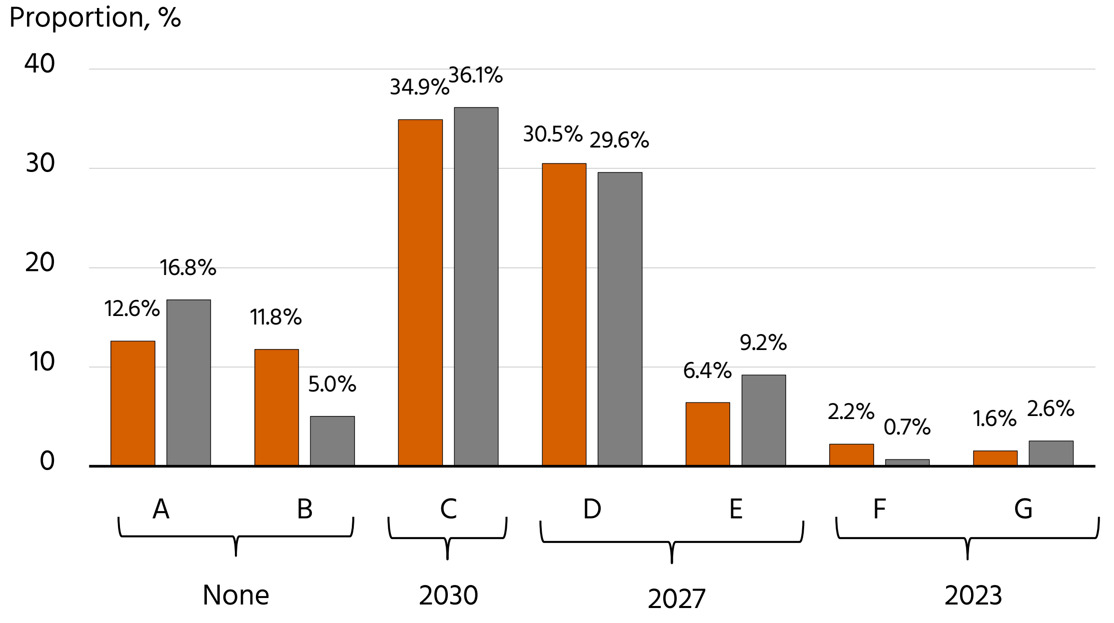
Proportion of floorspace by unit size

Source: Gerald Eve



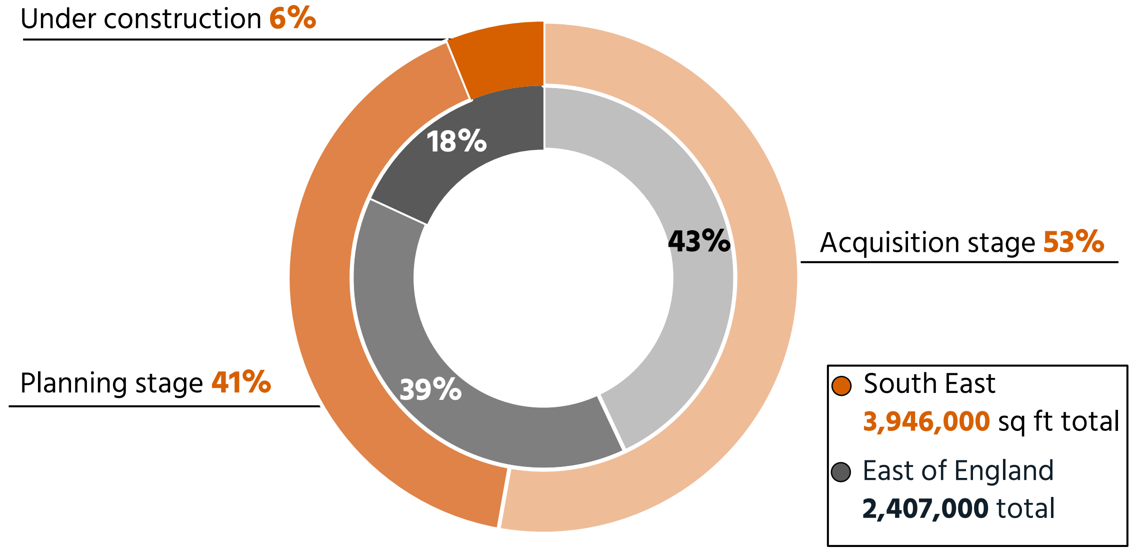
Floorspace by EPC grade (& deadline to non-compliance)

Source: Gerald Eve



Development pipeline

Source: Gerald Eve, Property Data

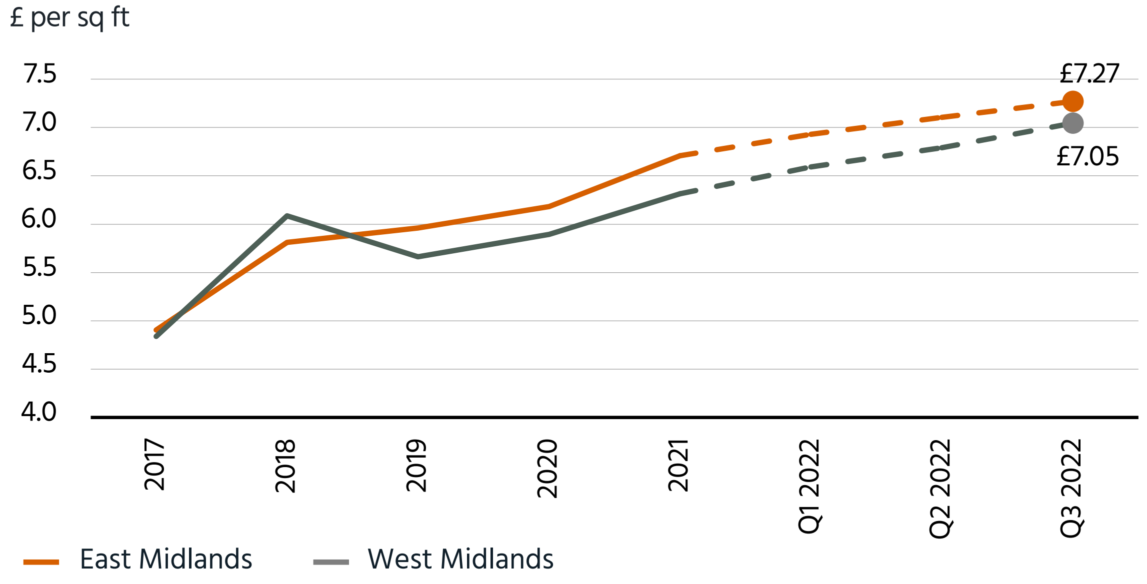


THE MIDLANDS

Continue with this region

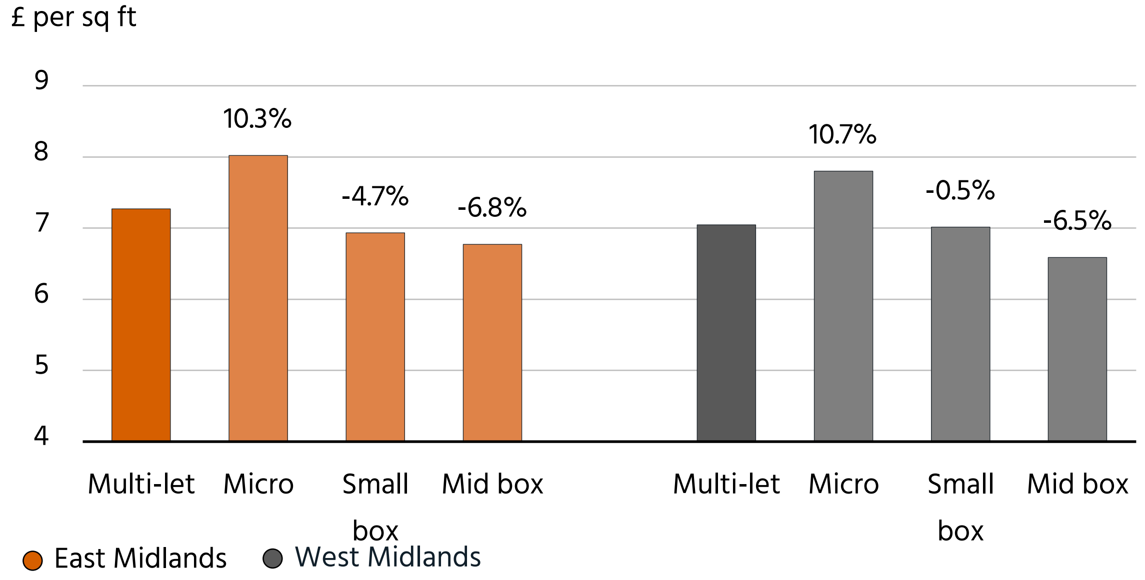
All-grades ERV by area

Source: Gerald Eve



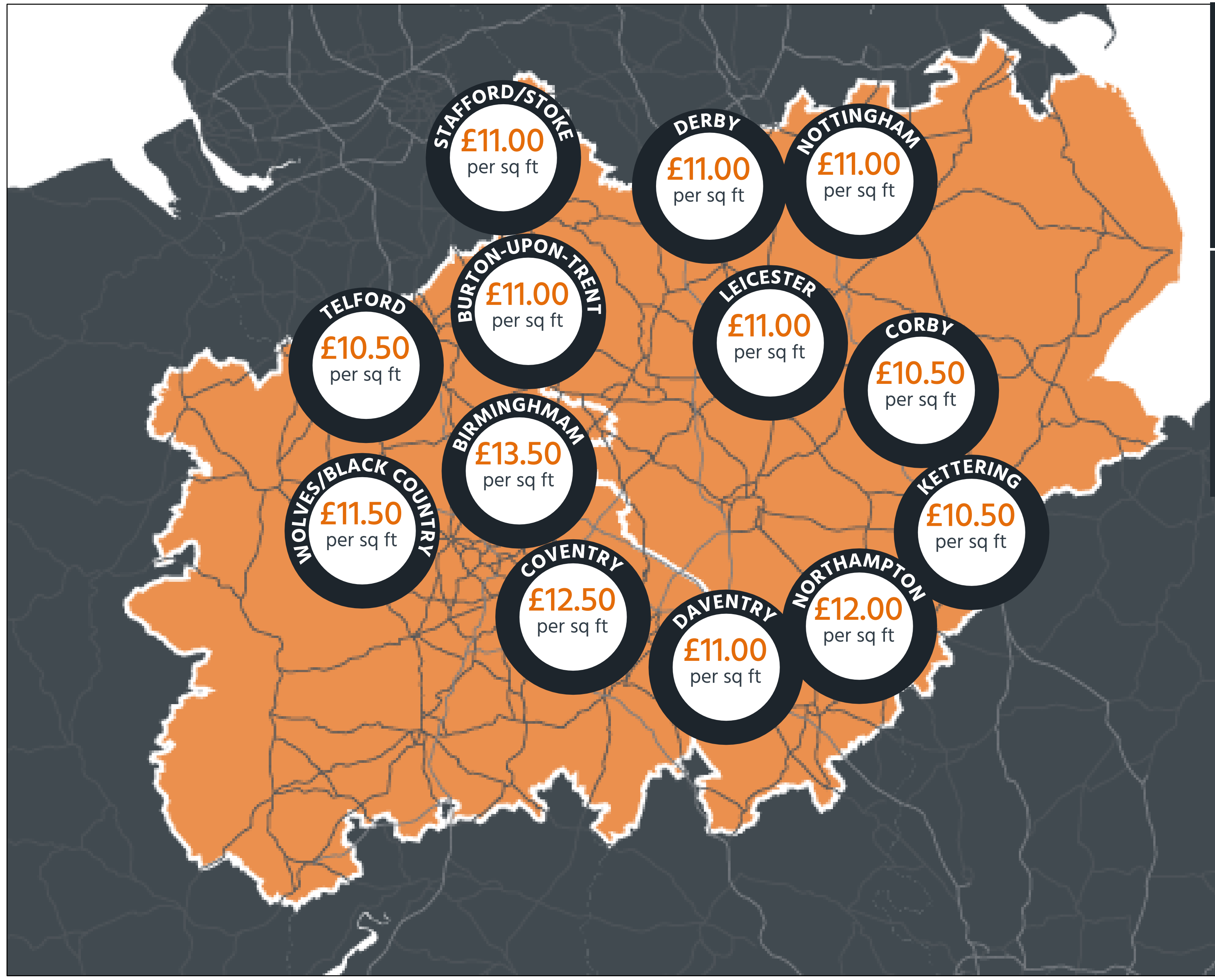
Q3 all-grades ERV by unit size and % premium/discount

Source: Gerald Eve



Q3 prime rents and equivalent yields

Source: Gerald Eve



EAST MIDLANDS

5.25%

Q3 EQUIVALENT YIELD

4.25% Q2

WEST MIDLANDS

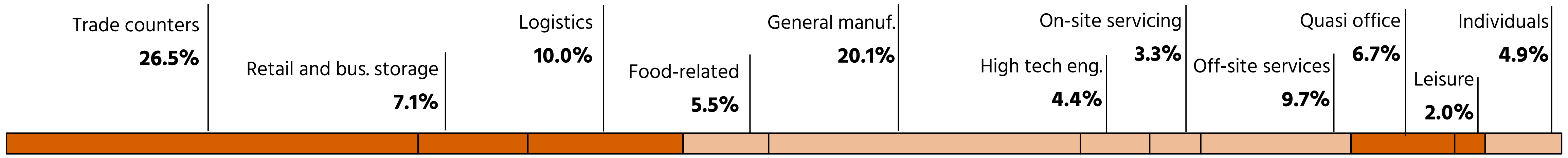
5.25%

Q3 EQUIVALENT YIELD

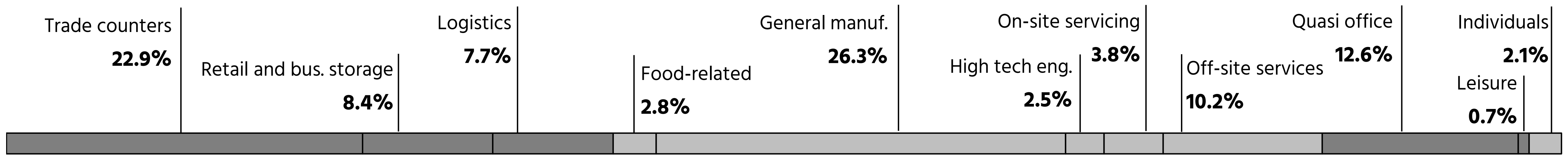
4.25% Q2

THE MIDLANDS

East Midlands



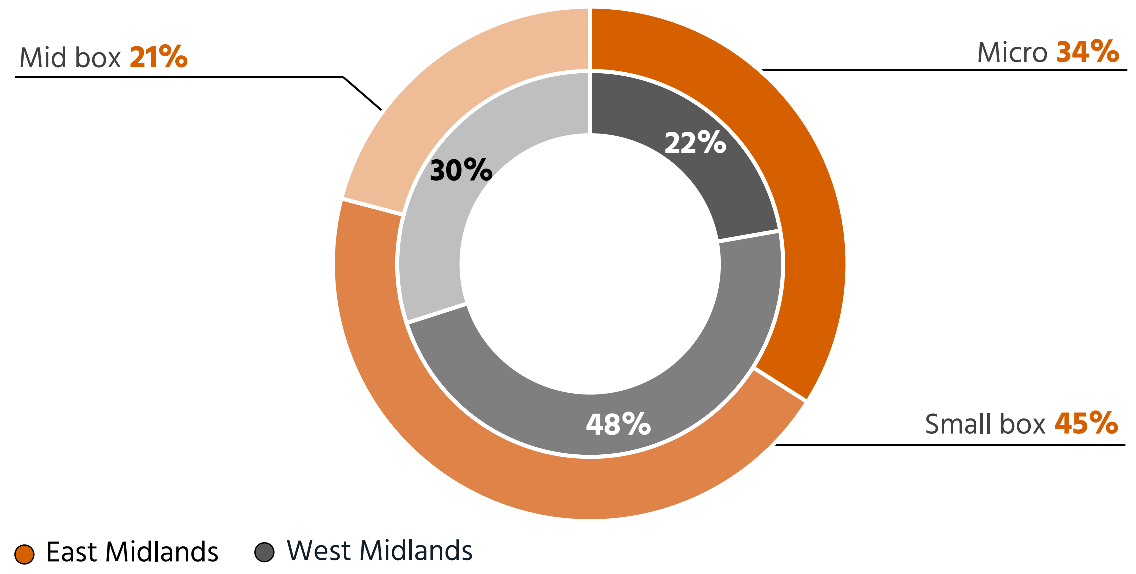
West Midlands



Prime rents vary relatively little in the Midlands, with Telford and Corby at £10.50 per sq ft and Birmingham the most expensive at £13.50 per sq ft. Multi-let space in the Midlands has a higher proportionate amount of manufacturing occupiers than the South, particularly in the West Midlands. Over a quarter of East Midlands floorspace is trade counter-occupied. Over 40% of multi-let space is EPC grade D or below and will need refurbishment before 2027. A significant 7.2% of stock in the West Midlands is at grades F&G and will need imminent refurbishment by April 2023. There are 51 schemes in the pipeline, totalling 3.7m sq ft. While only 7% of the West Midlands pipeline is under construction, one of the largest scheme, Network Space's 110,000 sq ft Tunstall Arrow North, is due for completion in Q4.

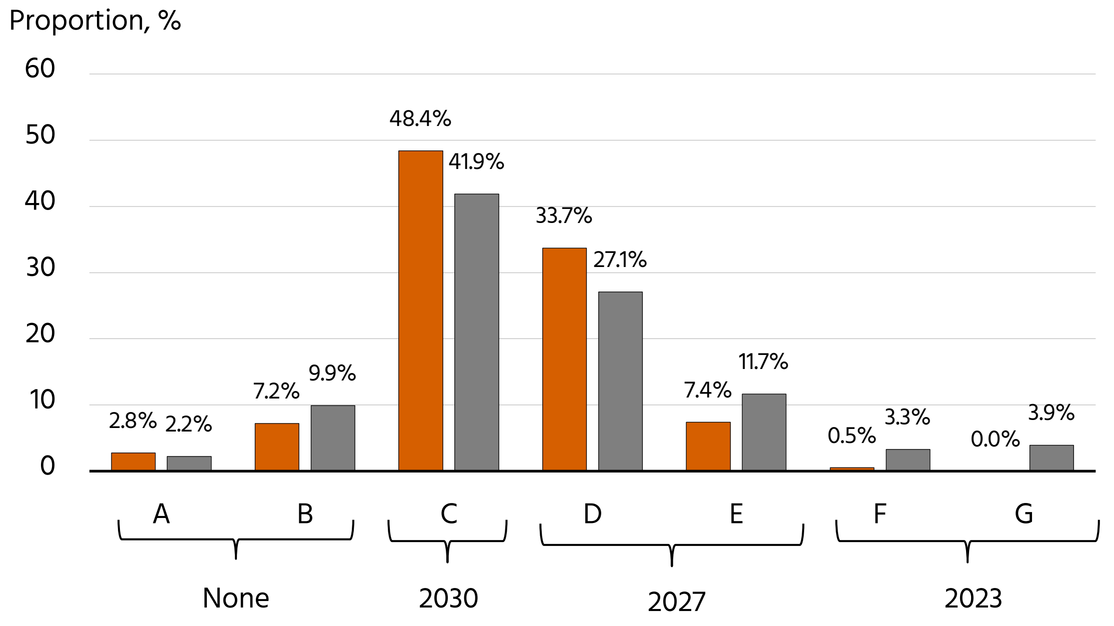
Proportion of floorspace by unit size

Source: Gerald Eve



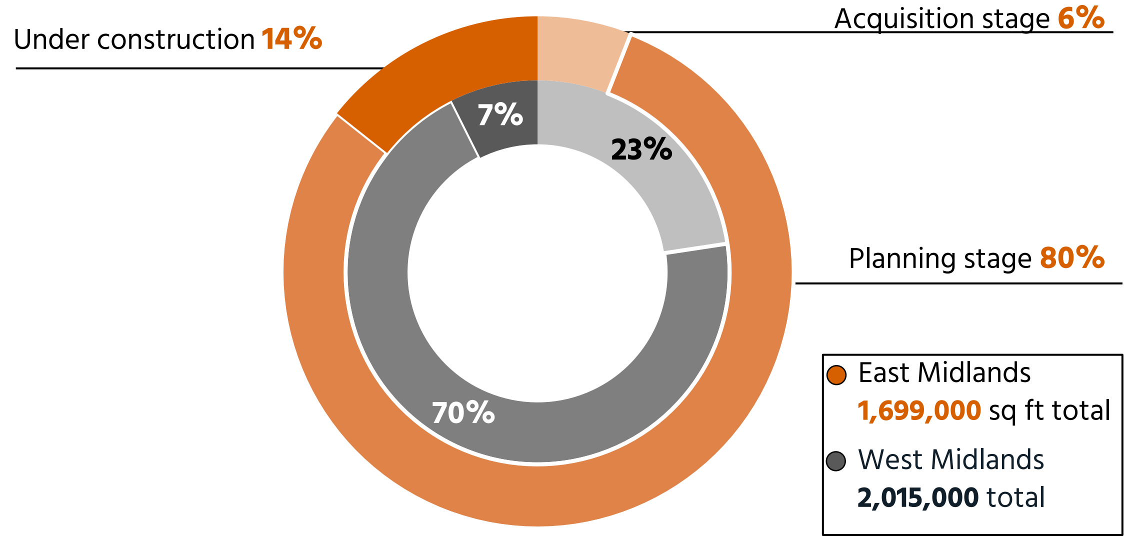
Floorspace by EPC grade (& deadline to non-compliance)

Source: Gerald Eve



Development pipeline

Source: Gerald Eve, Property Data

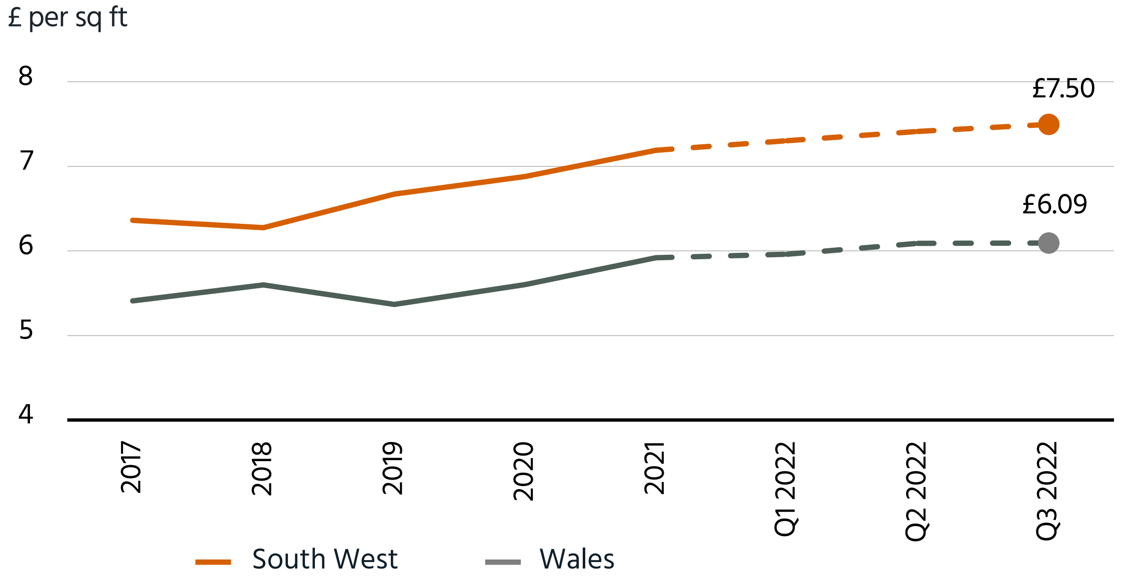


SOUTH WEST AND WALES

Continue with this region

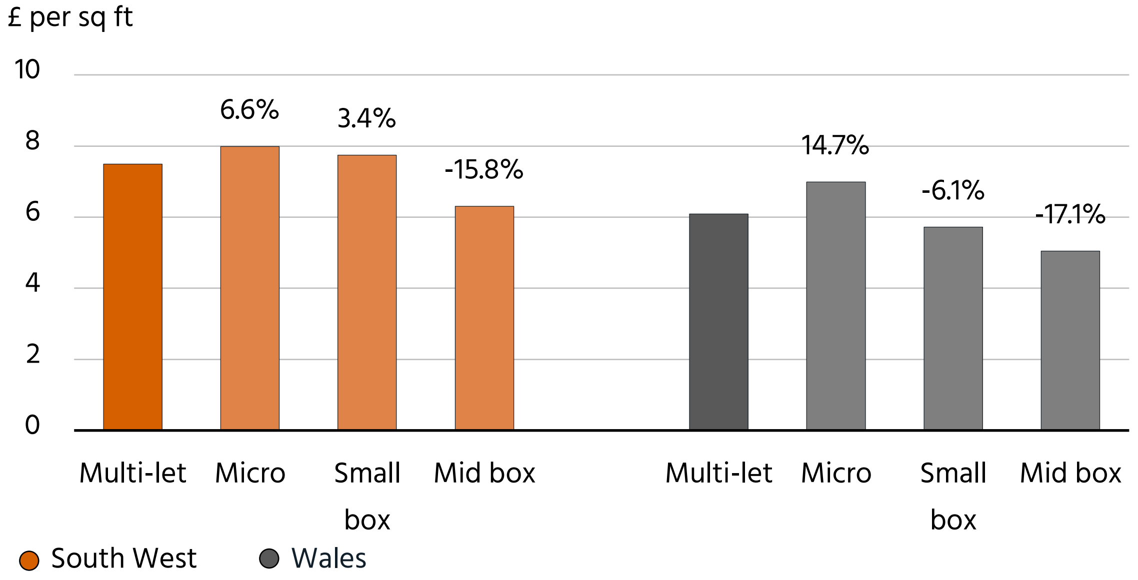
All-grades ERV by area

Source: Gerald Eve



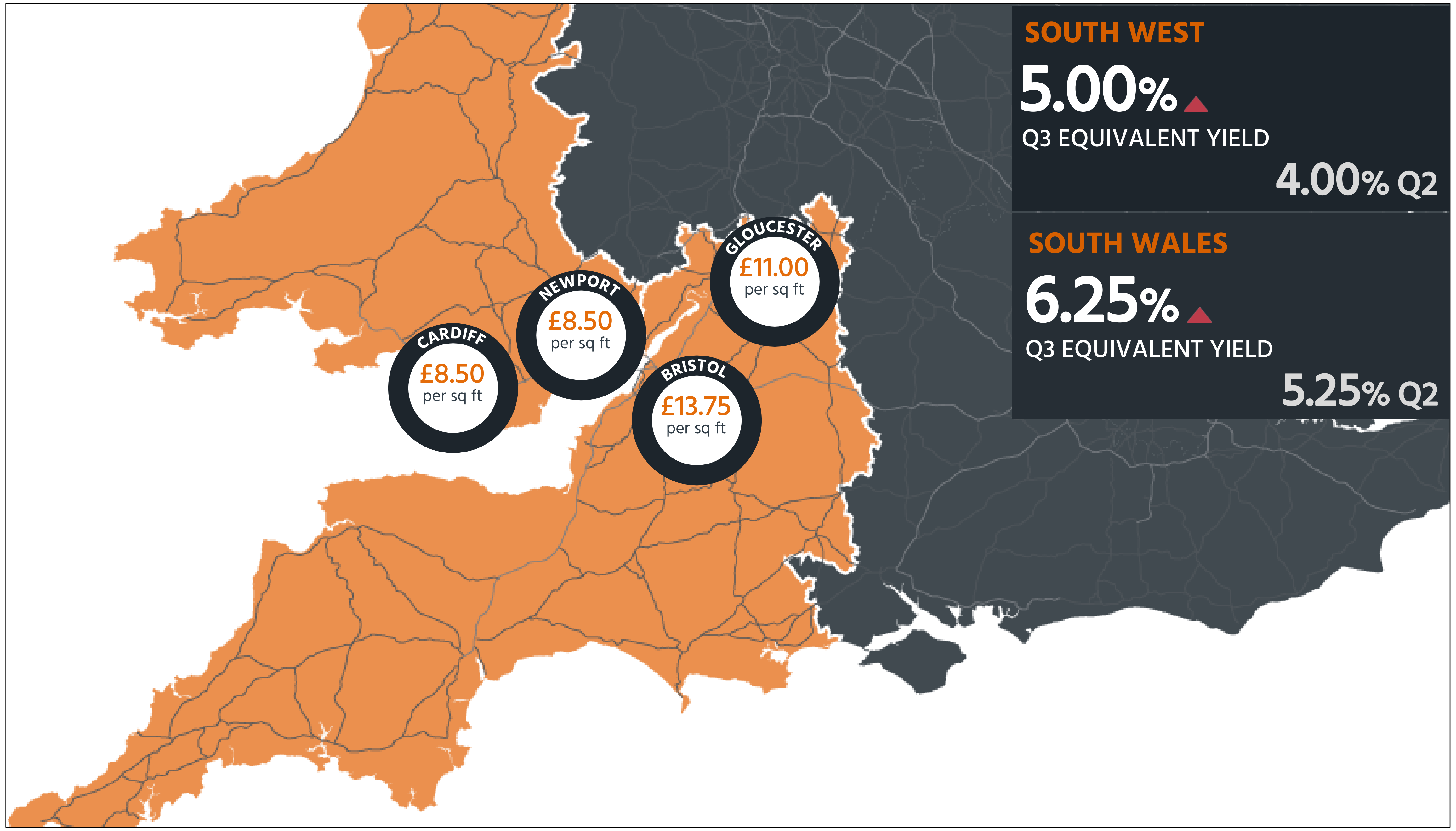
Q3 all-grades ERV by unit size and % premium/discount

Source: Gerald Eve



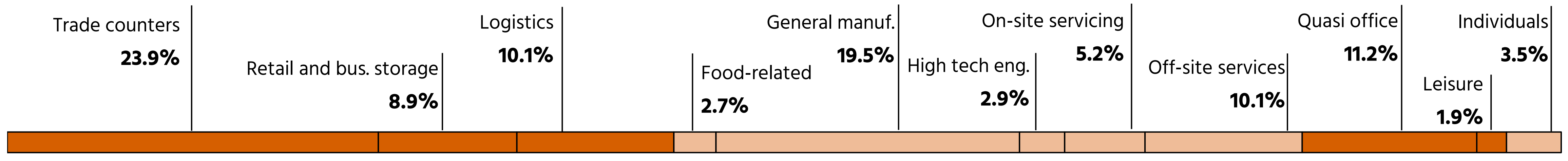
Q3 prime rents and equivalent yields

Source: Gerald Eve

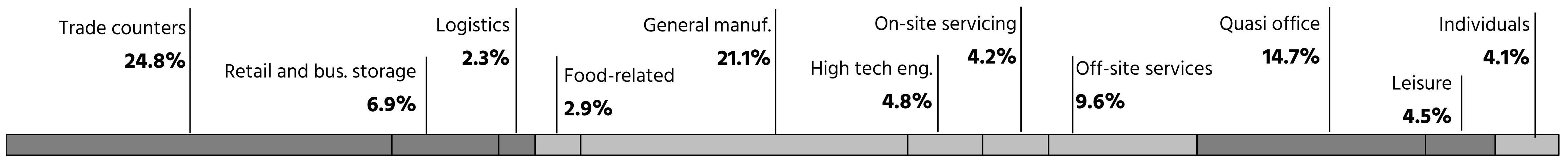


SOUTH WEST AND WALES

South West



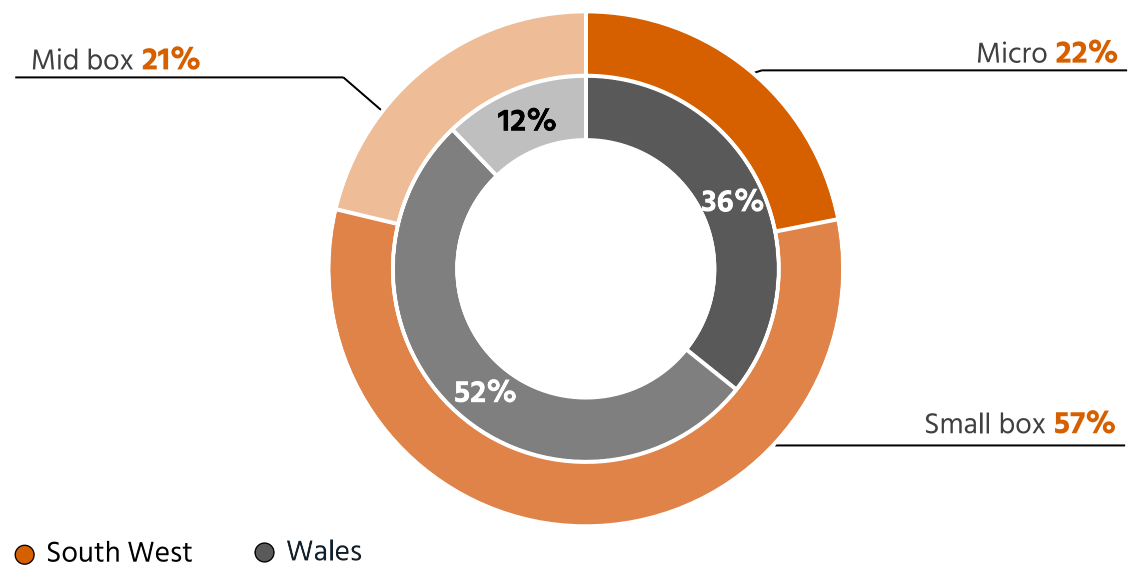
Wales



The prime market in this region is dominated by Bristol, valued at £13.75 per sq ft, compared with only £8.50 per sq ft across in South Wales. Wales multi-let, like Scotland, is characterised by a significantly lower proportion of logistics tenants than elsewhere in the UK. While relatively small proportions of both markets are rated as EPC grades F&G, there is a large proportion that are D&E, meaning that around half of the stock will need to be refurbished by 2027 if it is to remain compliant. There are 31 schemes in the pipeline and generally a low level of activity compared with the rest of the UK. Wales has the second smallest potential pipeline in the UK after Scotland but a massive 40% of it is under construction. Four units at Modwen Park Newport are due for completion in Q4, totalling 107,000 sq ft.

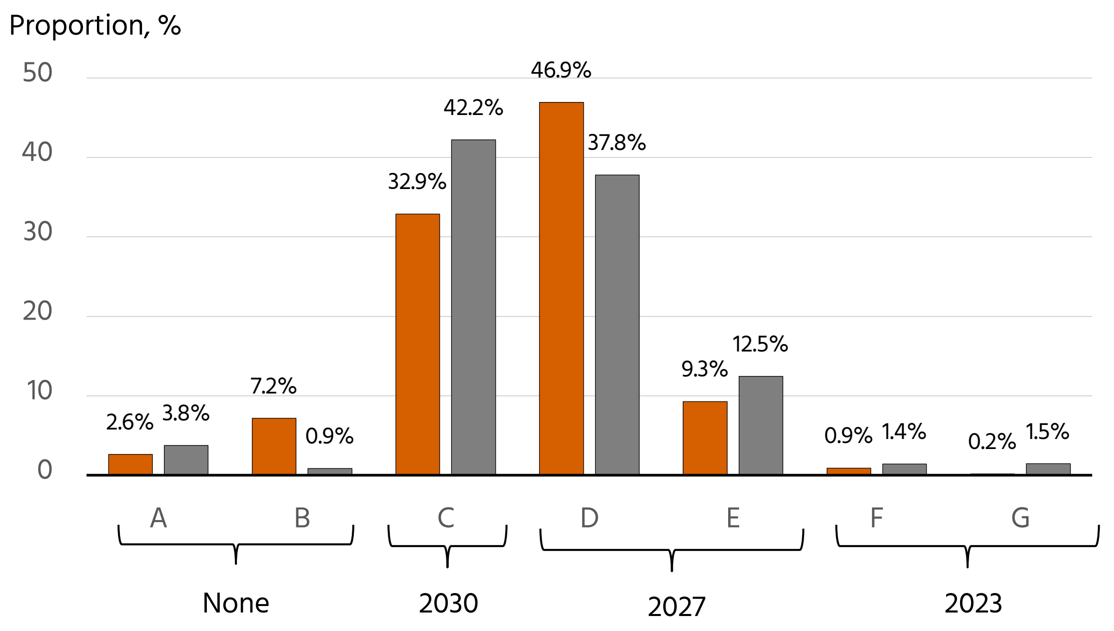
Proportion of floorspace by unit size

Source: Gerald Eve



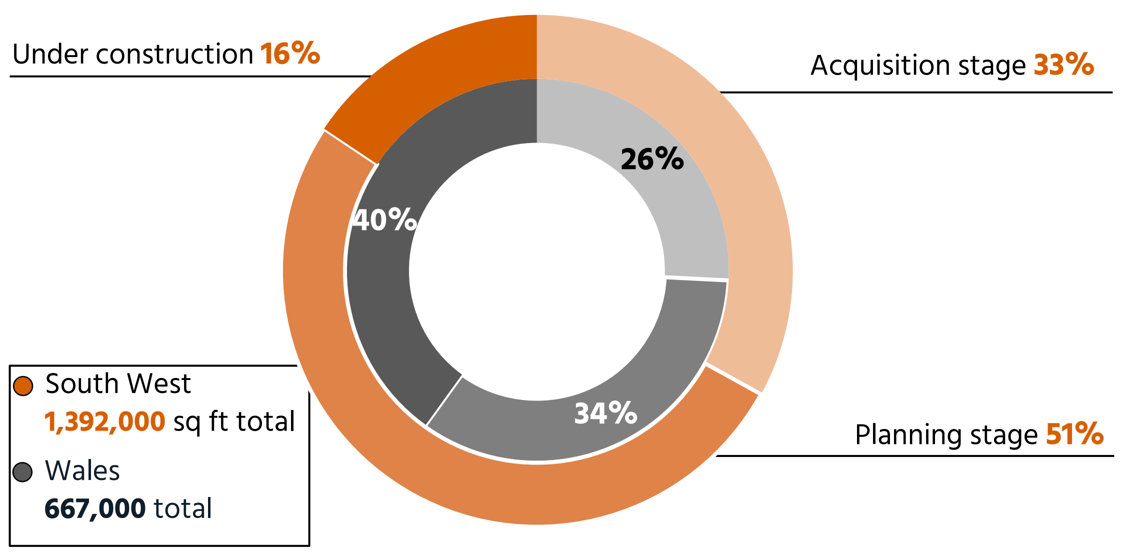
Floorspace by EPC grade (& deadline to non-compliance)

Source: Gerald Eve



Development pipeline

Source: Gerald Eve, Property Data



THE NORTH

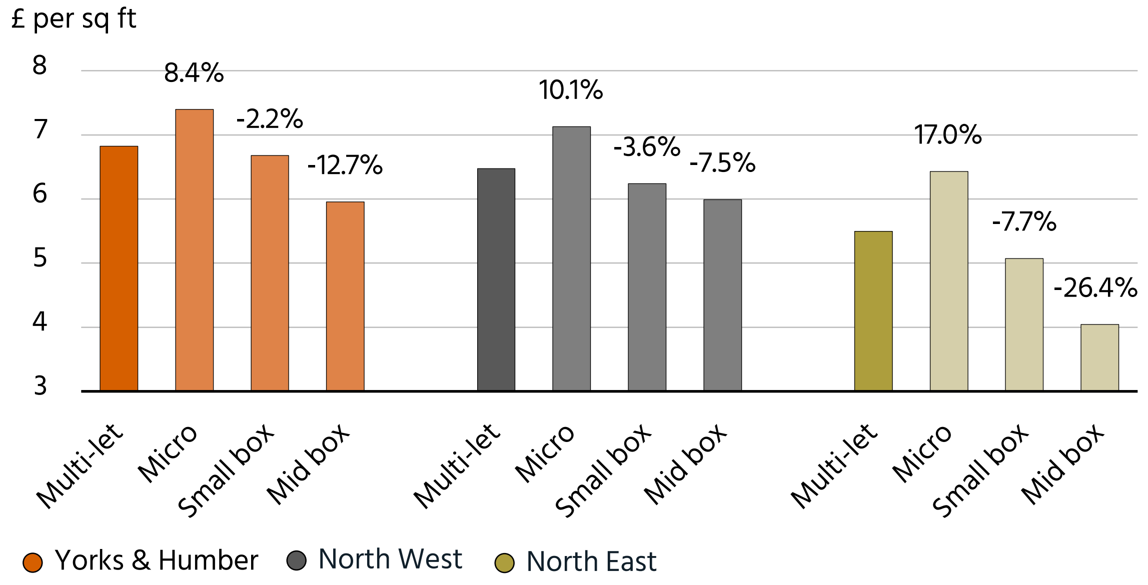
Continue with this region

All-grades ERV by area

Source: Gerald Eve

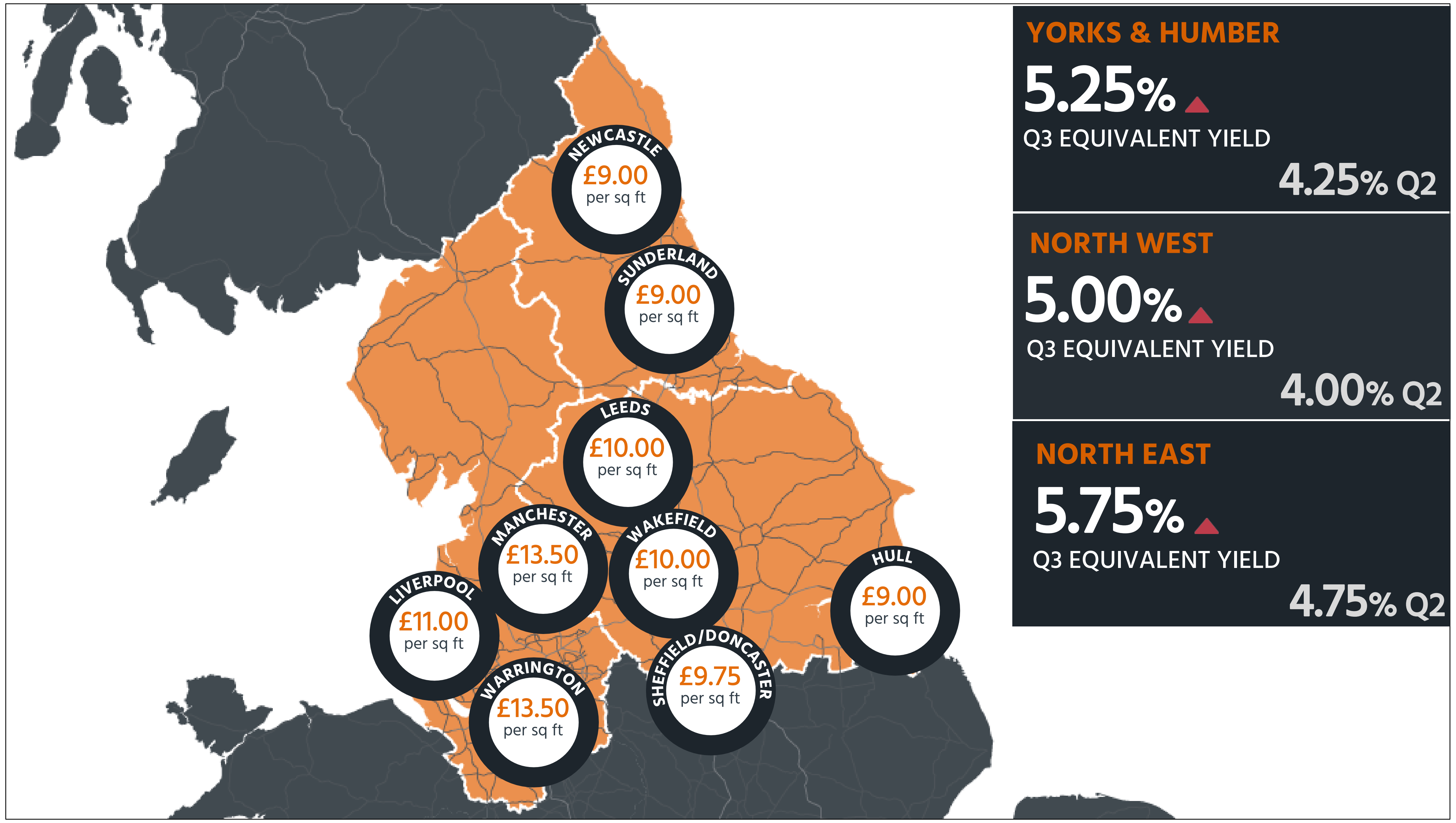
Q3 all-grades ERV by unit size and % premium/discount

Source: Gerald Eve

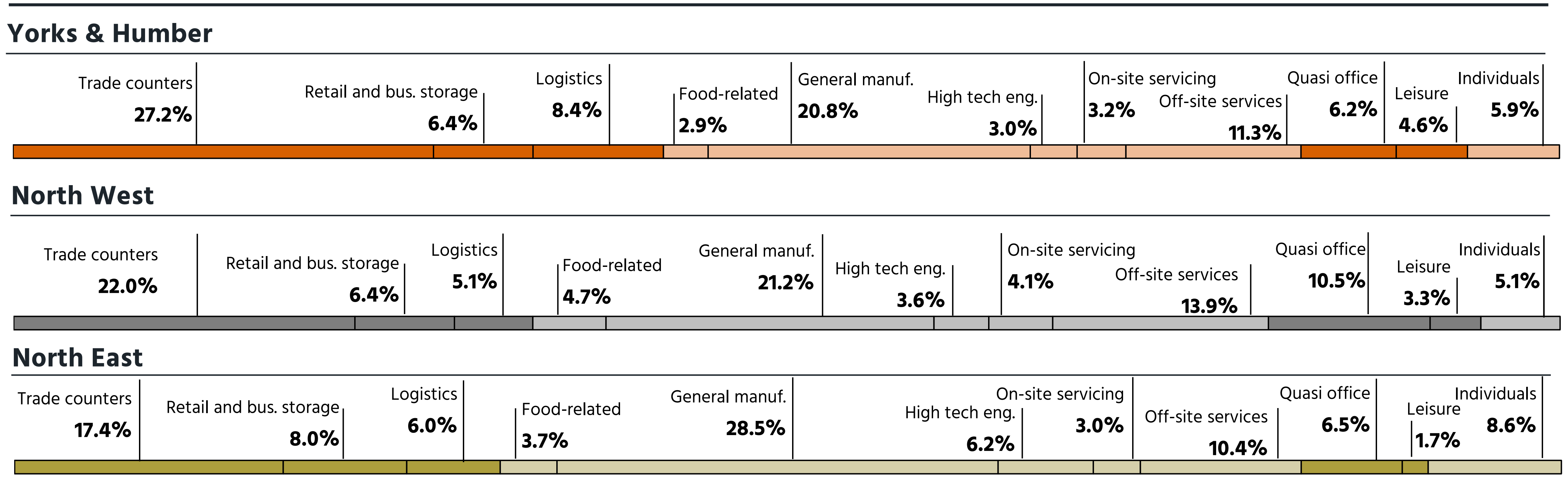


Q3 prime rents and equivalent yields

Source: Gerald Eve

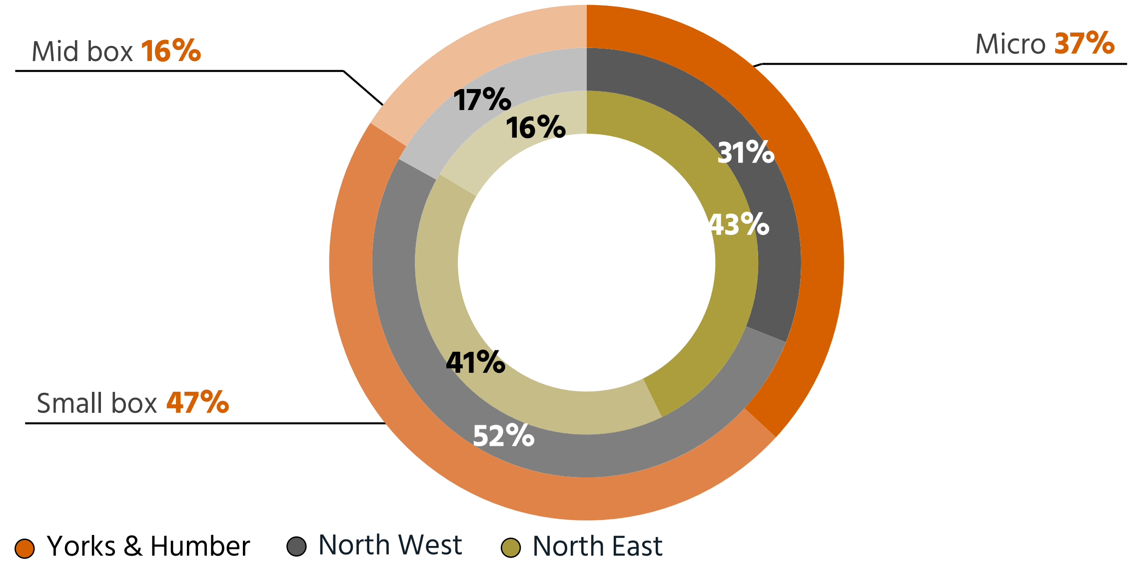


THE NORTH

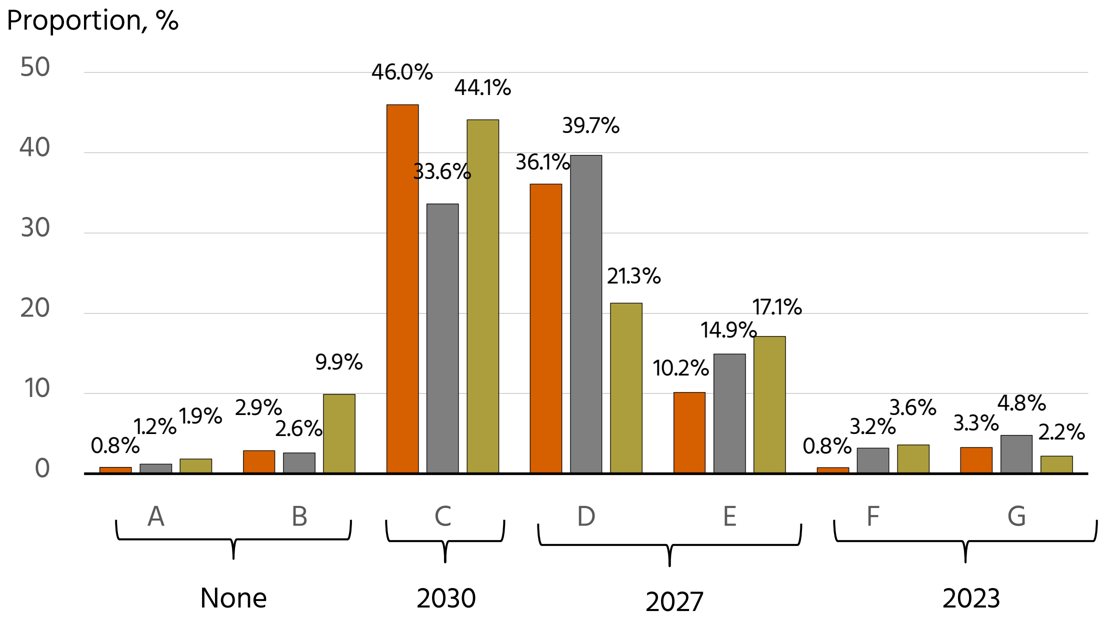


The North of England is characterised by diversity - relatively expensive prime space in the North West, such as Manchester and Warrington at £13.50 per sq ft, and cheaper markets in Hull, Newcastle and Sunderland at £9.00 per sq ft. Strong rental growth across the wider market in H1 2022 subsequently lost momentum in Q3. There is a sizeable cluster of EPC grade D and below that will need intervention within five years. The effective UK multi-let development pipeline is minimal, but the North West is the most active. There are 72 known schemes totalling just under six million sq ft. However, only 11% of this is currently under construction, with around 400,00 sq ft due to complete in Q4 2022 and only around 230,000 sq ft in 2023. The largest scheme is 110,000 sq ft at Greenbank Terrace, due in Q4. This comprises of six industrial units, ranging from 3,800 sq ft to 40,000 sq ft.

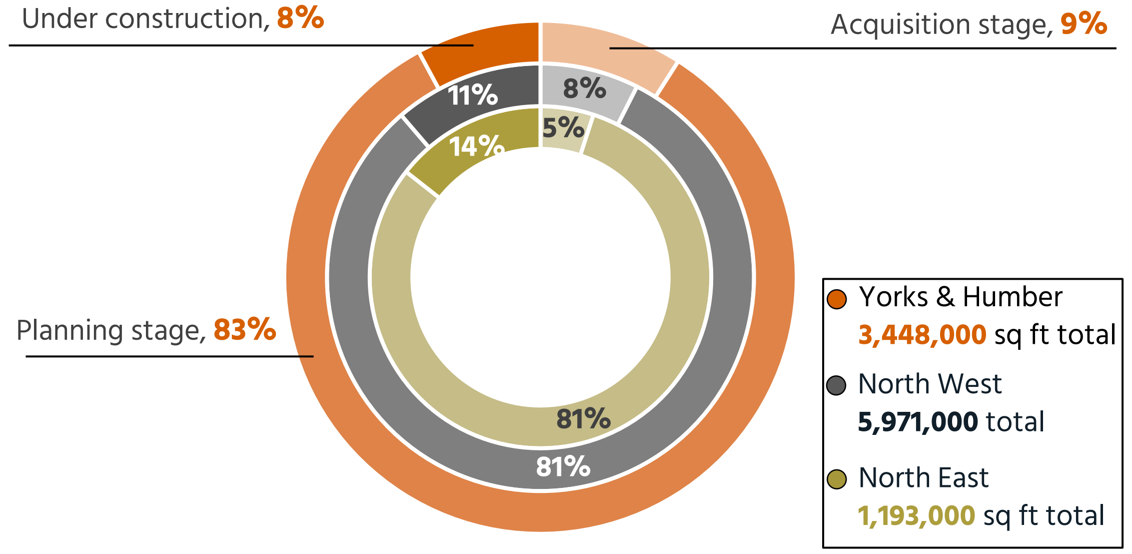
Proportion of floorspace by unit size
Source: Gerald Eve



Floorspace by EPC grade (& deadline to non-compliance)
Source: Gerald Eve



Development pipeline
Source: Gerald Eve, Property Data

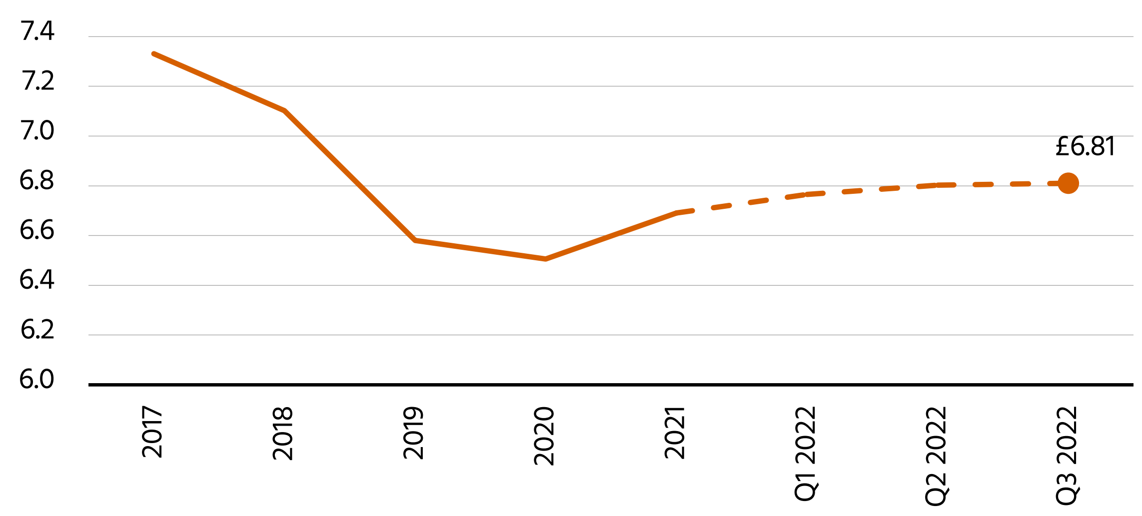


SCOTLAND

Continue with this region

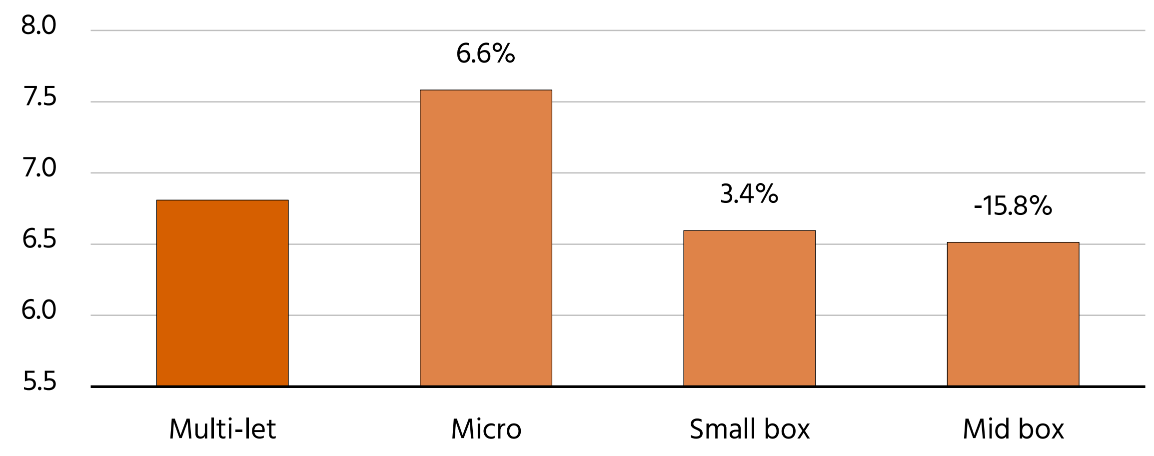
All-grades ERV

Source: Gerald Eve



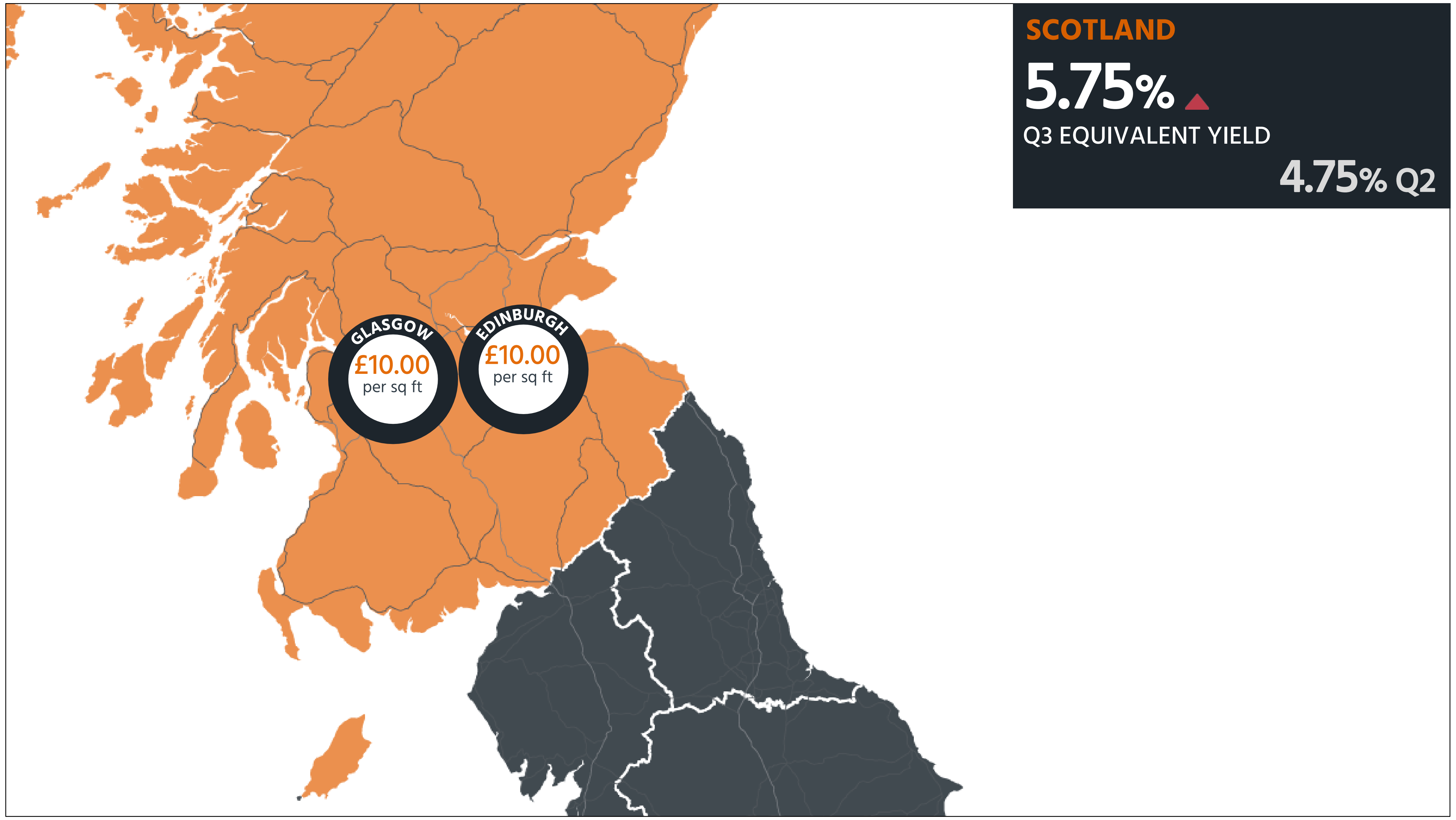
Q3 all-grades ERV by unit size and % premium/discount

Source: Gerald Eve



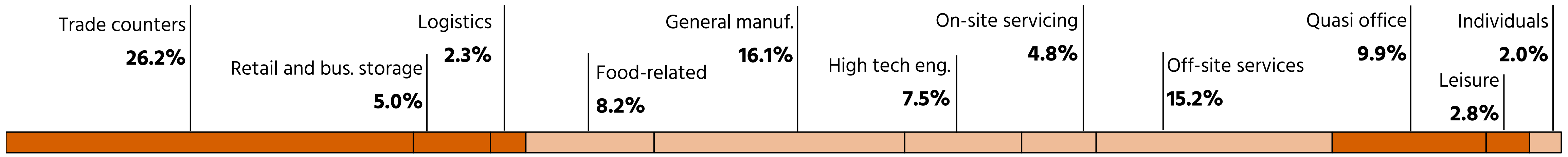
Q3 prime rents and equivalent yields

Source: Gerald Eve



SCOTLAND

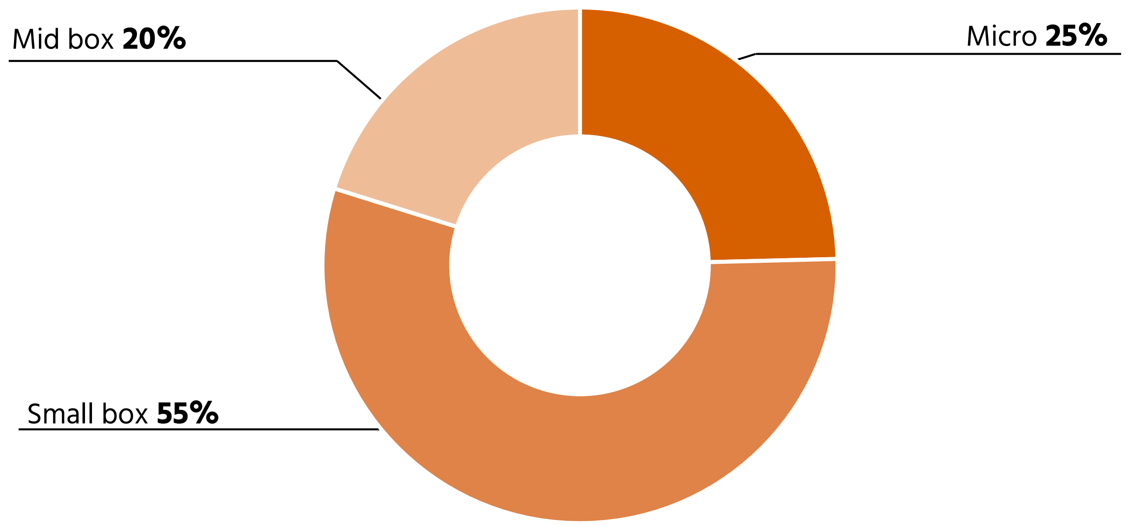
Scotland



Both prime Scottish multi-let markets have been at £10 per sq ft for over a year, up from £9.75 per sq ft in Q2 2021. So, while there was strong rental growth momentum across the UK up to mid-2022 this is not reflected in the Scotland figures. However, these prime markets are on the cusp of a potential step up when there is evidence of a letting on one of the four new EPC grade A speculative sub-50,000 sq ft units at the 130,000 sq ft Bellshill industrial estate just east of Glasgow. Scotland has the lowest multi-let development pipeline in the UK. When Bellshill completed in Q3 2022 it left only 200,000 of potential schemes in the pipeline and these are still at the planning stage. Scotland multi-let, similar to Wales, is characterised by a significantly lower proportion of logistics tenants than elsewhere in the UK.

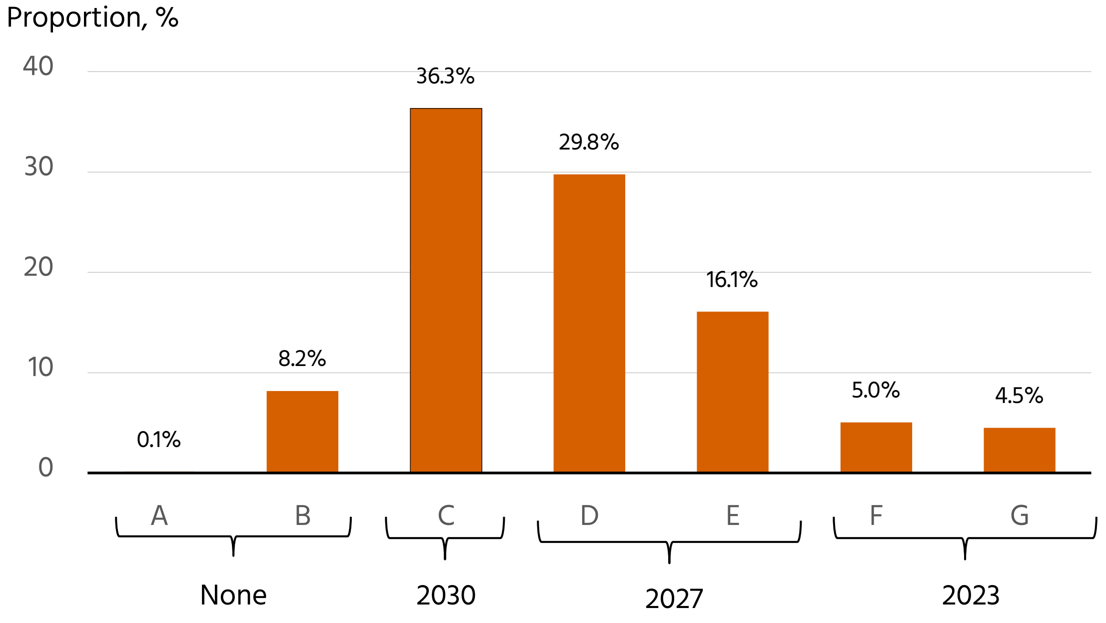
Proportion of floorspace by unit size

Source: Gerald Eve



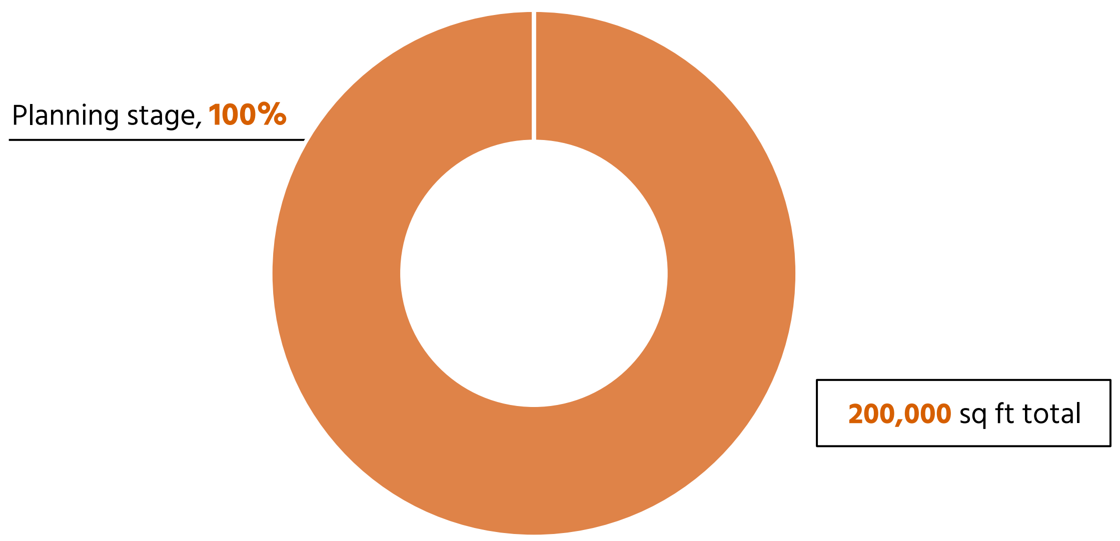
Floorspace by EPC grade (& year of non-compliance)

Source: Gerald Eve



Development pipeline

Source: Gerald Eve



CONTRIBUTORS

Many thanks to the leading UK multi-let industrial property investors who contribute their tenancy data to the Multi-Let study

Interested in contributing to this study? Click here to contact our Research team to discuss.

SAMPLE AND DEFINITIONS

2,200+
Estates

13,300+
Units

£29.3bn
Total capital value

142.6m sq ft
Total floorspace

£1.3bn
Market rent

20
Contributors

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

Multi-let is Gerald Eve's unique and market-leading syndicated study that provides detailed industry-reference insight. The results are built from the bottom up, using individual tenancy information from preeminent multi-let industrial property investors.

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

The information spans 14 years, covering many tens of thousands of individual assets over that time.

This report covers industrial units with a maximum lease length of 30 years.

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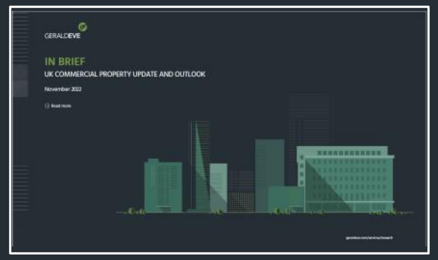
FURTHER INSIGHT



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November 2022

Prime Logistics
Q3 2022

London Markets
Q3 2022

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