GERALDEVE

PRIME LOGISTICS

The definitive guide to the
UK's distribution property market

Q4 2022

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MARKET OVERVIEW

MANUFACTURERS PLUG THE DEMAND GAP LEFT BY INTERNET RETAILERS IN Q4

The consumer recession forced several internet retailers, such as Amazon, ASOS, and Gousto to cut costs and offload warehouses in Q4. The amount of sub-let space on the market from these types of occupiers is set to increase further as the wider recession unfolds this year. This good quality space will be released into a market with strong fundamentals though. Availability is very low and pent-up demand from manufacturers is keeping demand above pre-pandemic levels. We retain our positive outlook for rents, albeit at more 'normal' rates of growth than we've seen in the last few years.

14.7m sq ft
Take-up
Q4 2022

3.6%
Availability rate
Q4 2022

1.8%
New/modern availability rate
Q4 2022

2.0%
Prime rental growth
Q4 2022

6.9m sq ft
Spec development starts
Q4 2022

25bps
Outward prime yield shift in Q4 2022

OCCUPIER DEMAND

OCCUPIER DEMAND STABILISES 5% BELOW 5 YEAR AVERAGE

Take-up was 14.7m sq ft in Q4, almost exactly the same as in Q3 and 5% below the 5 year quarterly average. We are now over the pandemic peak in terms of occupier demand, with far fewer expansionary deals and critically urgent space requirements than recorded in 2021. However, occupier take-up for 2022 as a whole was 65.8m sq ft, down 25% on the record high in 2021, but still the second most active year on record. Demand was squarely focused on new stock in Q4: pre-lets accounted for 53% and new speculative buildings accounted for 10% of all activity. Secondary space continues to account for a relatively small proportion of demand given very low supply and corporate ESG commitments.

INTERNET RETAILERS RETRENCH

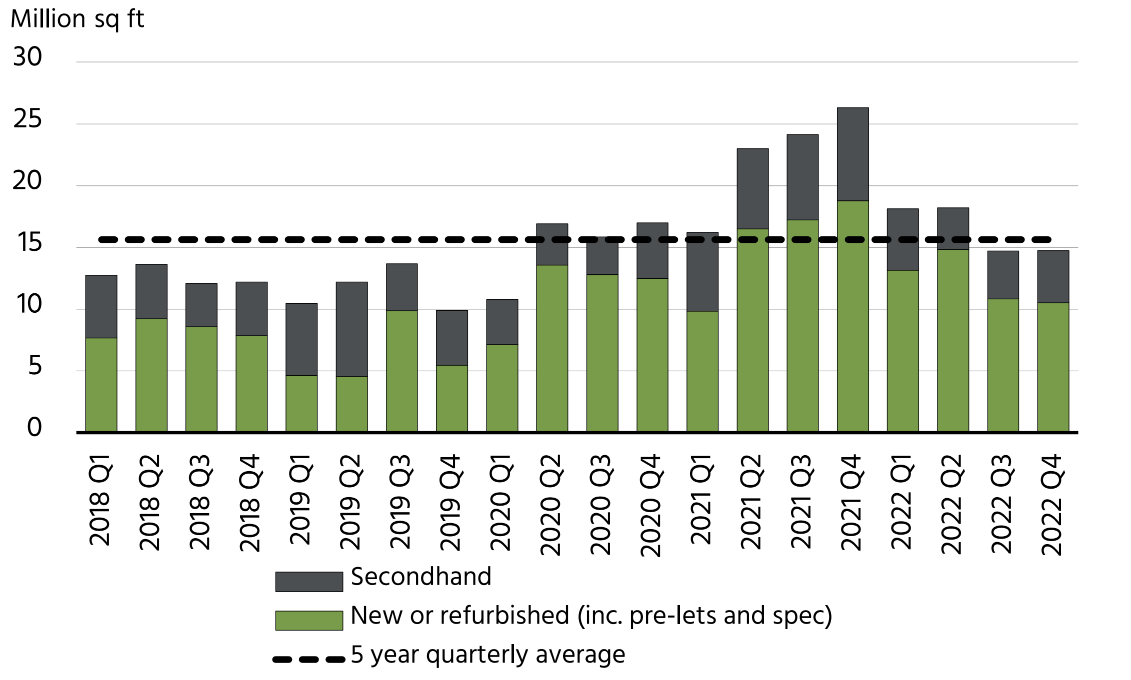
E-commerce remains a structural driver of demand for logistics but the sector is now starting to feel the impacts of the switch back to pre-pandemic shopping patterns and the retail recession more generally. Weaker consumer demand, slower overseas delivery times and disruptive industrial strike action have all weakened the outlook for both dedicated internet retailers and parcel & post operators this year. Internet retailers accounted for 12% of all activity in 2022, down from the 30% peak in Q2 2021. The expected long (albeit shallow) recession and subsequent weak recovery in the real economy will undoubtedly pose further risks to internet retailers, especially those linked to discretionary consumer spending.

GREEN ENERGY-LINKED MANUFACTURERS PLUG THE DEMAND GAP LEFT BY INTERNET RETAILERS IN Q4

Manufacturers dominated activity in Q4, accounting for 56% of all take-up and nearly all big box deals over 500,000 sq ft. Activity was driven by occupiers in the green energy production sector – Green Lithium, SeAH Wind and Nissan & Envision AESC all signed pre-lets over 1 m sq ft in Teesside. Other active manufacturing sectors included housebuilding, life sciences and electric vehicle production. Occupiers seeking supply chain resilience and nearshoring operations closer to end markets to meet sustainability goals are likely to continue to be acquisitive this year.

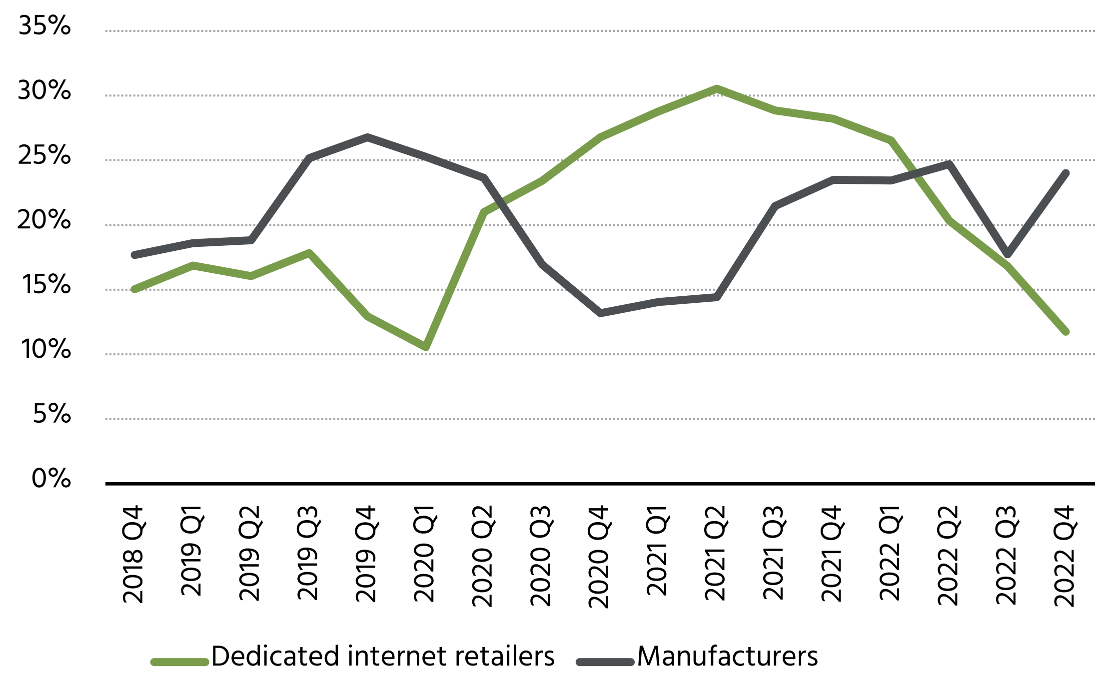
Quarterly take-up by quality and 5-year average

Source: Gerald Eve



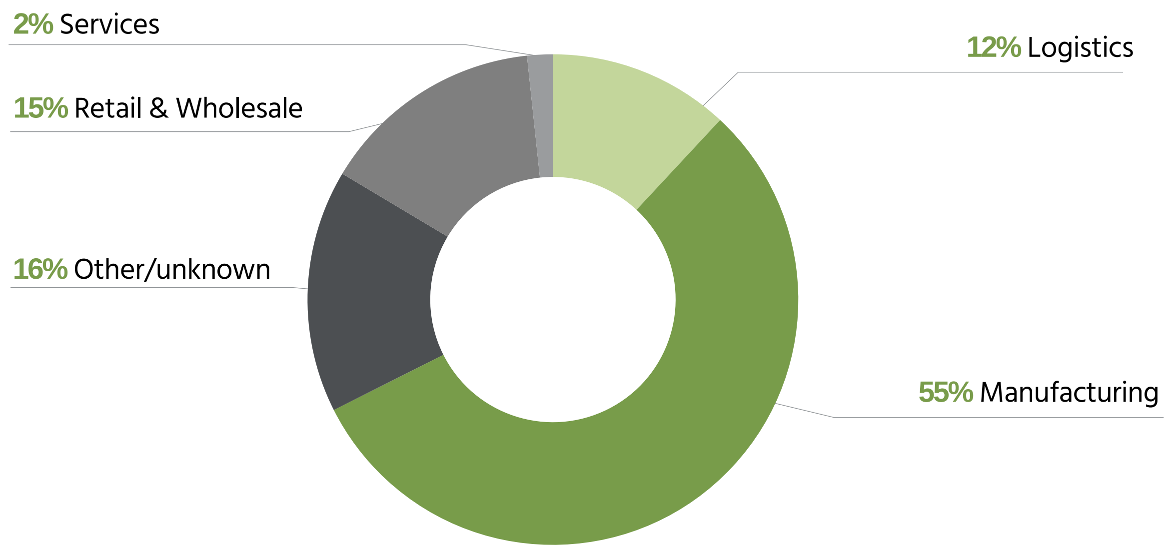
% rolling annual take-up by sector

Source: Gerald Eve



Q4 2022 take-up by occupier sector

Source: Gerald Eve



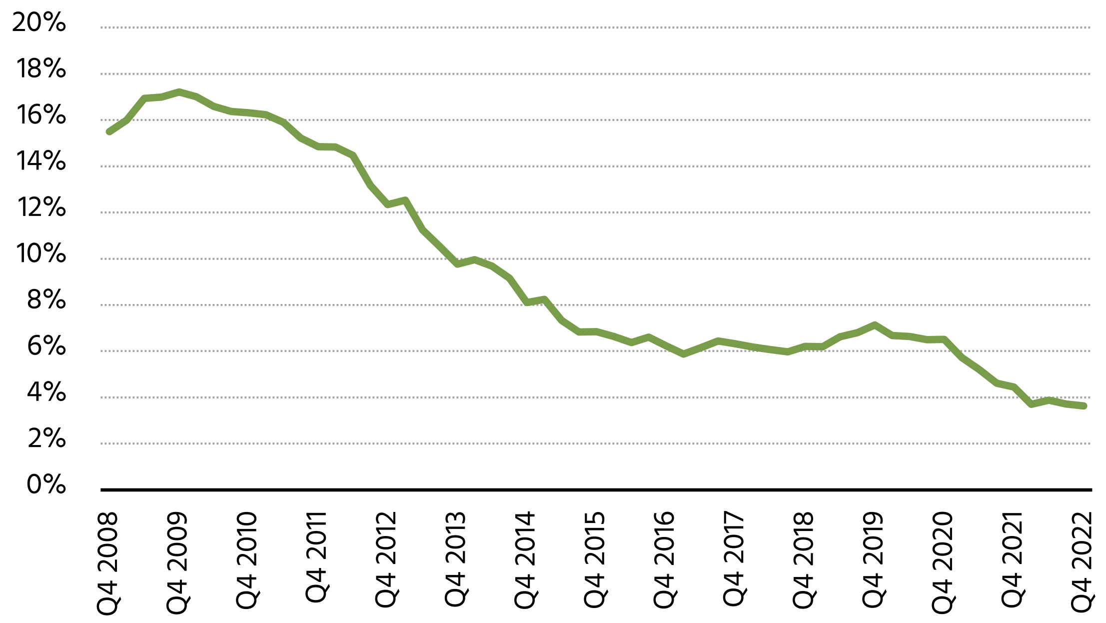
SUPPLY AND DEVELOPMENT

LACK OF SUPPLY CONTINUES TO DEFINE THE MARKET

The overall UK availability rate reached a new low of 3.6% in Q4. New/modern buildings now account for 61% of all availability and within this, space under construction accounts for 32%. There are very few secondhand buildings on the market ready for immediate occupation. Q4 will likely mark the low point of availability though as more space enters our availability figures through the spec development pipeline and more recession-linked secondary stock is returned. Up until now, available secondhand space has been released through tenant expansion or accommodation upgrades. However, future secondhand availability is likely to derive from occupiers cutting costs and rationalising portfolios.

UK long term availability rate

Source: Gerald Eve

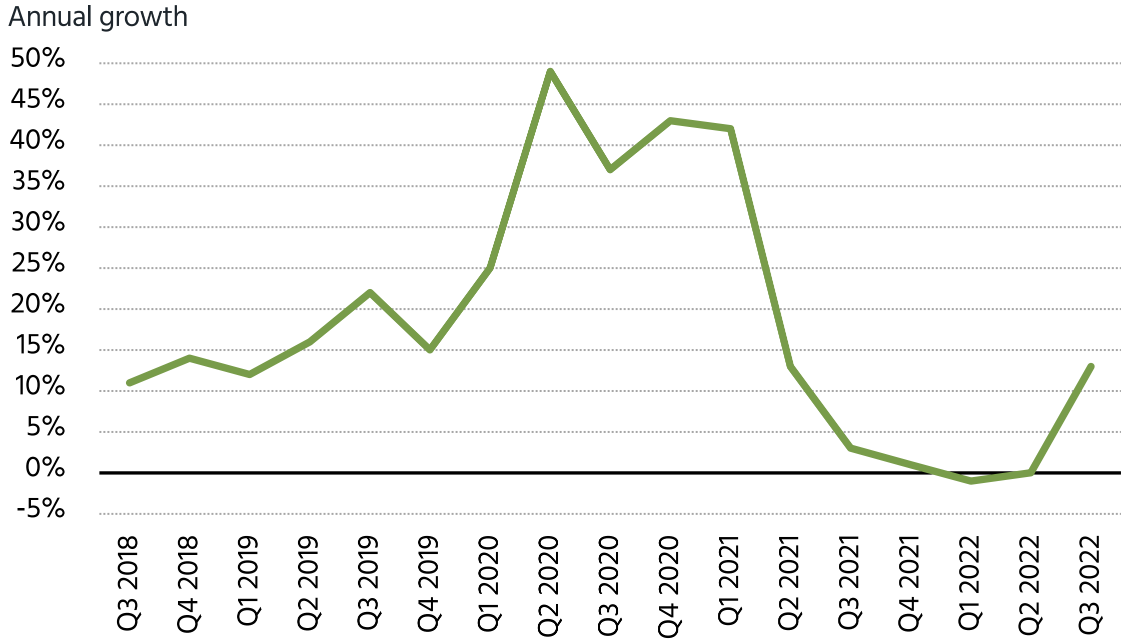


INCREASE IN SUB-LET SPACE AS OCCUPIERS CUT COSTS

Online retail sales have fallen for most retailers since the height of the pandemic. There is a growing list of occupiers who are now taking steps to cut costs and prepare for the recession by offloading warehouse space. Amazon, Gousto, ASOS, Jaguar Land Rover, Sky Studios and Evri have all sought to offload or sub-let space. There have also been examples of occupiers buying or letting buildings only to immediately offer them for short term sub-let. It’s unusual for occupiers to risk short term capital in such a way, but is illustrative of the supply shortage and occupiers’ inventiveness to secure long term supply chain certainty.

Amazon.com online store net sales

Source: Amazon.com company filings

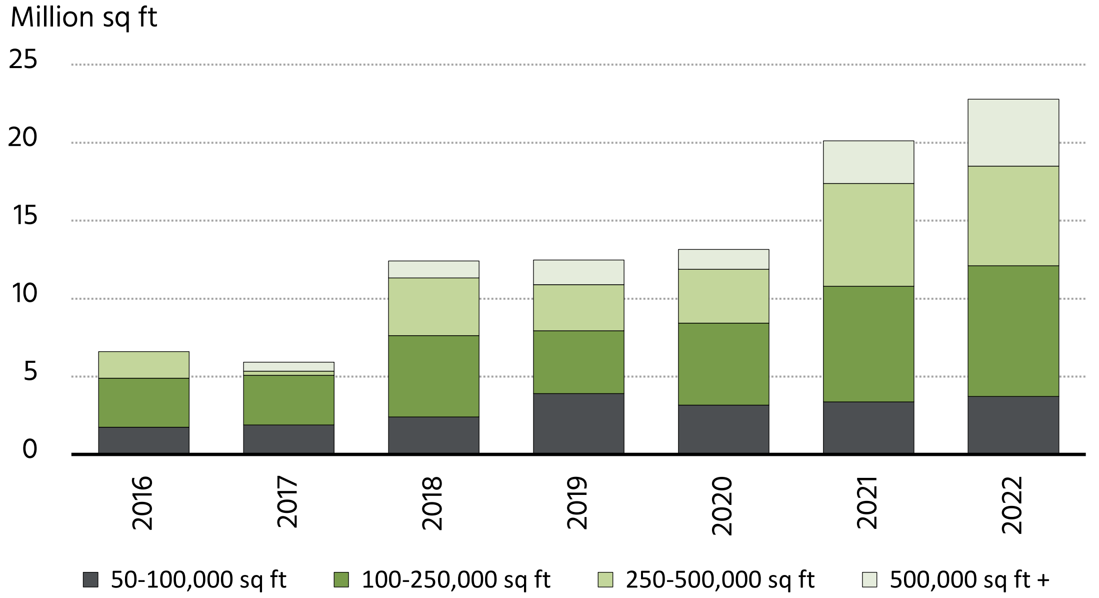


SPEC DEVELOPMENT ACCELERATED IN 2022, BUT SLOWDOWN NOW LIKELY

2022 was the most active year on record for speculative development starts, with 22.8m sq ft getting underway. The majority of this space is still under construction. However, the sharp outward movement in yields and build costs in H2 2022 has made spec development less viable, especially for schemes involving debt. Residual land values have fallen dramatically and vendors are proving reticent to sell land at these reduced levels. This will likely limit the supply of future sites, and when combined with a broader softening of occupier demand, lead to a slowdown in speculative development in 2023.

Annual speculative development starts by building size

Sources: Gerald Eve

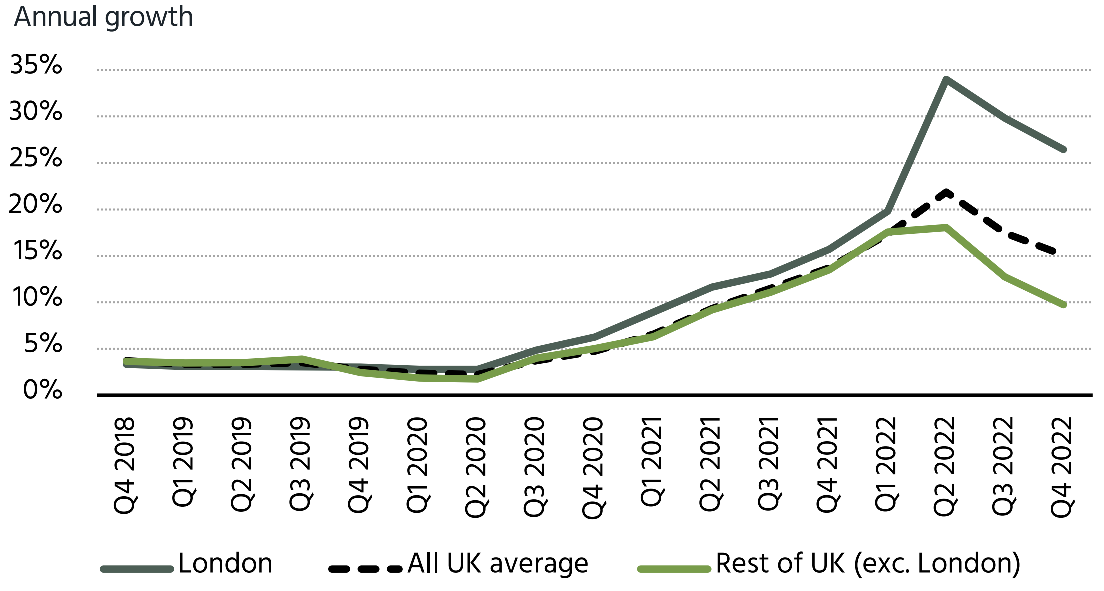


RENTS AND OCCUPIER COSTS

PRIME LOGISTICS RENTS CONTINUE TO GROW

Despite the prevailing economic turbulence, prime headline rents increased in several markets in Q4. These increases equate to 2.0% prime quarterly rental growth, an increase on the 0.7% in Q3, but far below the quarterly growth recorded in the first half of 2022. On an annual basis, rents grew 15.1% in 2022, higher than the 13.7% recorded in 2021. Deals were done on speculative buildings in Q4 which nudged on rents, but on balance sentiment softened and deal terms were more heavily scrutinised. Whilst landlords are pushing on quoting rents given prevailing low supply, occupier purchasing power and appetite for new space is weakened. High quoting rents on build-to-suits in particular proved off-putting for some occupiers in Q4.

Annual prime logistics rental growth
Source: Gerald Eve



OCCUPIER COSTS AT A GLANCE

10.5%
CPI INFLATION (DEC 2022)

63%
ANNUAL INCREASE IN NON-DOMESTIC ELECTRICITY (SEPT 22)

15.1%
ANNUAL GROWTH IN PRIME LOGISTICS RENTS (2022)

3.5%
BANK OF ENGLAND BASE RATE (NOV 2022)

7.2%
PRIVATE SECTOR REGULAR PAY GROWTH (SEPT-NOV 22)

16.5%
ANNUAL GROWTH IN PRODUCER INPUT PRICES, (DEC 2022)

£1.79
PRICE OF DIESEL, 17% UP ON YEAR (DEC 22)

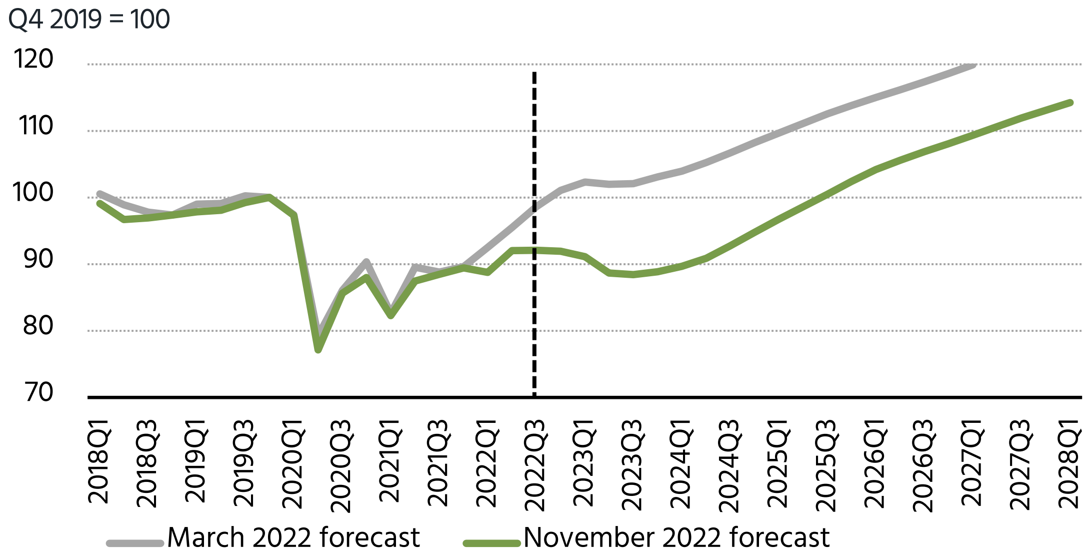
124%
ANNUAL INCREASE IN NON-DOMESTIC GAS (SEPT 22)

Sources: ONS, Gerald Eve, Bank of England, Oxford Economics

COST PRESSURES TO DENT BUSINESS INVESTMENT

Cost pressures are mounting for occupiers and future order books have been dented by the consumer recession and cost-of-living crisis. Increased operational, labour and utilities costs, not to mention more expensive debt costs, have put increased pressure on already-tight margins. Government support for businesses in the form of the energy price cap is set to end in April, the same time as the potential increase in business rates liabilities. This has materially weakened the outlook for future business investment, with the OBR now expecting falls throughout most of 2023. In turn, occupiers are likely to be cautious around expansion and lean towards lease renewals as the short-term cost-effective option.

Business investment outlook
Sources: ONS, OBR



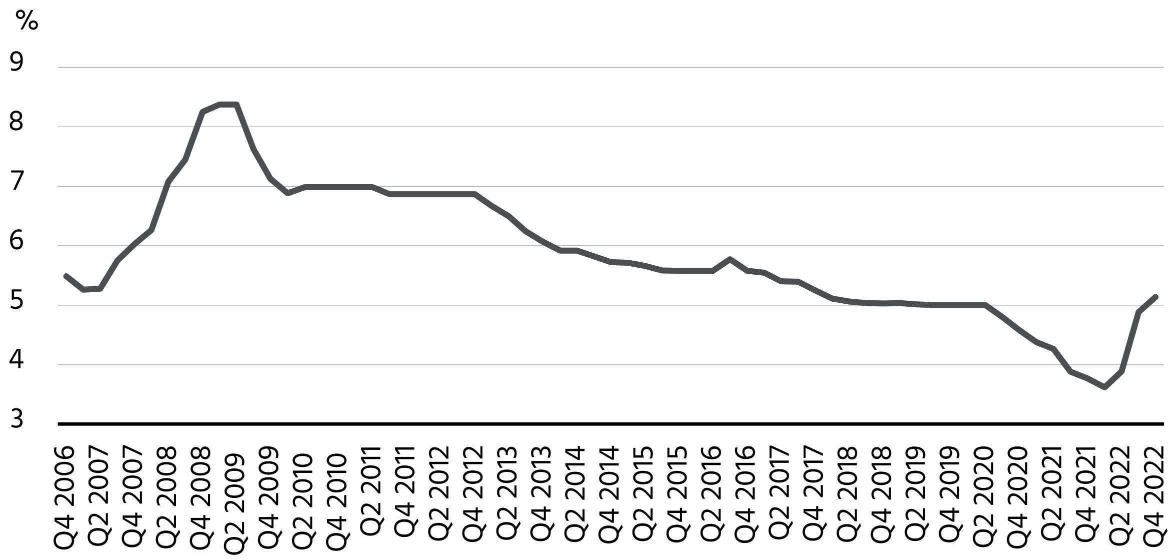
INVESTMENT

AVERAGE UK PRIME YIELD BACK TO Q4 2017 LEVEL

Average prime logistics yields moved out a further 25bps in Q4. This is off the back of the 100bp outward shift in Q3, the largest ever in one quarter on record. The UK average prime yield ended 2022 at 5.14% - the highest since Q4 2017 and capped off a total 137bps outward movement in 2022. The market showed signs of stability by year-end though, and some investors previously deterred by perceived market risk had returned to benefit from any price reductions. It's a buyers' market, and purchasers can afford to be selective on assets, with the best quality stock proving most liquid. There's been less liquidity in the value-add market as some sellers hold on to 'old' pricing and overall trading is down.

All UK average prime logistics yield

Source: Gerald Eve

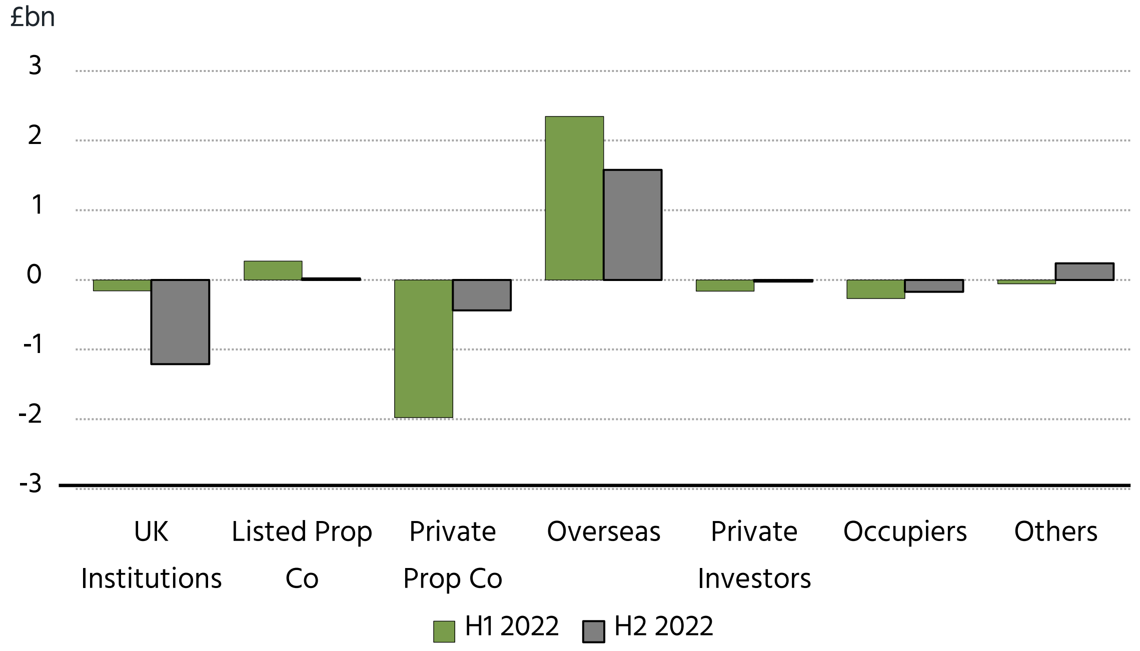


INSTITUTIONS KEY SELLERS POST-MINI BUDGET

2023 is likely to be a year of opportunity on the buy-side given the recent outward yield movement, but sellers may be reticent to sell if it's perceived to be the bottom of the market cycle. There will be some motivated sellers though – funds meeting redemptions or reweighting portfolios, or, sales through the debt market. Gilts and bonds have seen wild drops in value, which in turn for some funds has made the slow-moving illiquid property sector seem overweight. In order to balance portfolios, we could see a continuation of sales of good quality assets as funds rebalance or exit out of real estate all together.

2022 half-year industrial net investment by investor

Sources: Property Data, Gerald Eve



LEVERAGE CONSTRAINED BY INCREASED COST OF DEBT

Falling capital values and reductions in debt serviceability ratios, driven by increased interest costs, could trigger refinancing issues in 2023. Debt maturities this year could require additional equity.

Lenders will tighten their risk appetite and we expect:

- Increased margins
- Lower loan-to-value ratios
- Difficulty in refinancing assets at high LTVs
- High all-in debt costs

There will be a reduced willingness to originate new debt facilities in 2023. Lenders will focus on prime assets and locations. Non-prime assets or assets with poor ESG creds will prove much harder to finance.

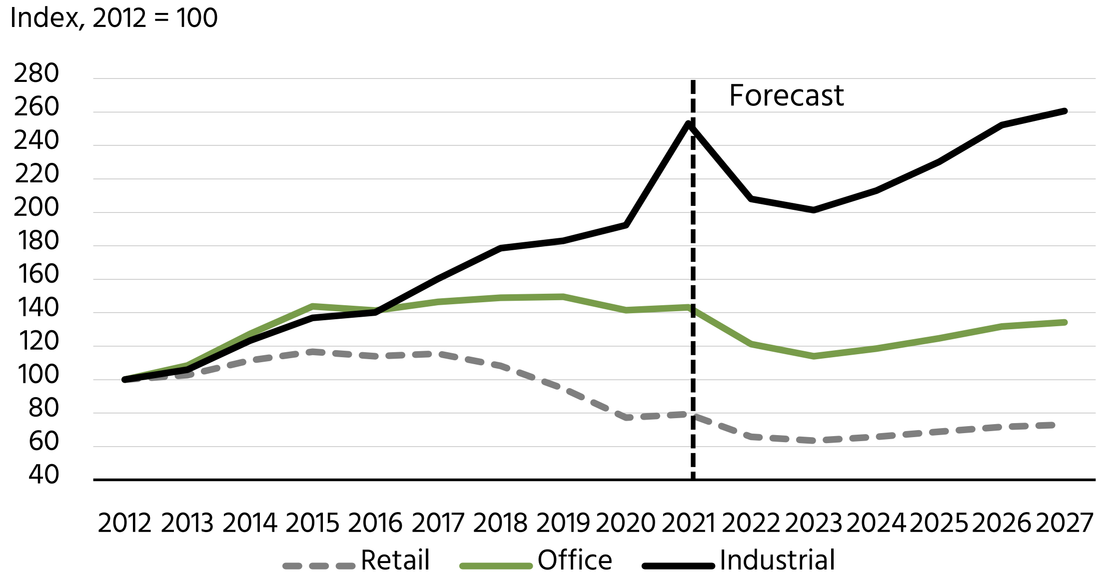
SPOTLIGHT: OUTLOOK FOR PRICING, AVAILABILITY AND RENTS

PRIME INDUSTRIAL PRICING TO BOTTOM-OUT IN 2023

The impact of rising interest rates in the wake of the ill-fated mini Budget in September 2022 had a significant impact on low-yielding warehouses. It's estimated that the direct investment market fell 28% from peak by year-end and this was soon being reflected in valuations given the relatively high levels of market liquidity. Such a price correction now offers attractive buy-side opportunities to some and an increased number of buyers have returned. Further moderate falls in values are expected to be reflected in valuations this year, especially non-prime assets.

Indexed capital value growth by main sector

Sources: MSCI, Gerald Eve

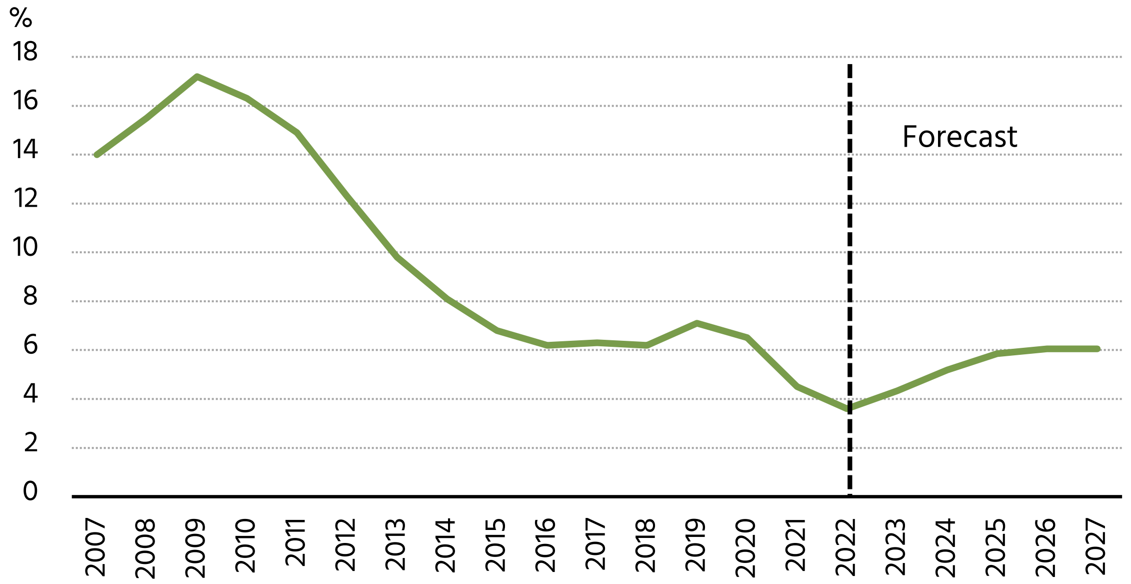


AVAILABILITY SET TO INCREASE FROM RECORD LOW

Relative to previous downturns, the anticipated increase in the UK rate of availability is set to be moderate. And from a very low base. An increase in speculative development completions this year set against weakened occupier demand will push up the availability of new stock in 2023, and combine with an increase in secondhand space as occupiers realign operations to new market conditions. High build costs and restrictive debt conditions will curtail spec development this year though, and ultimately keep a lid on the delivery of new product.

UK logistics availability rate forecast

Source: Gerald Eve

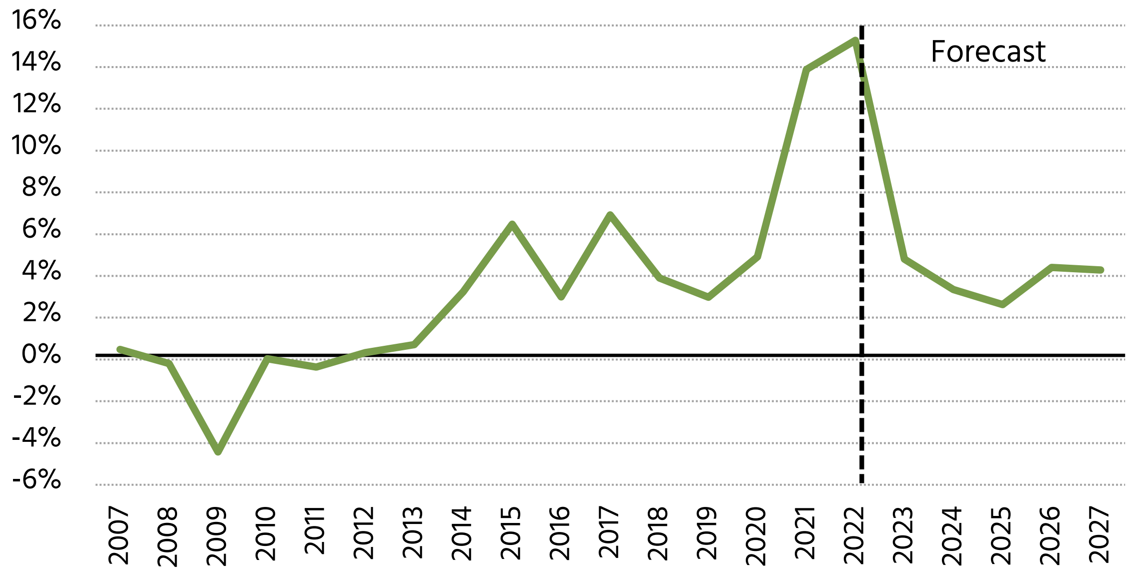


RENTAL GROWTH TO RETURN TO 'NORMAL'

Despite the expected increase in availability, the outlook for prime rental growth is still positive. Overall demand is set to weaken, but new product with the best sustainability credentials will remain of interest to occupiers. Competition will reduce and deal terms will be heavily scrutinised, but the occupier will continue to be hamstrung by the broad based lack of supply. High build-to-suit rents are likely to channel demand into speculative space, the delivery of which is set to contract given high build costs and yield softening. Growth rates could increase from 2025 as economic activity and confidence improve.

Prime logistics annual rental growth forecast

Source: Gerald Eve



OUTLOOK AT A GLANCE

RENTS

Despite weakening occupier demand, record low supply is supportive of a positive rental growth outlook. The increased risk and cost associated with speculative development will keep a lid on the delivery of new product.

AVAILABILITY

Availability is set to rise as speculative developments complete and cost-cutting measures return unwanted buildings. Sub-lets likely to grow in importance. The market will continue to be defined by a lack of supply, with more moderate increases than seen in previous downturns.

DEVELOPMENT

Those developers with conviction and with tied-in construction costs will start new schemes, but overall speculative development is set to slow. Where possible, rising costs will be passed on to the occupier.

INVESTMENT

Recent value falls likely to result in buy-side opportunities this year. Funds likely to continue to be net divestors of space, with prime, ESG-accredited buildings proving most liquid. Investors will need evidence of economic recovery before risk appetite returns.

OCCUPIER DEMAND

Demand is likely to settle at 10-20% above pre-pandemic volumes. E-commerce remains a structural driver, but further consolidation is likely. Industries linked to green energy production and onshorers will be key sources of demand.

SUSTAINABILITY

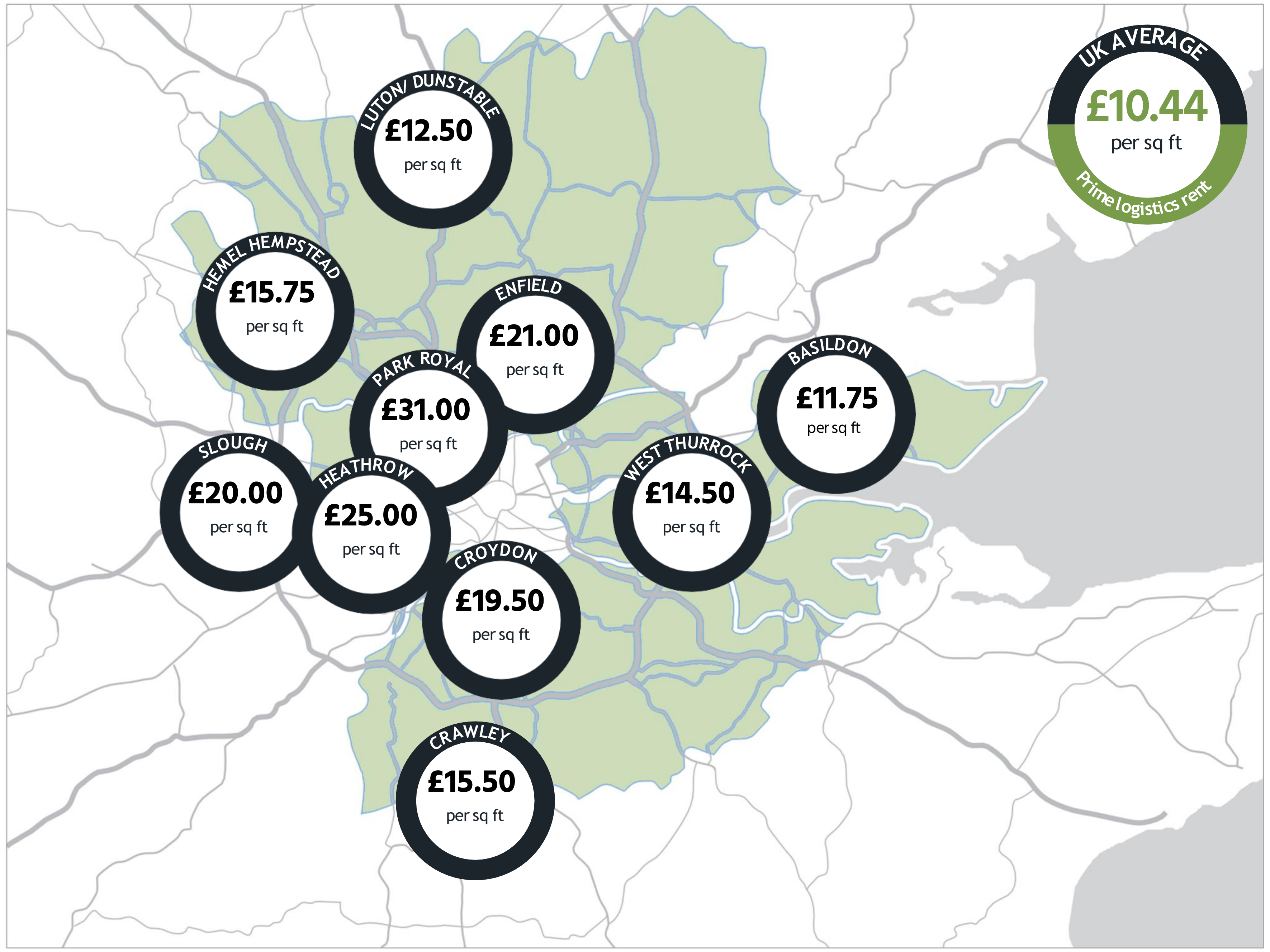
Refurbishments linked to MEES regulations likely to increase as landlords future-proof where possible. Shorter voids for buildings with the best credentials are likely and onsite energy generation viewed favourably occupiers.

GERALD EVE REGIONS

Click here for more detailed regional analysis and insight.

LONDON

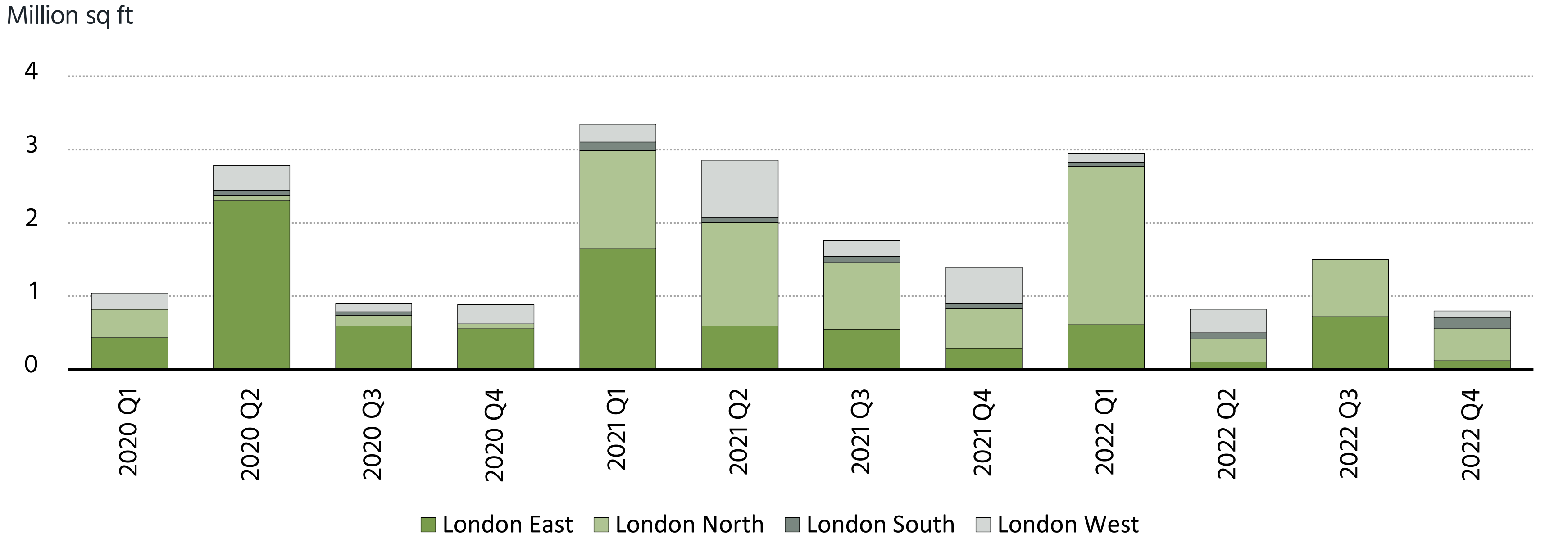
PRIME LOGISTICS RENTS



Prime rent: typical achievable headline rent in £ per sq ft for units of good quality over 50,000 sq ft and let on a typical 10 year lease to a tenant of strong covenant.

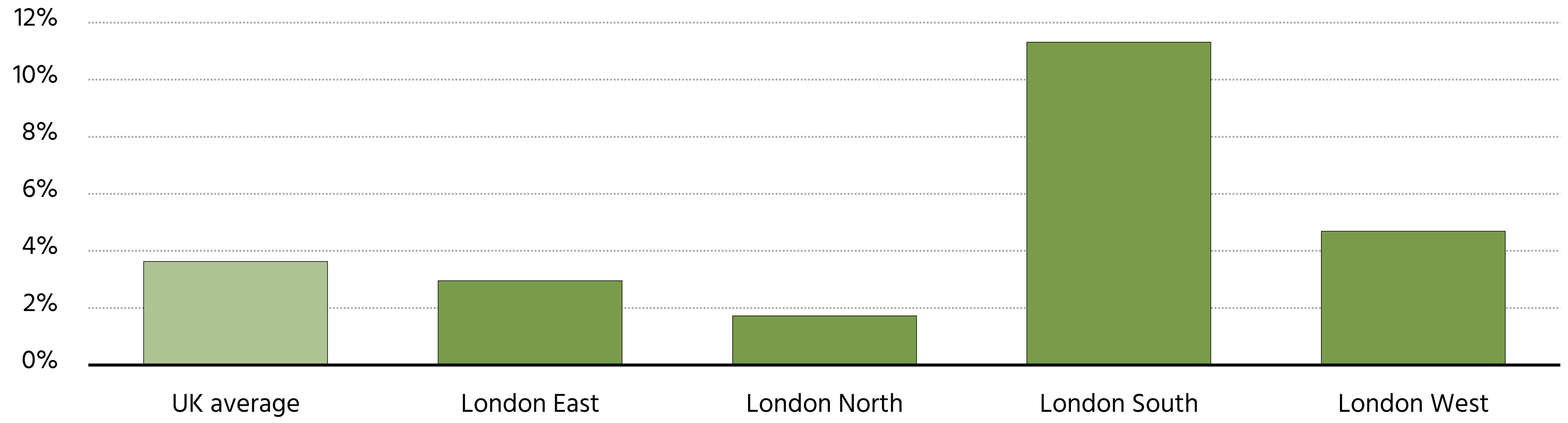
Occupier quarterly take-up

Source: Gerald Eve



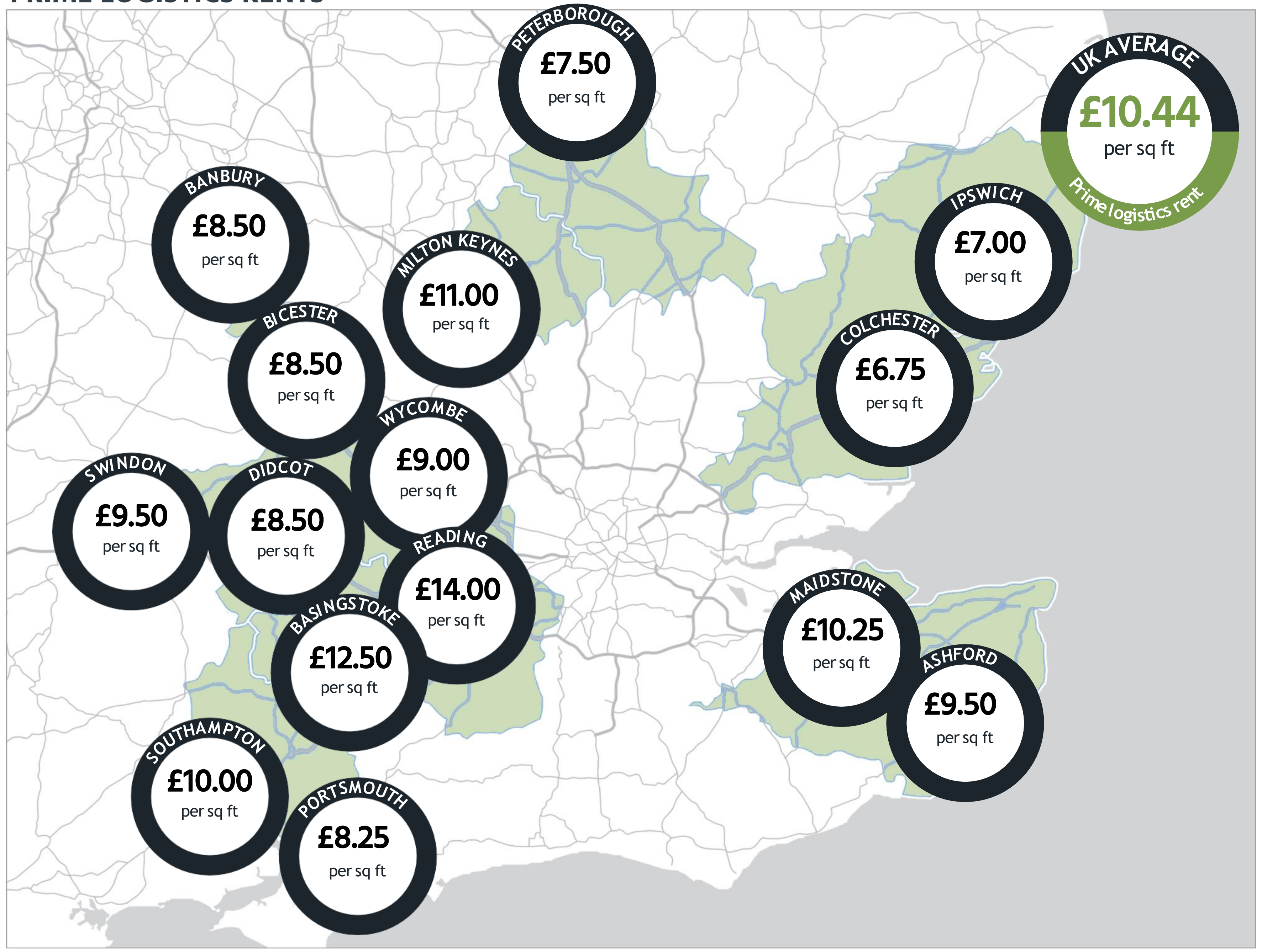
Availability rate

Source: Gerald Eve



THE SOUTH EAST AND EAST

PRIME LOGISTICS RENTS



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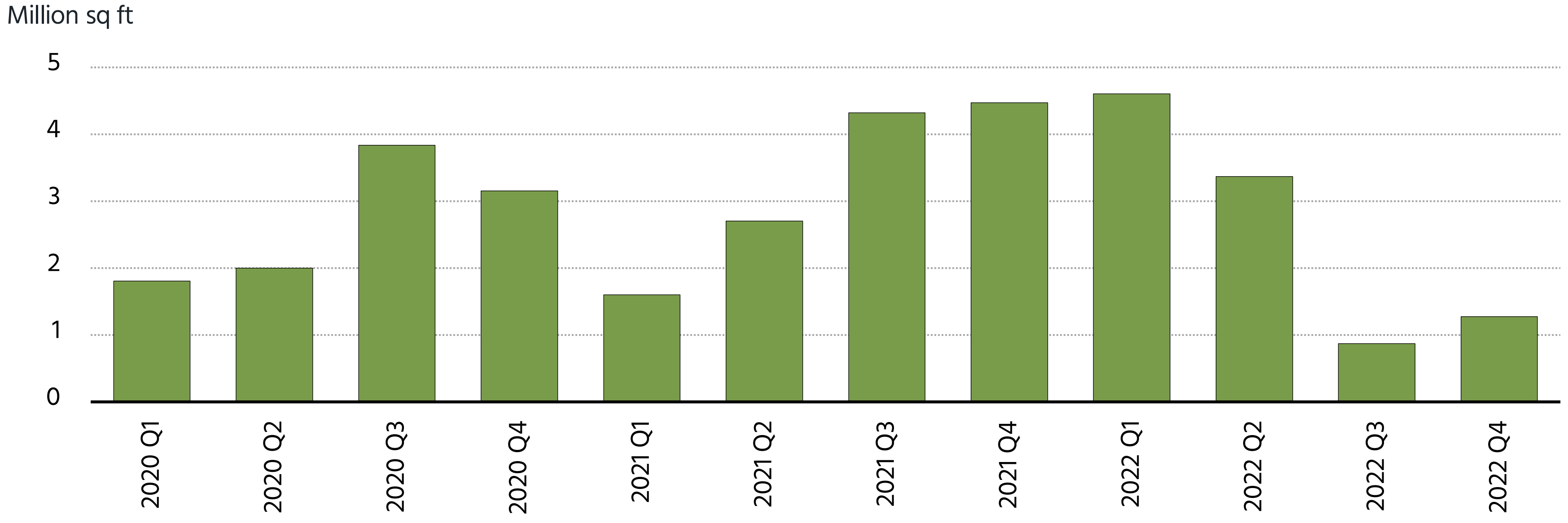
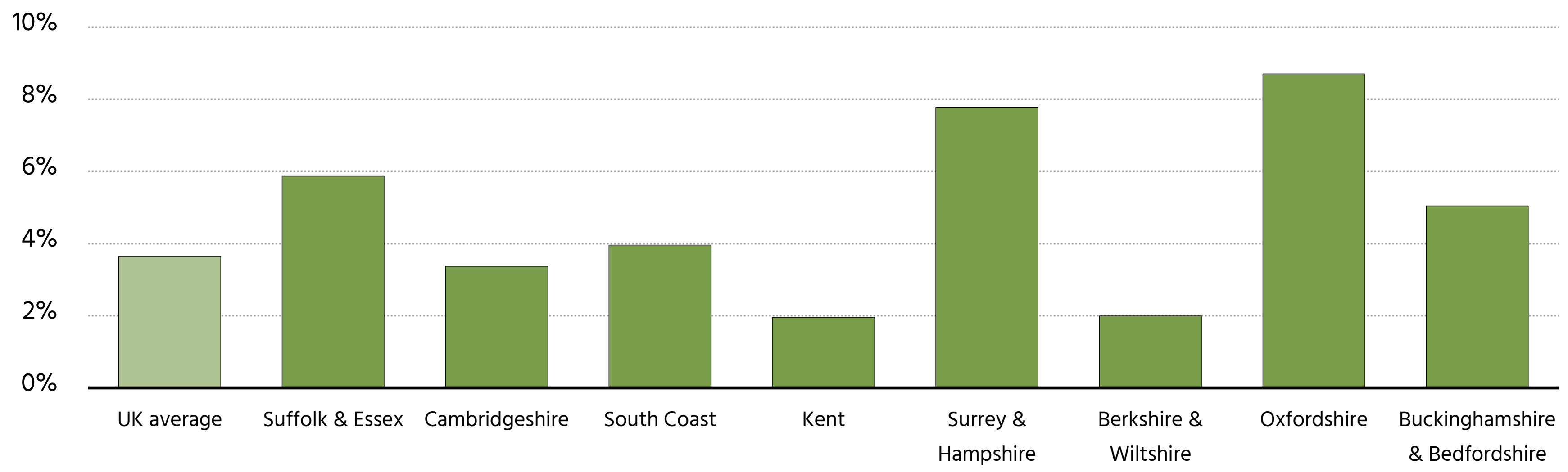
Occupier quarterly take-up

Source: Gerald Eve



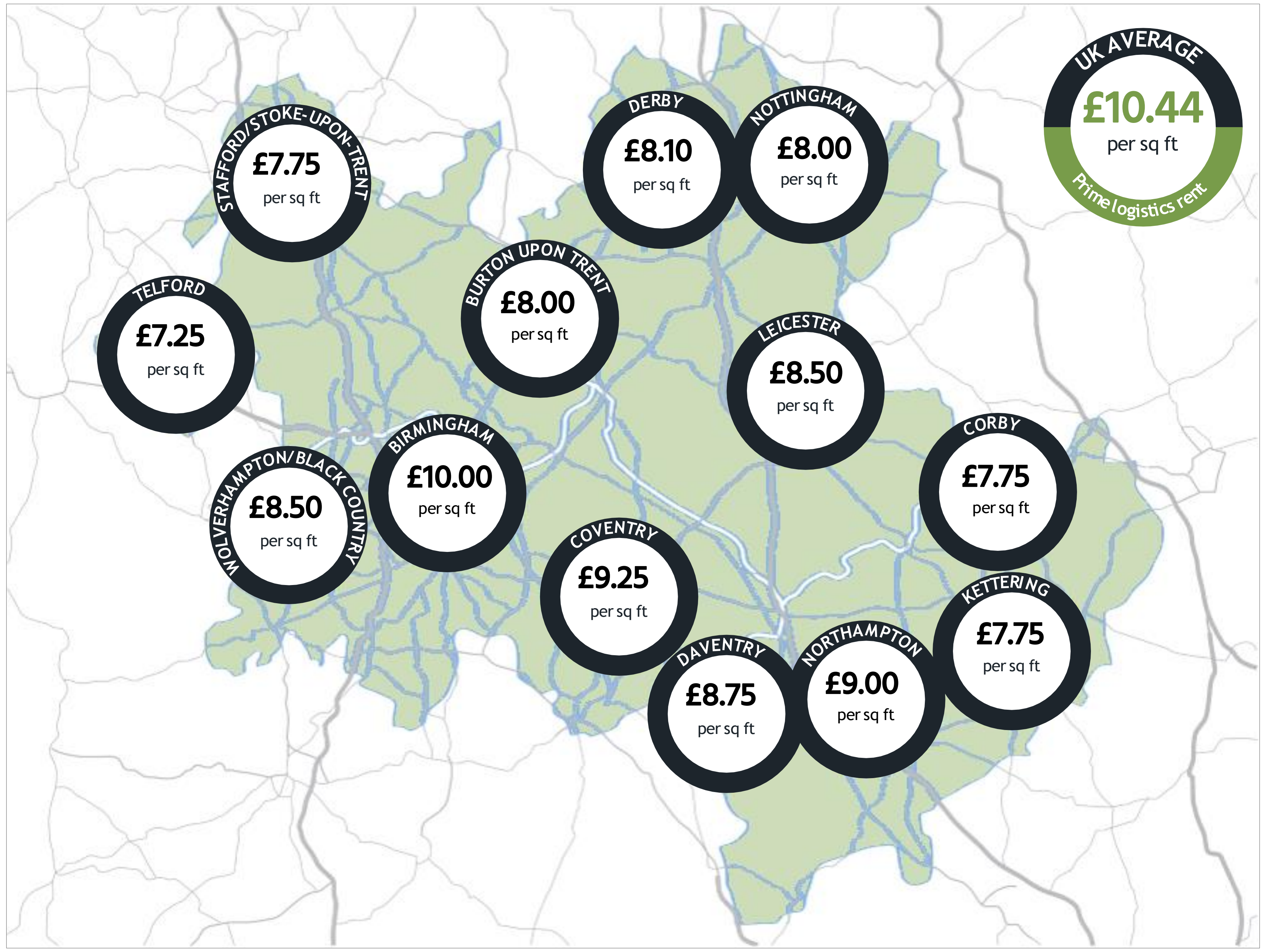
Availability rate

Source: Gerald Eve



MIDLANDS

PRIME LOGISTICS RENTS



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Occupier quarterly take-up

Source: Gerald Eve

Availability rate

Source: Gerald Eve

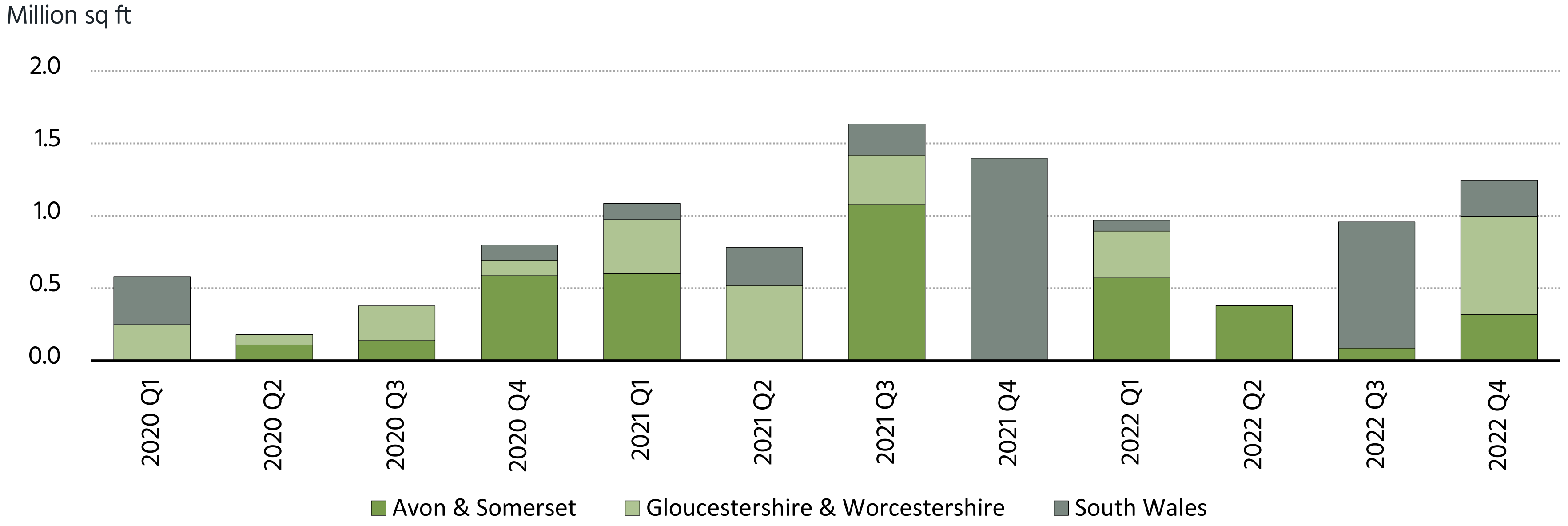
WEST OF ENGLAND AND SOUTH WALES

PRIME LOGISTICS RENTS

Prime rent: typical achievable headline rent in £ per sq ft for units of good quality over 50,000 sq ft and let on a typical 10 year lease to a tenant of strong covenant.

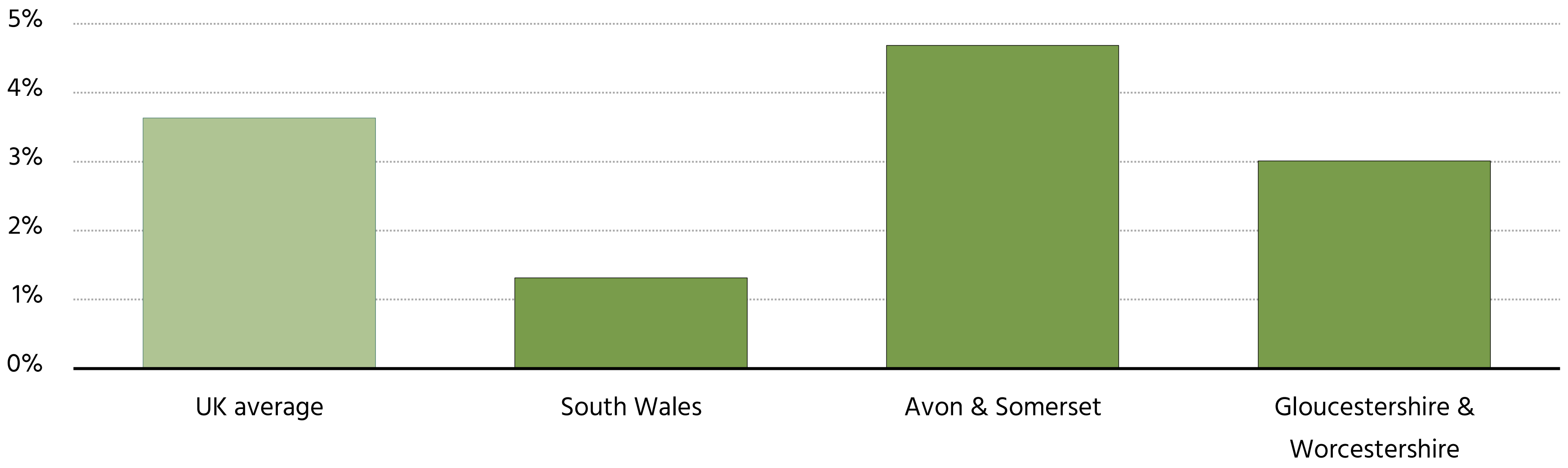
Occupier quarterly take-up

Source: Gerald Eve



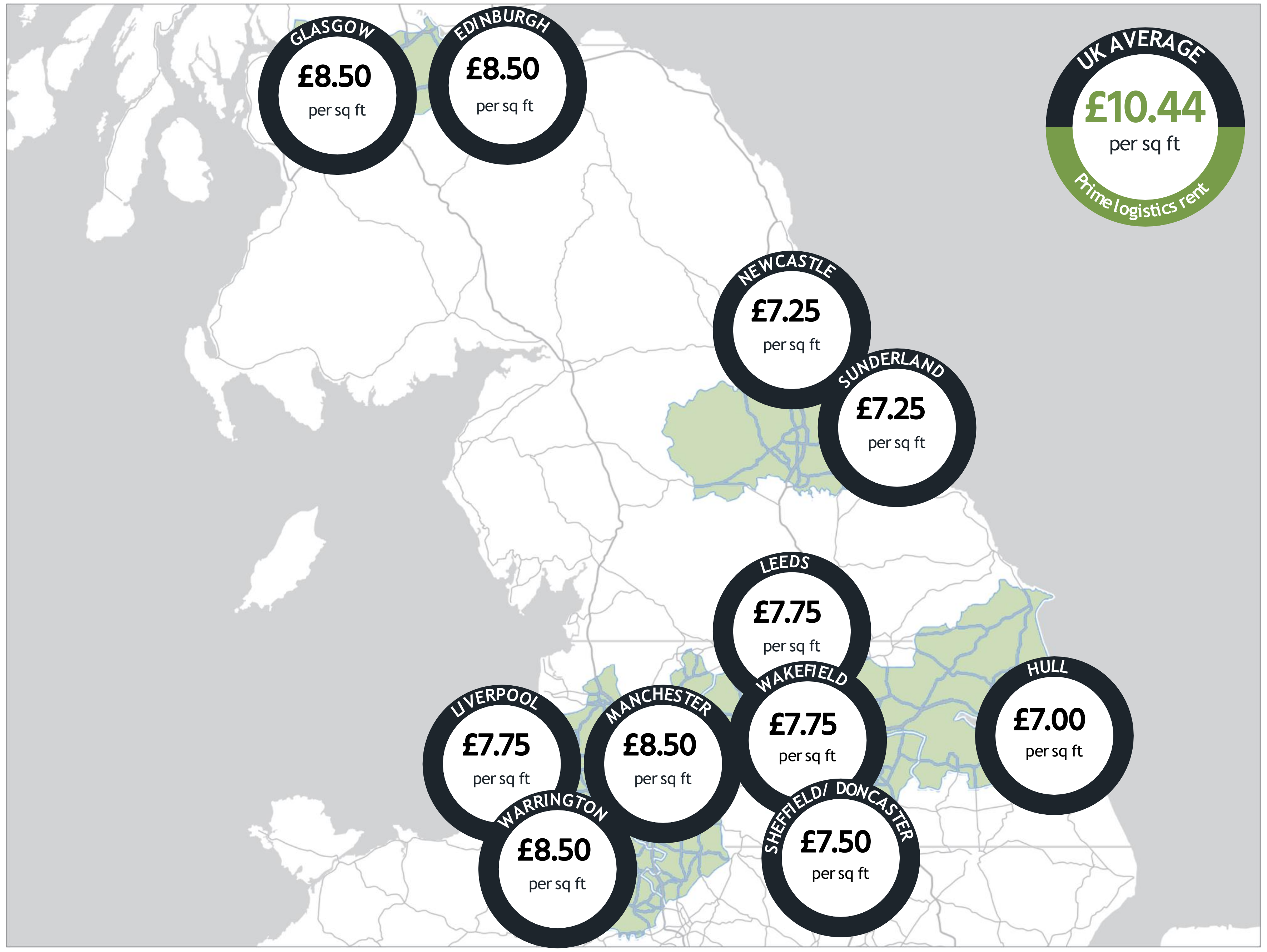
Availability rate

Source: Gerald Eve



NORTHERN ENGLAND AND SCOTLAND

PRIME LOGISTICS RENTS



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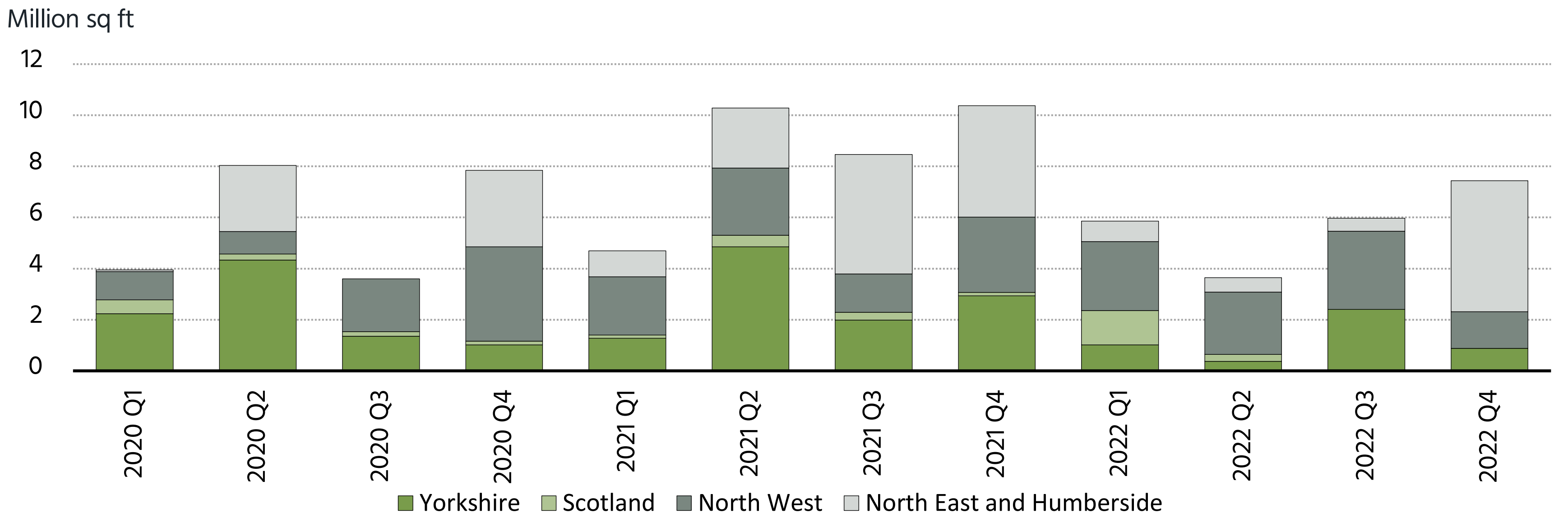
Occupier quarterly take-up

Source: Gerald Eve



Availability rate

Source: Gerald Eve

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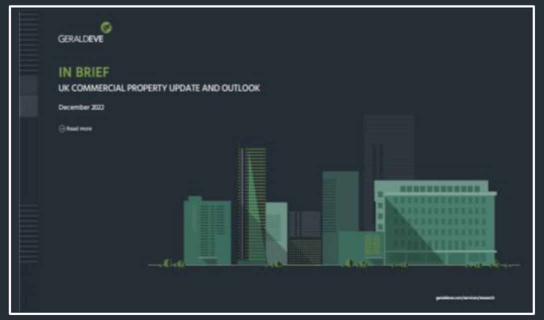
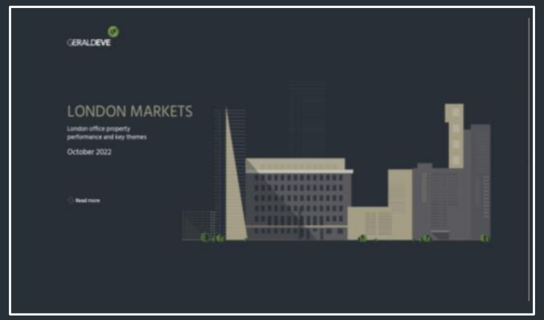


In Brief
December 2022

Multi-let
December 2022



London Markets
Q3 2022

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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.

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