GERALDEVE
A NEWMARK COMPANY

PRIME LOGISTICS

The definitive guide to the
UK's distribution property market

Q4 2023

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MARKET OVERVIEW

COST-CONSCIOUS OCCUPIERS SCALE BACK DEMAND TO MATCH POST-PANDEMIC TRADING CONDITIONS

Occupier take-up was 11.9m sq ft in Q4 2023, up 4% on Q3, but 20% lower than a year earlier. Total demand in 2023 was the lowest since 2017 and 16% below the 10-year average, reflecting the general pause in expansionary activity and the more challenging and uncertain economic backdrop. Occupiers took a more cautious and cost-conscious approach, befitting the weaker post-pandemic trading conditions and elevated cost of doing business.

Q1 2024 has started off more positively. Occupier deals rolled over from last year have completed and investors are increasingly confident that debt financing will become easier and more affordable. Macroeconomic headwinds will continue to weigh on occupier activity in 2024 though, and long-term business planning will be hampered by short term uncertainty. But lettings will continue to tick over and the outlook for prime rents remains positive, albeit not as stellar as during the pandemic years.

The speculative development pipeline is set to be much lower over the medium term than it has been over the past few years. Set against this there are growth pockets of demand – including automotive, renewable energy, nearshoring and occupiers linked to e-commerce that will support demand.

Q4 2023 UK LOGISTICS MARKET DASHBOARD

Sources: Gerald Eve, ONS, RCA

		Q4 2023	Two-year trend
OCCUPIER DEMAND	Take-up	11.9m sq ft	
	% new/modern	66%	
AVAILABILITY	Availability rate	6.0%	
	New/modern availability rate	4.6%	
DEVELOPMENT	Development starts	7.2m sq ft	
	Spec development starts	2.5m sq ft	
OCCUPIER COSTS	Average prime rent, sq ft	£11.55	
	Average weekly earnings	£666	
INVESTMENT	Average prime yield	5.5%	
	Transaction volume	£1.7bn	
ECONOMY	Annual GDP growth	0.2%	
	Retail sales % online	28.3%	

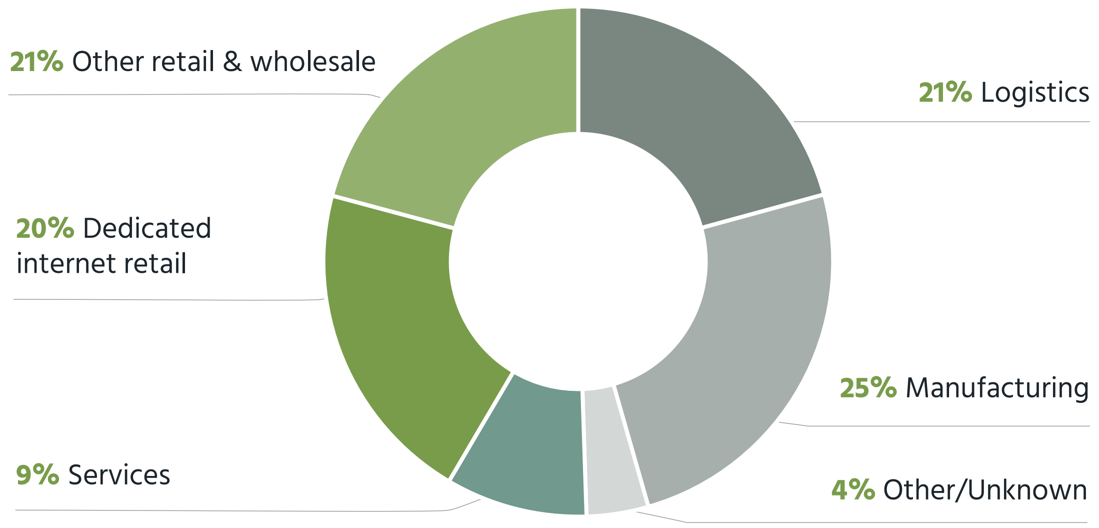
OCCUPIER DEMAND

QUARTERLY TAKE-UP INCREASED AGAIN IN Q4

Occupier take-up was 11.9m sq ft in Q4, up 4% on Q3 but 20% down on a year earlier. Despite the quarterly increase (driven in part by a single large occupier land purchase for multi-storey development) take-up was relatively subdued for much of 2023. High inflation, a weak economy and rising interest rates made occupiers more likely to halt expansion plans and realign property networks with the weakened trading conditions. On an annual basis, take-up in 2023 was the lowest since 2017 and much more in line with pre-pandemic norms. Activity in Q4 continued to be focused on the best quality and most energy efficient space, both new-build and refurbished secondary.

Q4 2023 take-up by occupier sector

Source: Gerald Eve

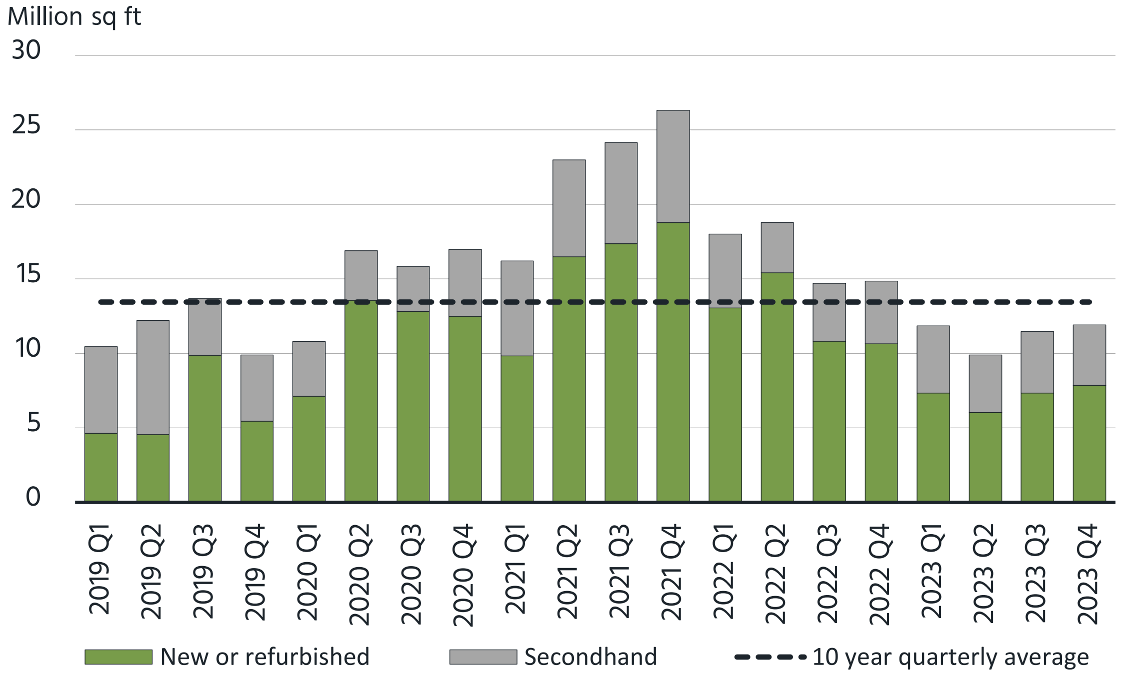


RETAILERS INCREASE SHARE OF DEMAND IN Q4

The retail sector was the most active group in Q4, accounting for 41% of demand. Specialist internet retailers, food retailers and occupiers linked to homewares were all active. Across 2023 as a whole though it was the manufacturing sector which was most active, accounting for 35% of all demand. Some of this activity can be attributed to nearshoring operations and realigning supply chains, but some was also due to the natural churn of lease events and the opportunity to upgrade accommodation. Despite increasing market share in Q4, internet retailers only accounted for 11% of total demand in 2023. Given this tilt towards production, demand was also regionally skewed to the manufacturing heartlands in the Midlands and North West in 2023.

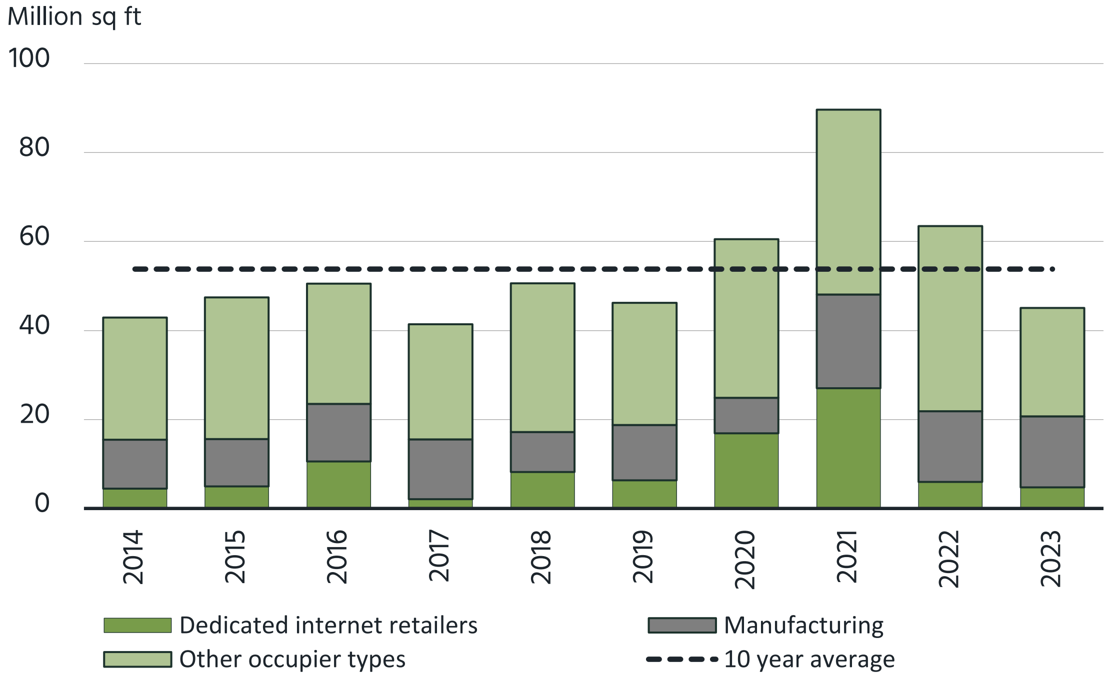
Quarterly take-up by quality

Source: Gerald Eve



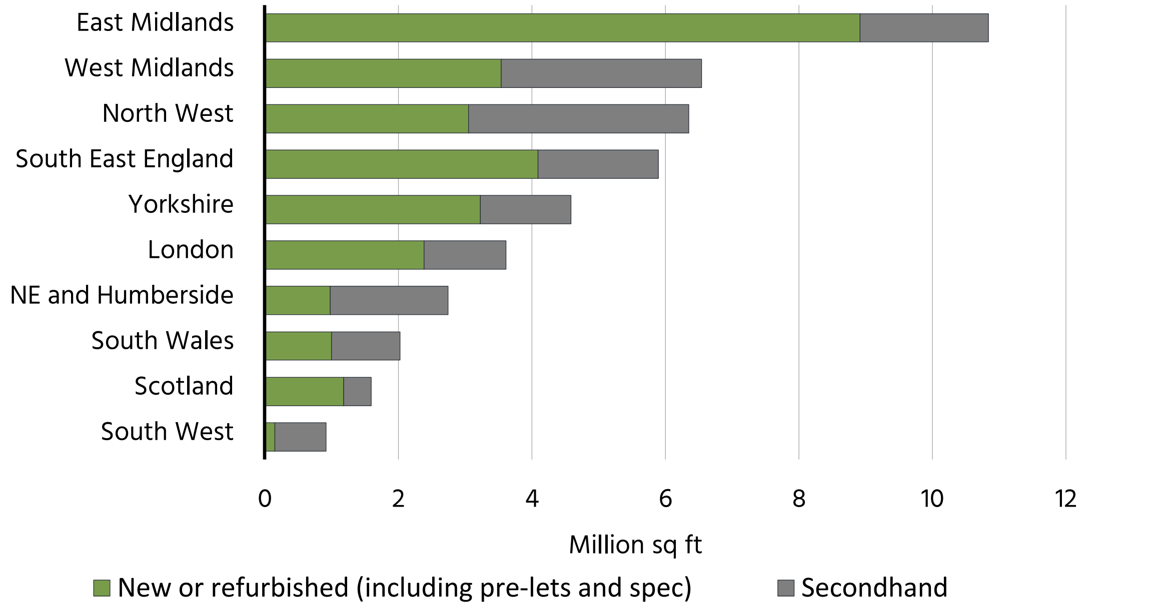
Annual take-up, sector proportions

Source: Gerald Eve



2023 take-up by region and quality

Source: Gerald Eve



SUPPLY AND DEVELOPMENT

AVAILABILITY INCREASED FURTHER TO 6.0%

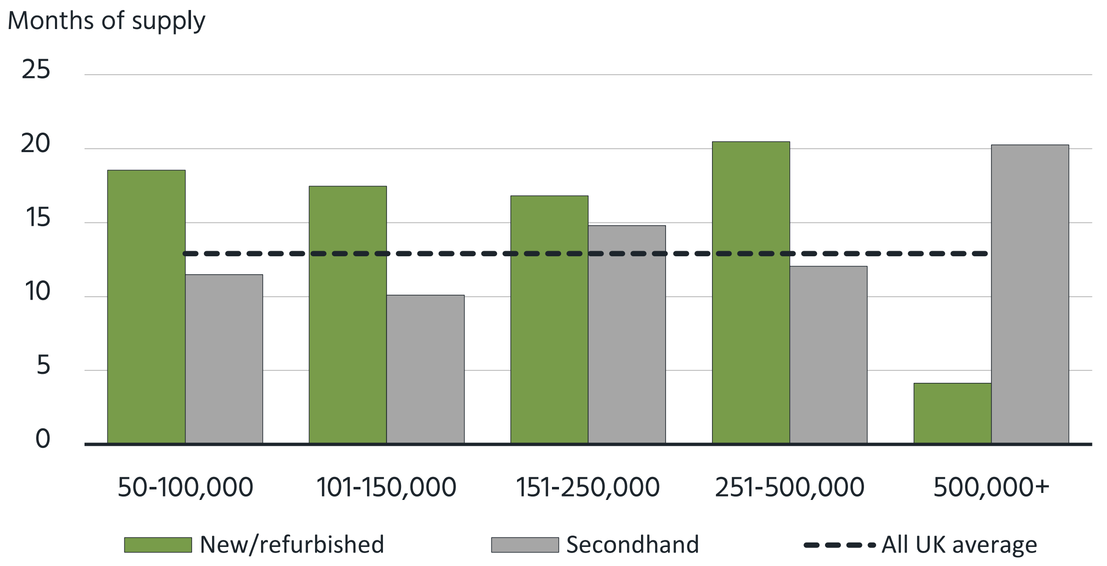
The overall rate of availability increased again from 5.8% in Q3 to 6.0% in Q4. This reflects a total of around 58m sq ft of marketed space - three million sq ft more than in Q3 and 25 million sq ft more than was on the market in Q4 2022. The increase in Q4 was due to the addition of both secondhand and newly completed speculatively built stock, although the overall quality of available space continues to be high, and new/modern buildings make up 61% of the total. The volume of sub-let or assigned space on the market was unchanged at 13% of the total.

AVAILABILITY STILL LOW IN AN HISTORIC CONTEXT

While the overall rate and volume of availability increased over 2023, supply remains low by historic standards. Occupiers still report of a lack of options in certain markets and the protracted planning process continues to hold back the delivery of new space. As the market returns to more typical trading conditions following the exceptional pandemic period, availability has increased from a low point of 3.6% in Q4 2022 to 6% in Q4 2023. This is below the 10-year average of 6.3%, and supply is still restrictive enough to support positive rental growth.

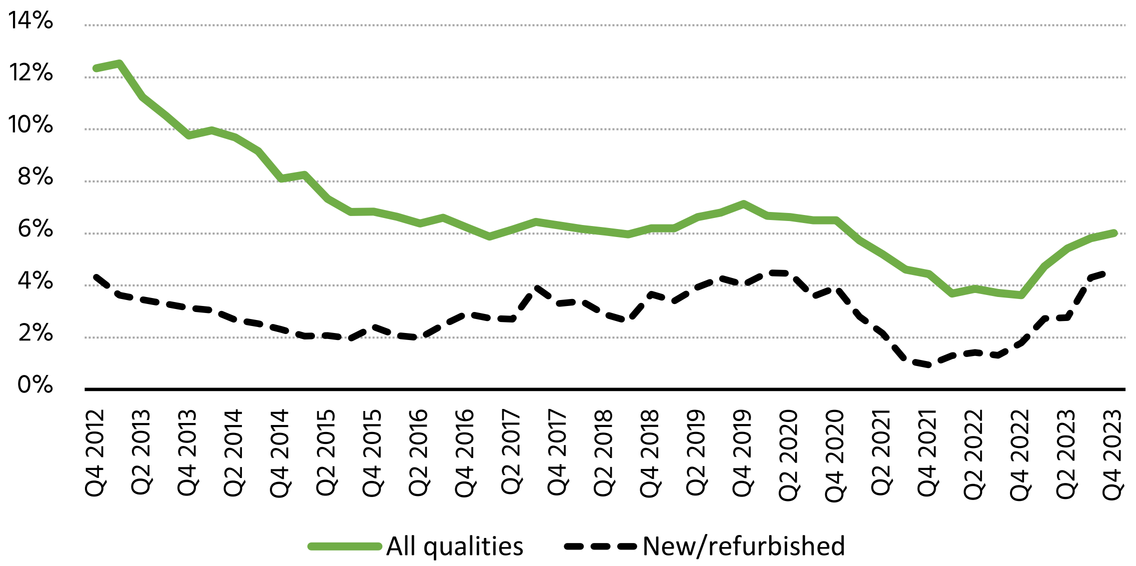
Q4 2023 months of supply by building size and quality

Source: Gerald Eve



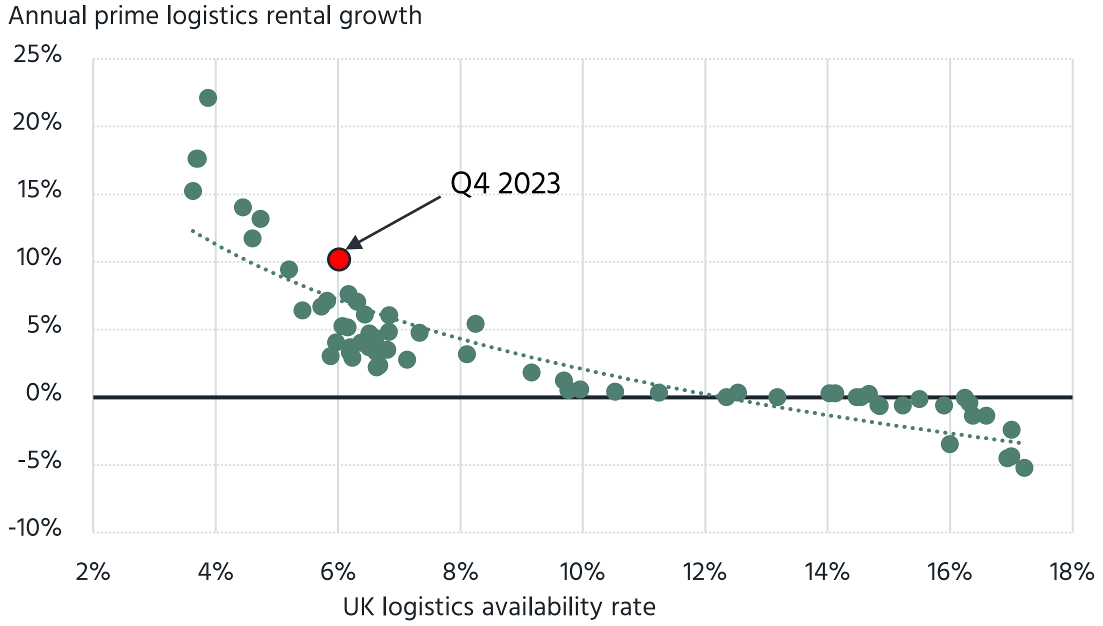
UK logistics availability rate by quality

Source: Gerald Eve



Rental growth and availability rate, Q1 2007-Q4 2023

Source: Gerald Eve



THERE ARE STILL POCKETS OF UNDERSUPPLY

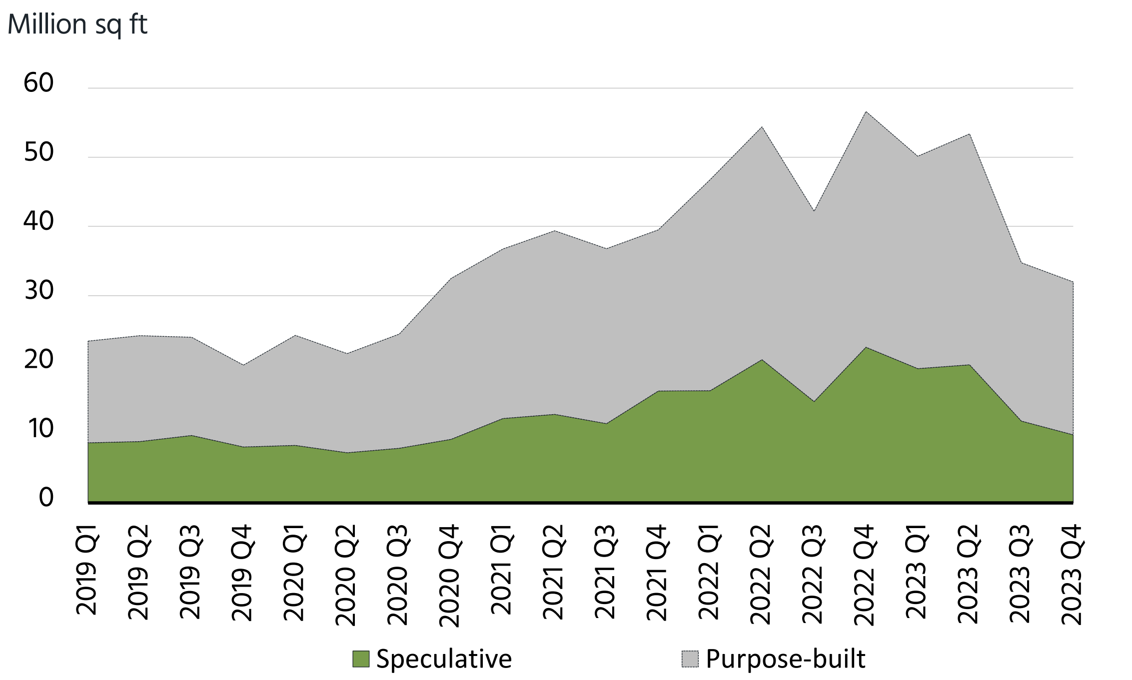
There is just over one year's worth of supply currently being marketed based on the last 10 years' average volume of take-up. Certain pockets of the market, particularly smaller secondhand units and the largest newly-built buildings are significantly below this average. The smaller bracket has proved popular with (mostly manufacturing) occupiers over the last year and developers have been hesitant to develop new buildings over 500,000 sq ft. As occupiers continue to reevaluate space requirements in 2024, the volume of secondhand space returned to the market will increase. Occupier plans to consolidate mid-sized RDCs into larger NDCs together with a subdued spec pipeline is likely to exaggerate the current supply profile through 2024.

SUPPLY AND DEVELOPMENT

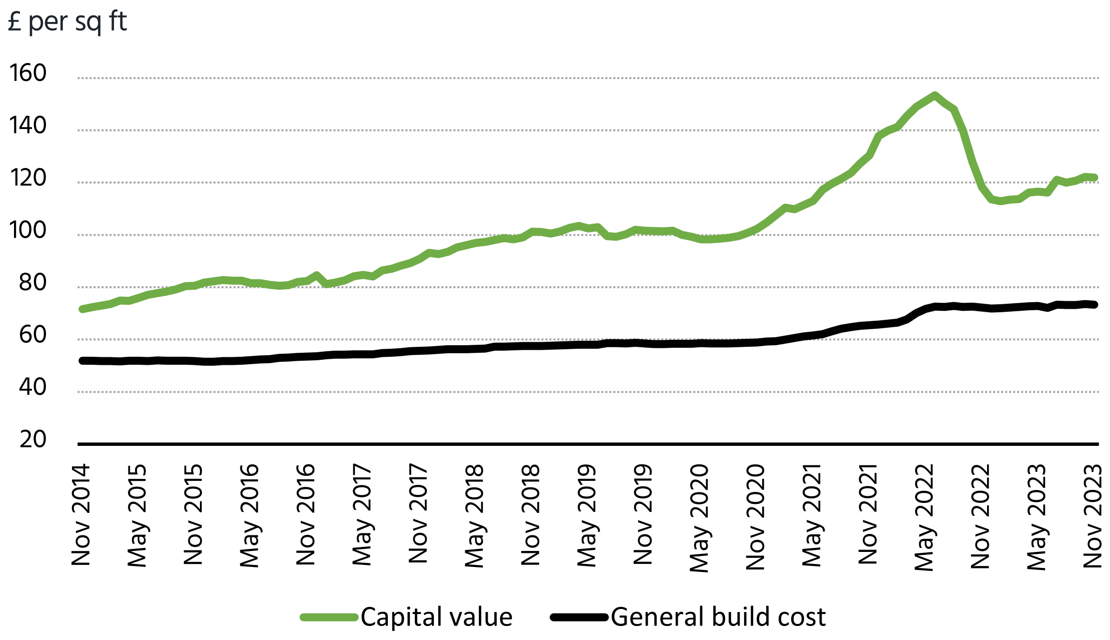
DEVELOPMENT ACTIVITY DOWN FROM PEAK

The quarterly volume of speculative development starts across the UK was 2.5m sq ft in Q4, the same as Q3, but 64% lower than a year earlier. This slowdown reflects the high cost of development and debt, set against the post-pandemic softening of occupier demand. The volume of speculative space under construction at the end of 2023 was the lowest since Q3 2021 and activity is likely to remain subdued through 2024. Land continues to be readied through planning and infrastructure works - indeed several new schemes were announced in Q4, but intentions are mostly to market this land for D&B rather than commence speculative construction.

Volume of development under construction by type
Source: Gerald Eve



Distribution warehouse capital value and build cost
Source: BCIS, MSCI, Gerald Eve



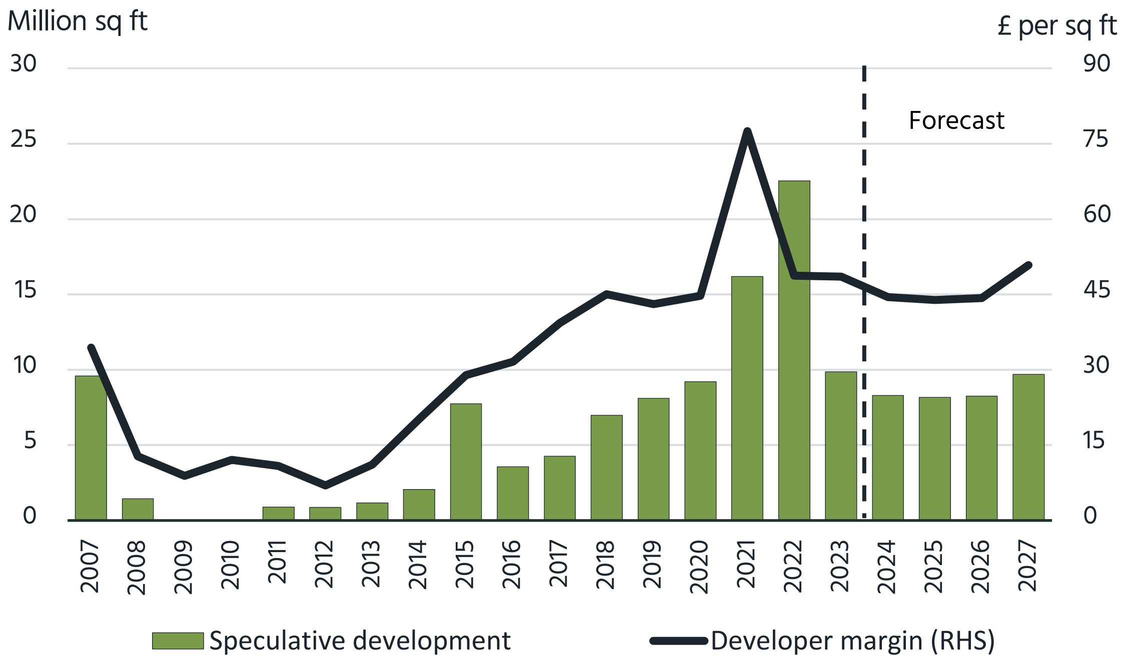
SPECULATIVE DEVELOPMENT LESS COMPELLING

The developer margin between industrial property capital value and build cost widened significantly through the pandemic period 2021-2022. Whilst build costs largely rose in line with prevailing inflation, capital value growth was exceptional and strongly encouraged speculative development, especially at a time of heightened occupier activity. Now that occupier activity has softened and pricing has corrected, the impetus to build is much reduced. Development decision-making is now more tentative, especially if financed with debt or if the land was bought during the time of peak pricing in 2021 or 2022.

SPECULATIVE DEVELOPMENT TO RETURN TO PRE-PANDEMIC RATE

Looking forward, build costs are set to continue to rise, albeit at much reduced growth rates than those over the last few years. Moreover, the potential for future capital value growth, while positive, will be limited to some extent by the reduced scope for yield compression. The annual volume of speculative development is therefore likely to be similar to pre-pandemic levels. This will in turn alleviate upward pressure on availability and continue to underpin growth in nominal prime rents.

Speculative development and build viability
Source: Gerald Eve



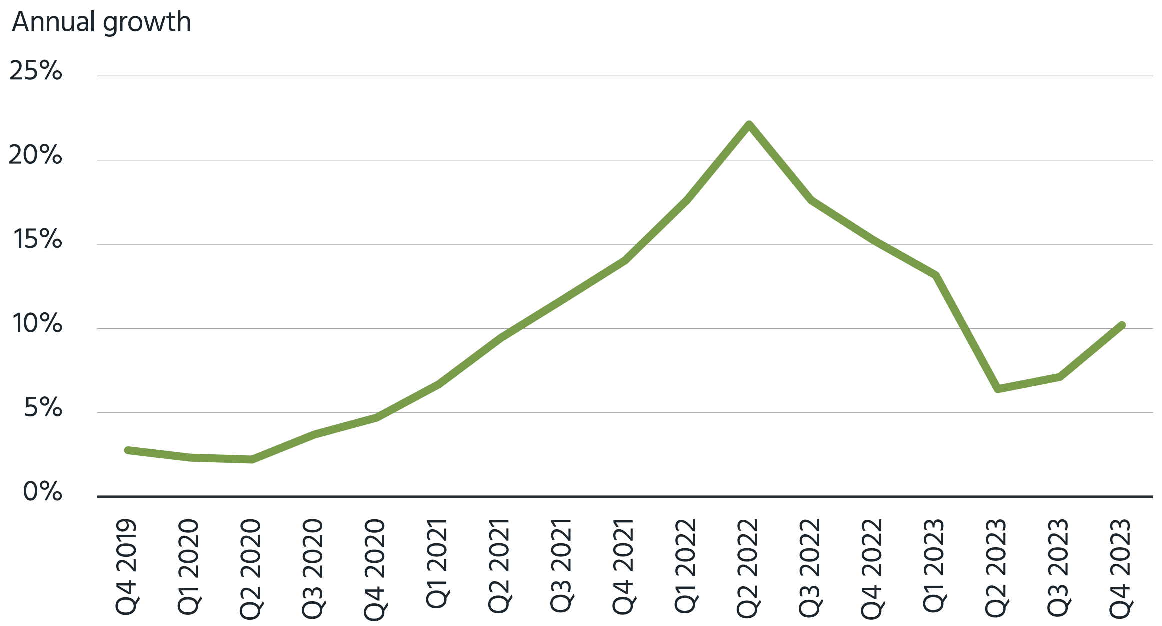
RENTS AND OCCUPIER COSTS

STRONG END TO 2023 FOR PRIME RENTAL GROWTH

A cooling of the prime rental market following the period of unprecedented growth during 2021-2022 was to be expected and the rate of annual growth fell during H2 2022 and H1 2023. However, annual rental growth ticked up again in H2 2023 – with average rental growth of 5% in Q4 and 10% over 2023 as a whole. This ongoing robustness in the market despite an increase in availability reflects the activity on new (smaller) speculatively built units and strong demand for energy-efficient buildings capable of meaningful cost savings. Deals on top quality new space can rapidly alter a location's rental tone and push prevailing prime benchmarks.

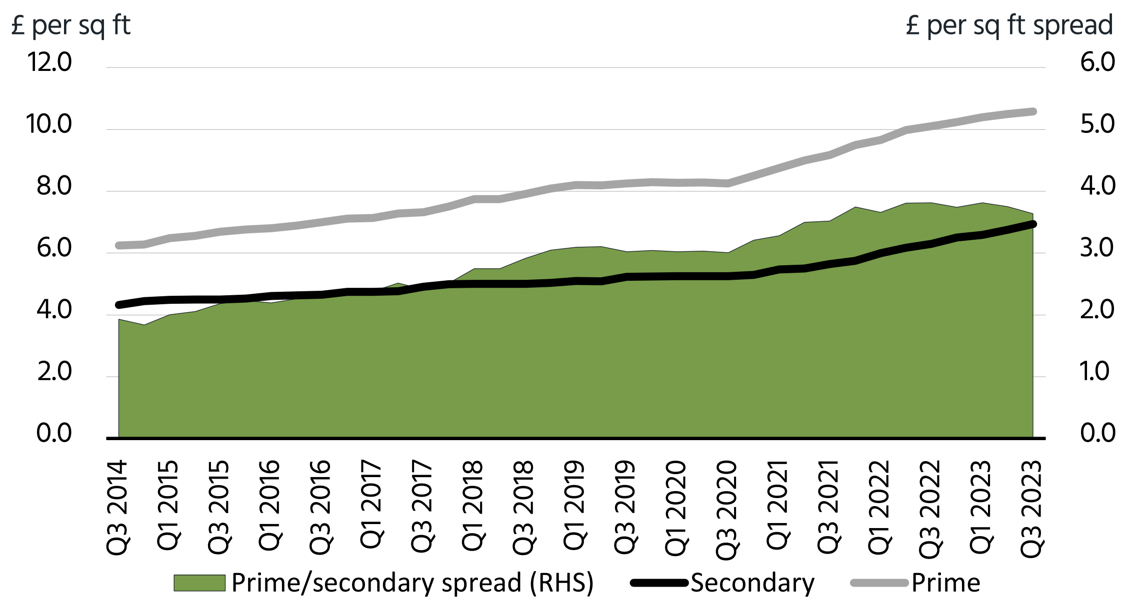
Average annual UK prime rental growth

Source: Gerald Eve



Distribution warehouse rents by quality

Source: MSCI



PRIME SECONDARY SPREAD TO WIDEN IN 2024

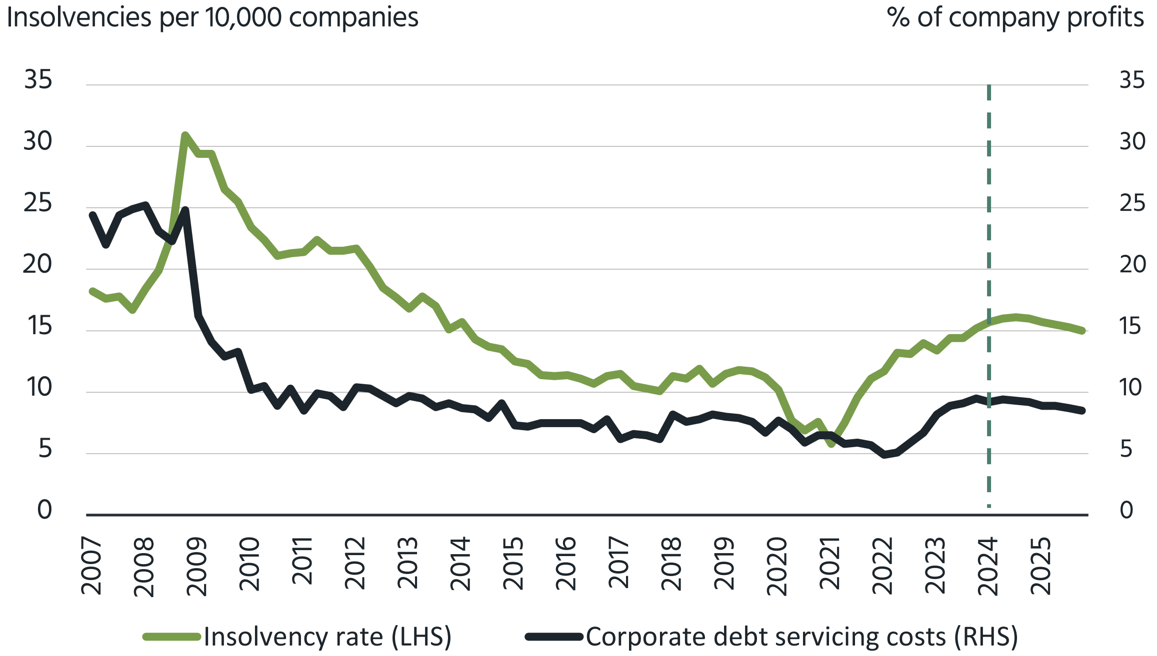
Occupier activity has been focused on new or modern buildings over the last few years. There has been a preference for energy-efficient modern buildings and pre-lets have proved popular. Prime rents have grown strongly, but secondary rents have grown too - occupier activity has mostly been expansionary, and the return of unwanted secondhand space has so far been relatively limited. But, increasingly, as occupiers look for ways to cut costs and make efficiencies in their supply chains the volume of secondhand space on the market is likely to rise back to the pre-pandemic average. Consequently, secondhand space is set to lose more ground against its prime counterparts, especially non-compliant energy-inefficient buildings.

CORPORATE INSOLVENCIES SET TO RISE

Geopolitical risk increased over 2023 and will almost certainly be sustained over 2024. Meanwhile the real economy is faltering and may already be in a very mild technical recession. Occupiers have had to quickly adjust to and now routinely prepare for a world of supply chain shocks, higher interest rates and lower global economic activity. This will continue to take its toll on some UK industrial occupiers. Debt servicing costs and corporate insolvency rates have risen, and whilst the outlook for interest rates is potentially improved relative to 2023, there will still likely be some fallout for logistics occupiers in 2024.

UK corporate insolvencies and debt servicing costs

Source: Oxford Economics



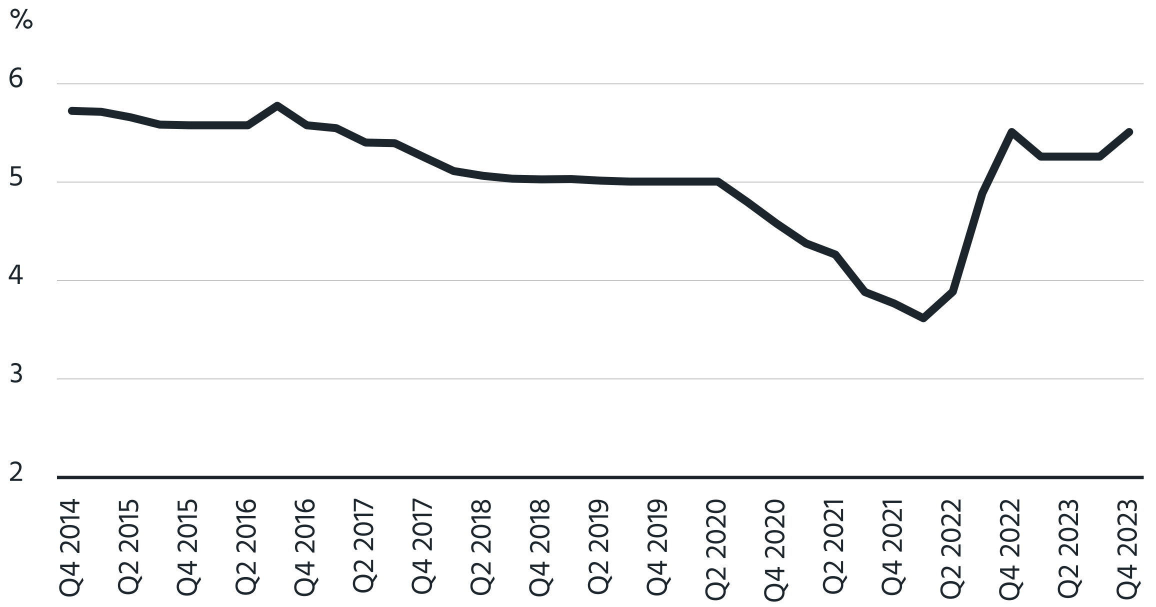
INVESTMENT

DEAL VOLUME LOW IN Q4, AND PRIME YIELDS SLIP 25BPS

The volume of UK investment transactions was very low in Q4, in part due to the October investor hiatus when geopolitical risk was perceived to be at its maximum. Many sales intended for Q4 were delayed, aside from the most urgent or distressed. Deals that did go through were typically done off-market and there was a lack of open market transactional evidence to gauge pricing. Prime yields in the direct market likely moved out around 25bps in Q4, though this may not fully feature in valuation measures given the pressures the maintain LTV ratios. Q4 could have been the bottom of the market in the current cycle. Some asset prices may still soften in the new year, but broadly pricing on prime or good quality secondary will stabilise or improve now.

All UK average prime logistics yield

Source: Gerald Eve

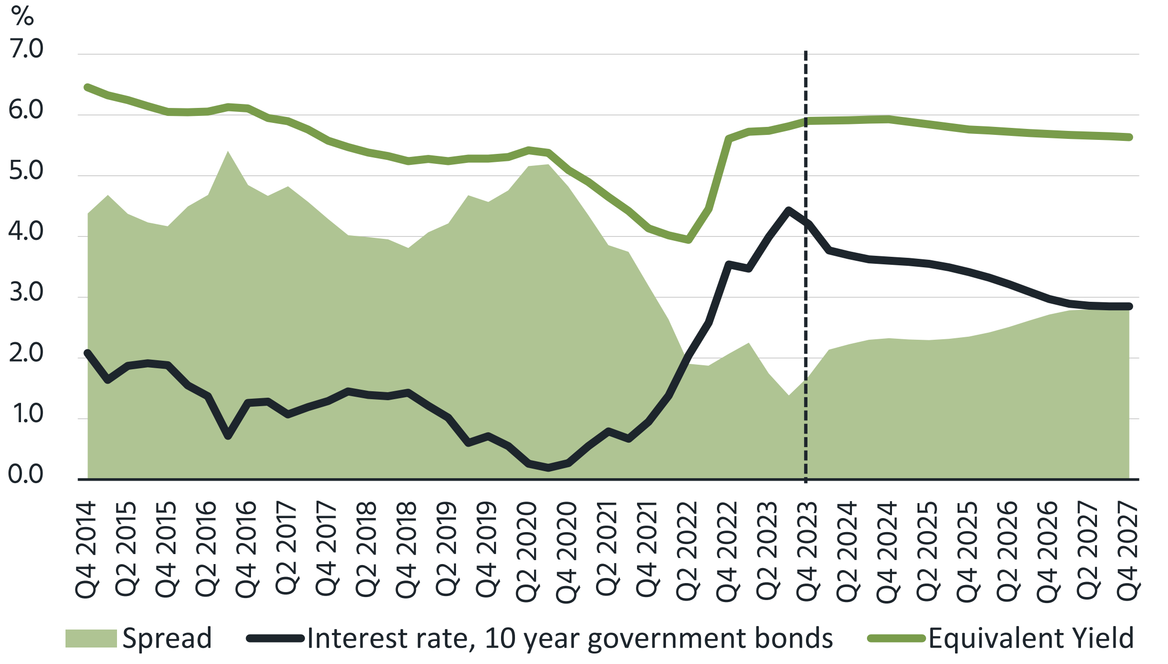


INVESTOR CONFIDENCE TO IMPROVE IN 2024

Some buyer hesitancy is likely early in 2024 until the market shows convincing signs it really is through the bottom. However, over 2024 we can expect to see increasing confidence and depth of buyer pool. Oxford Economics forecasts a 100bps cut to the base rate to support the economy by year-end 2024 and for the Bank Rate to fall to 3.25% by end-2025. If this view is adopted generally (and the 10-year bond yield has been trending downward) this is likely to motivate buyers with a lot of dry powder waiting to be deployed. Opportunities for investment are likely to be in short supply though as sellers will be relatively scarce at this point in the cycle.

Warehouse equivalent yield and 10-year bond yield spread

Source: Oxford Economics, Bank of England, MSCI



WHO ARE THE LIKELY SELLERS IN 2024?

Defined benefit pension funds: could seek to de-risk by selling real estate assets and invest in bonds or annuities to cover liabilities.

Retail funds: may be under further redemption pressure and look to make sales.

M&A activity: recent announcements suggest more consolidation in the REIT market in 2024.

Listed entities: may seek to sell to reduce LTV ratios in 2024.

Local authorities: are under financial pressure and may need to sell assets to free up capital.

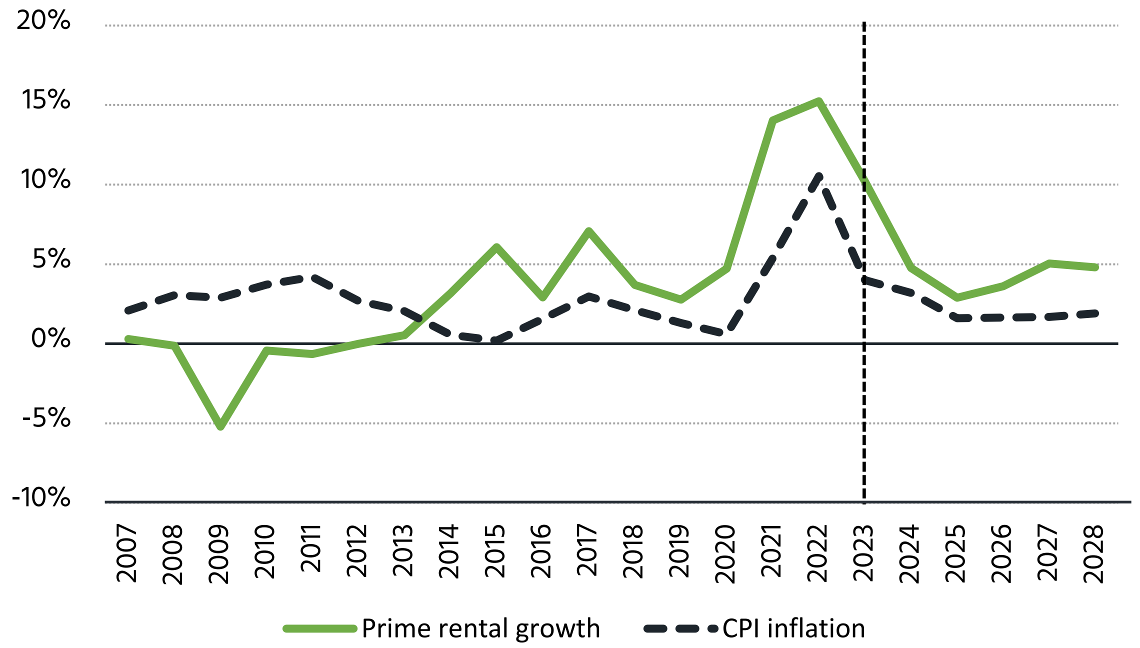
Occupiers: some may entertain sales and leasebacks to raise capital.

OUTLOOK: PRIME RENTS AND OCCUPIER GROWTH SECTORS

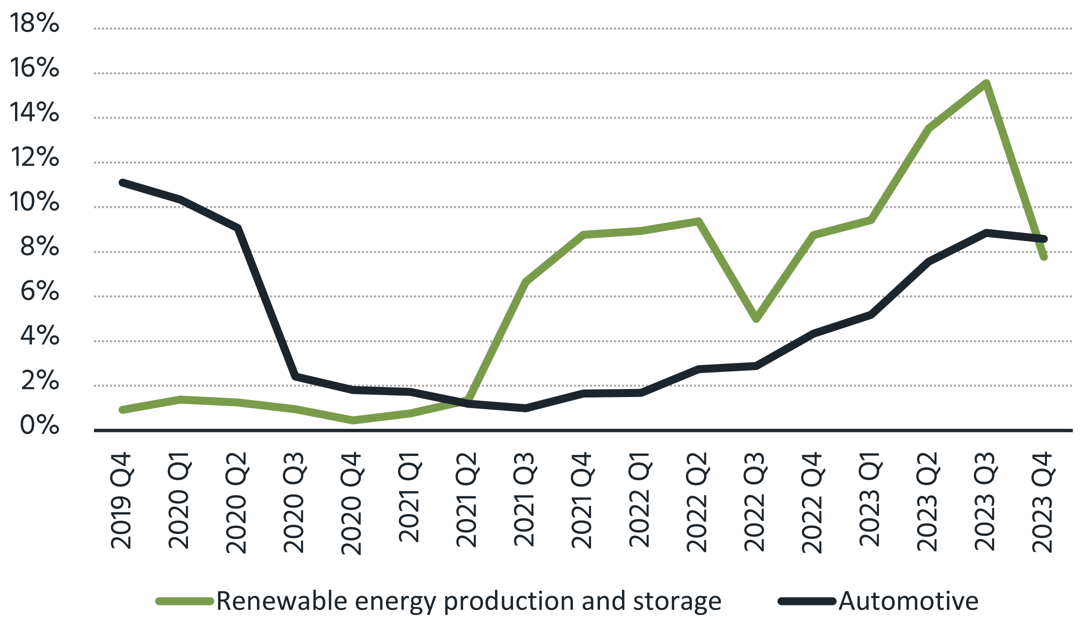
POSITIVE OUTLOOK FOR PRIME RENTAL GROWTH

Prime UK headline logistics rents grew by 10% in 2023. This again exceeded annual CPI growth, which was 4% in December 2023 and in real terms annual prime logistics rental growth has been positive since 2013. We expect this to continue. The 5-year outlook for rental growth is positive, but much lower than the highs of the last few years, averaging 4.2% per year to 2028, compared with 9.4% on average in the five years to 2023. Occupier consolidation will result in increased secondhand space, but only moderate increases in the overall rate of availability are expected in 2024. Speculative development starts slowed considerably over 2023 and prime space will remain in short supply.

Annual prime logistics rental growth and CPI
Source: Gerald Eve, Oxford Economics



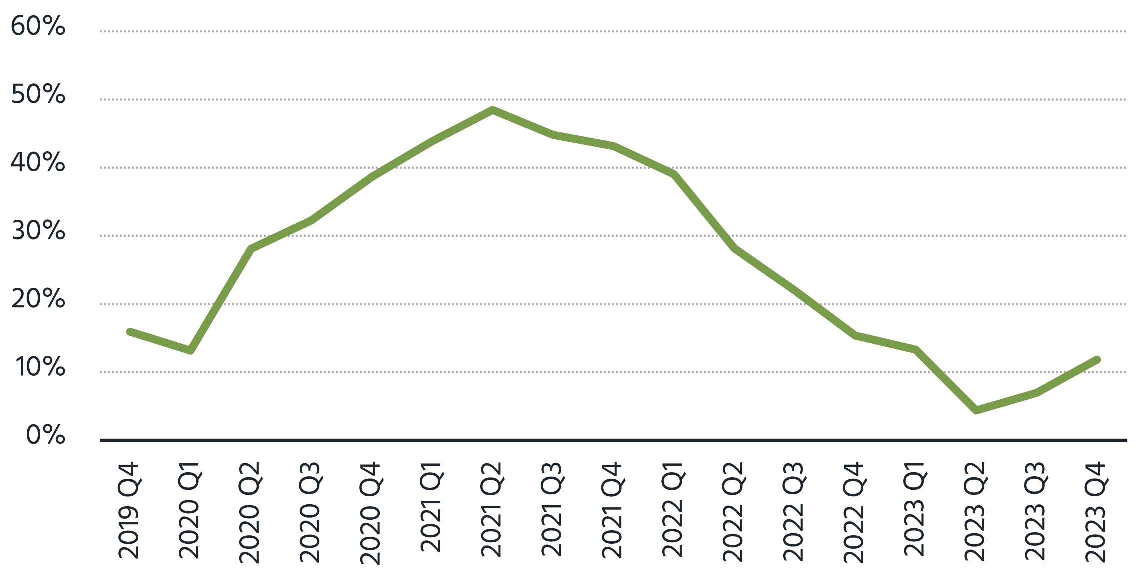
Proportion of rolling annual take-up by sector
Source: Gerald Eve



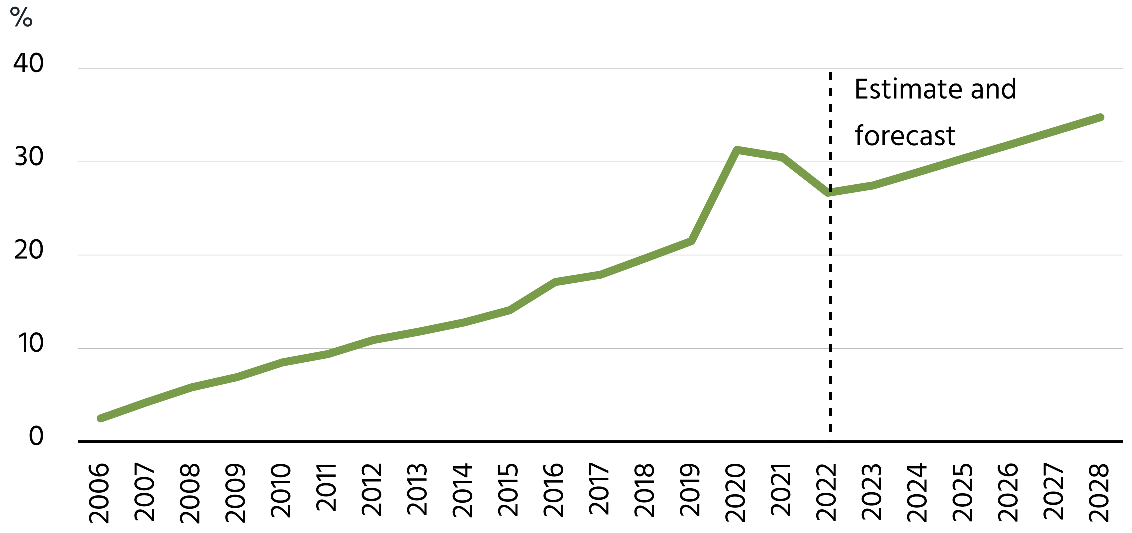
AUTOMOTIVE, RENEWABLE ENERGY, FOOD AND E-COMMERCE ARE THE SECTORS TO WATCH IN 2024

Overall demand is likely to remain relatively subdued in 2024 as occupiers double-down on tailoring their estates to more circumspect trading conditions. Nevertheless, there are some occupier sectors set for growth. A combination of new entrants and the switch to electric vehicles in the automotive sector could help boost manufacturing demand, as could manufacturers in the food sector. Renewable energy will continue to account for an increasing share of demand too as new sites for generating and storing renewable energy gain critical mass. E-commerce, a relatively small proportion of demand in 2023, is also likely to return to activity in 2024 as companies revisit growth plans in expectation of a stronger economy over the medium term.

Proportion of rolling annual take-up by internet retailers
Source: Gerald Eve

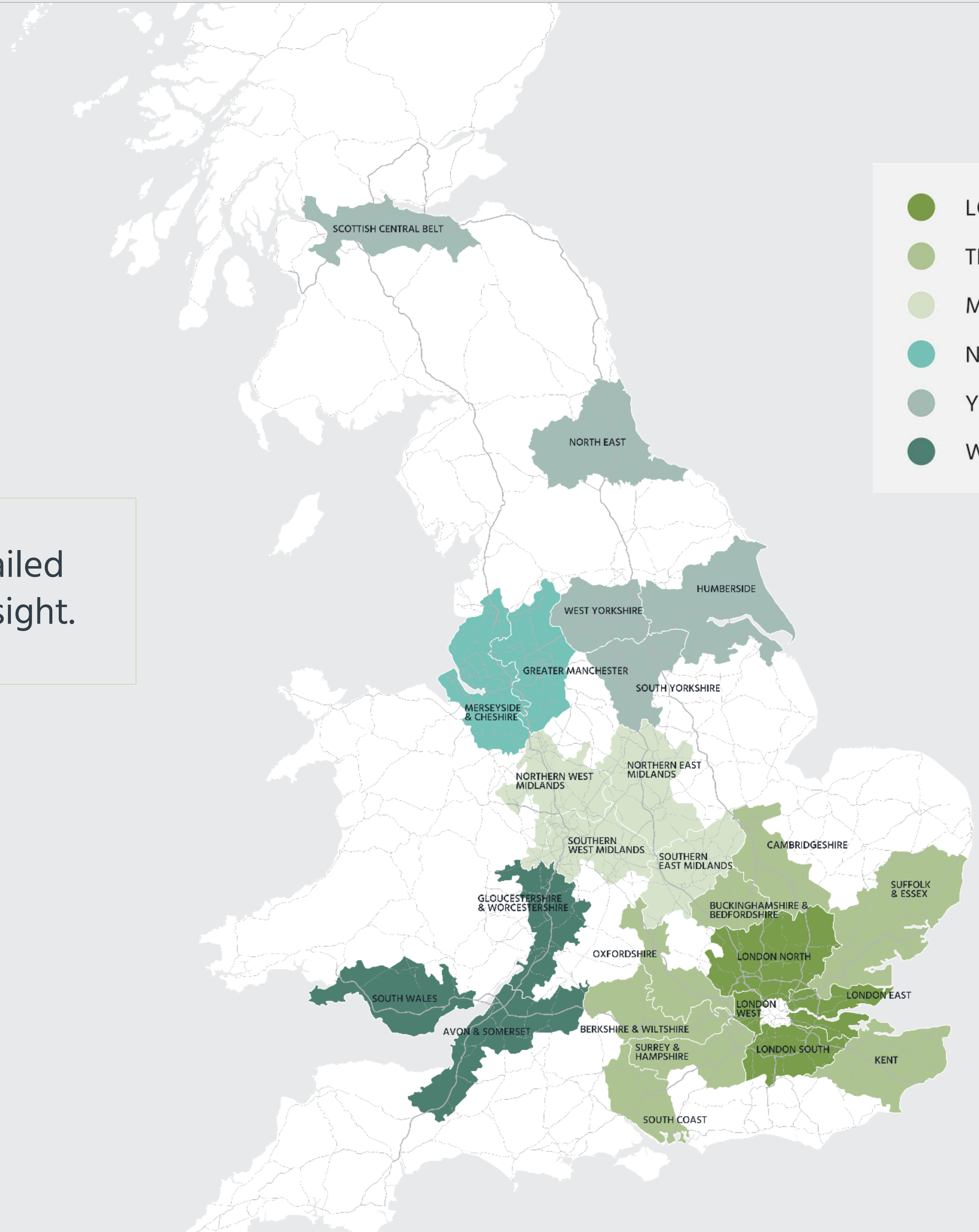


UK retail spending, percent online
Source: Gerald Eve, ONS



GERALD EVE REGIONS

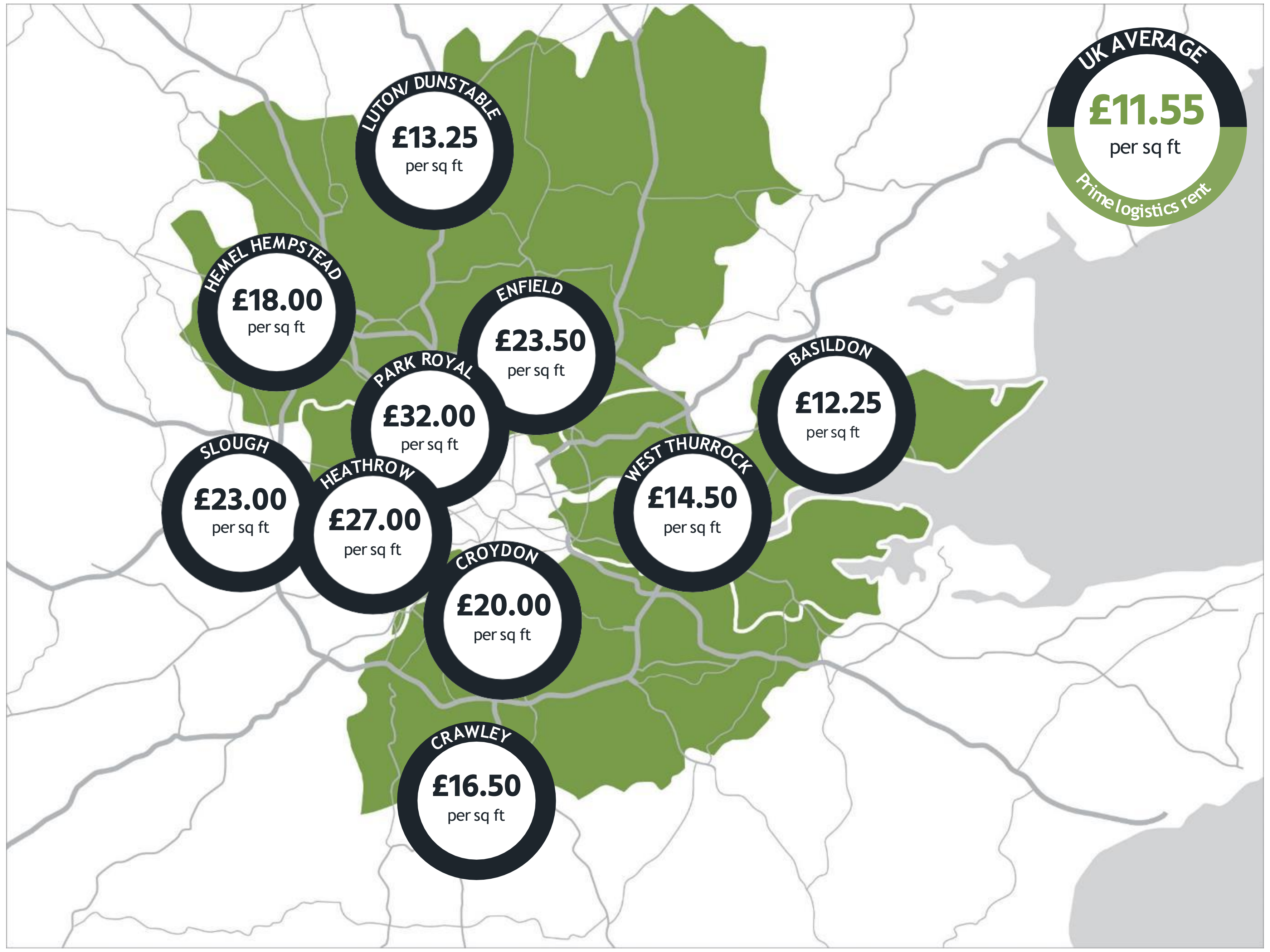
Click here for more detailed regional analysis and insight.



- LONDON
- THE SOUTH EAST AND EAST
- MIDLANDS
- NORTH WEST
- YORKSHIRE, NORTH EAST AND SCOTLAND
- WEST OF ENGLAND AND SOUTH WALES

LONDON

PRIME LOGISTICS RENTS



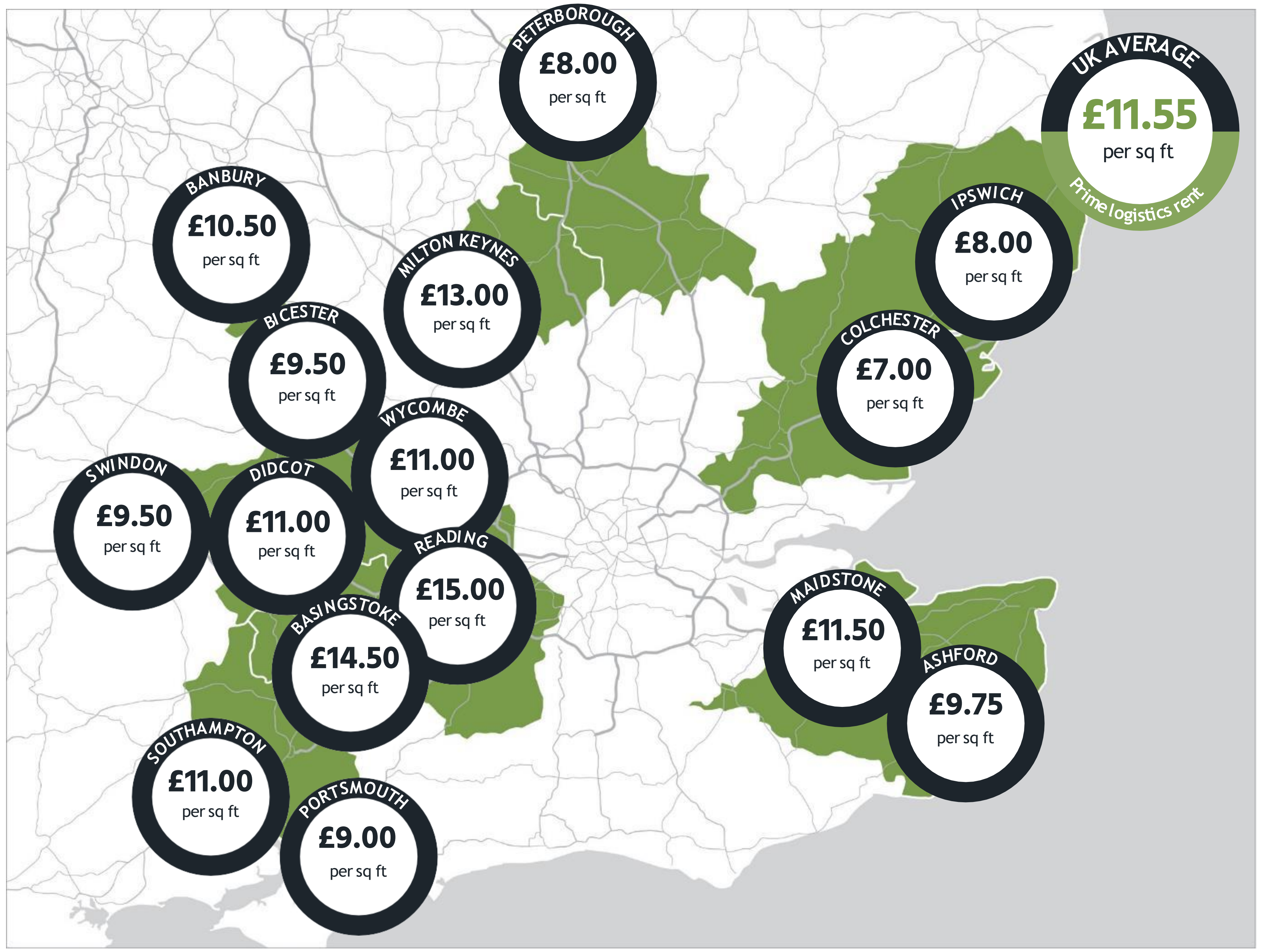
Prime rent: typical achievable headline rent in £ per sq ft for units of good quality over 50,000 sq ft and let on a typical 10 year lease to a tenant of strong covenant.

Quarterly occupier take-up by region
Source: Gerald Eve

Availability rate by region
Source: Gerald Eve

THE SOUTH EAST AND EAST

PRIME LOGISTICS RENTS



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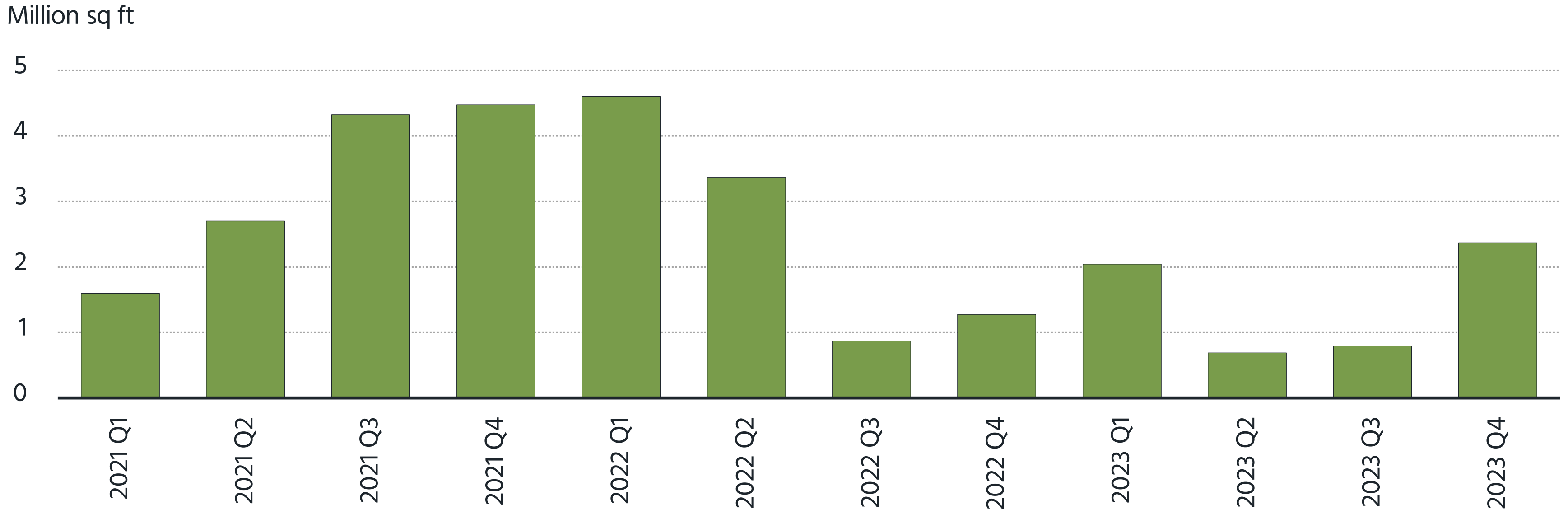

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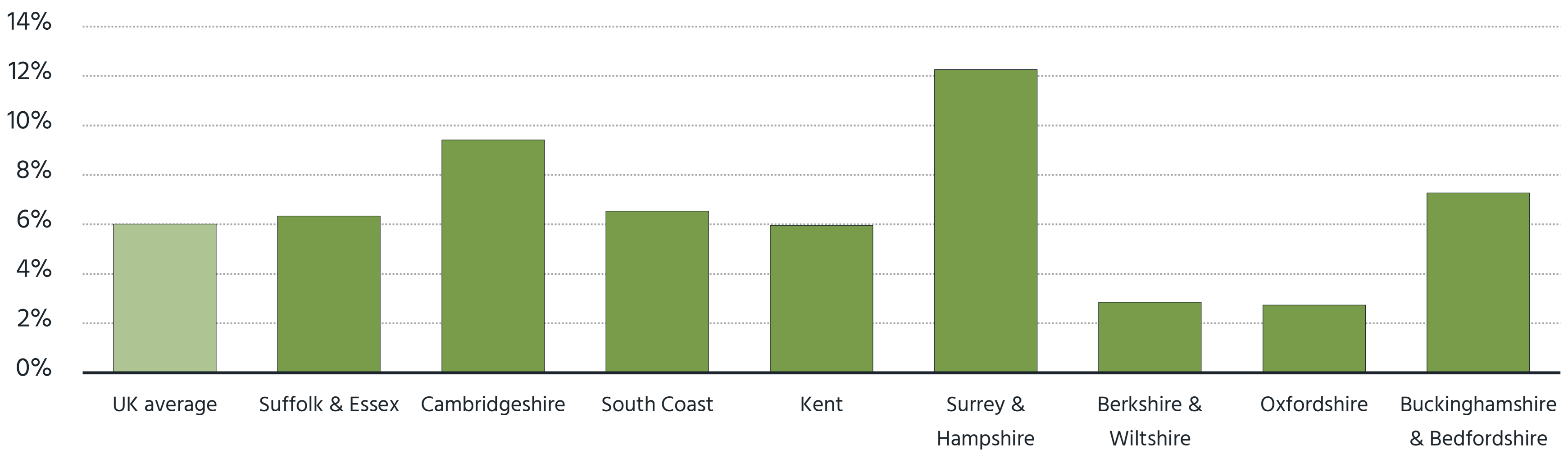
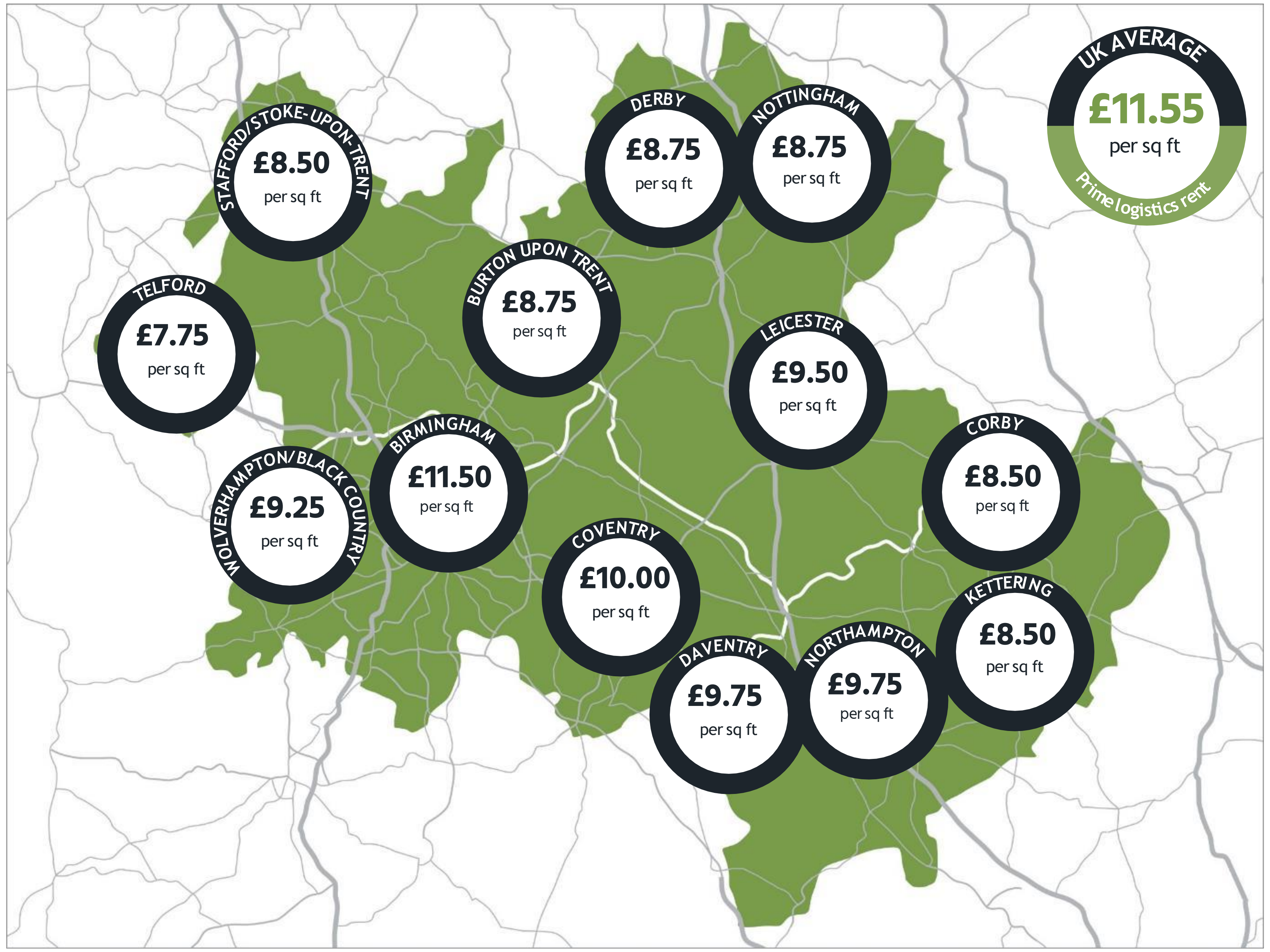
Source: Gerald Eve



MIDLANDS

PRIME LOGISTICS RENTS



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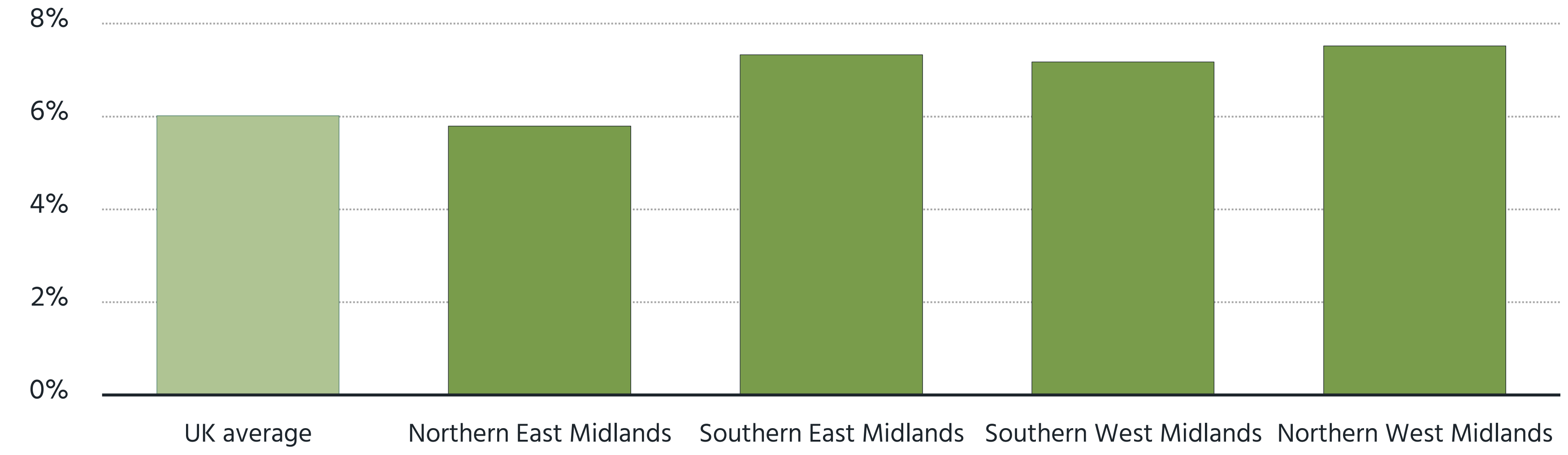
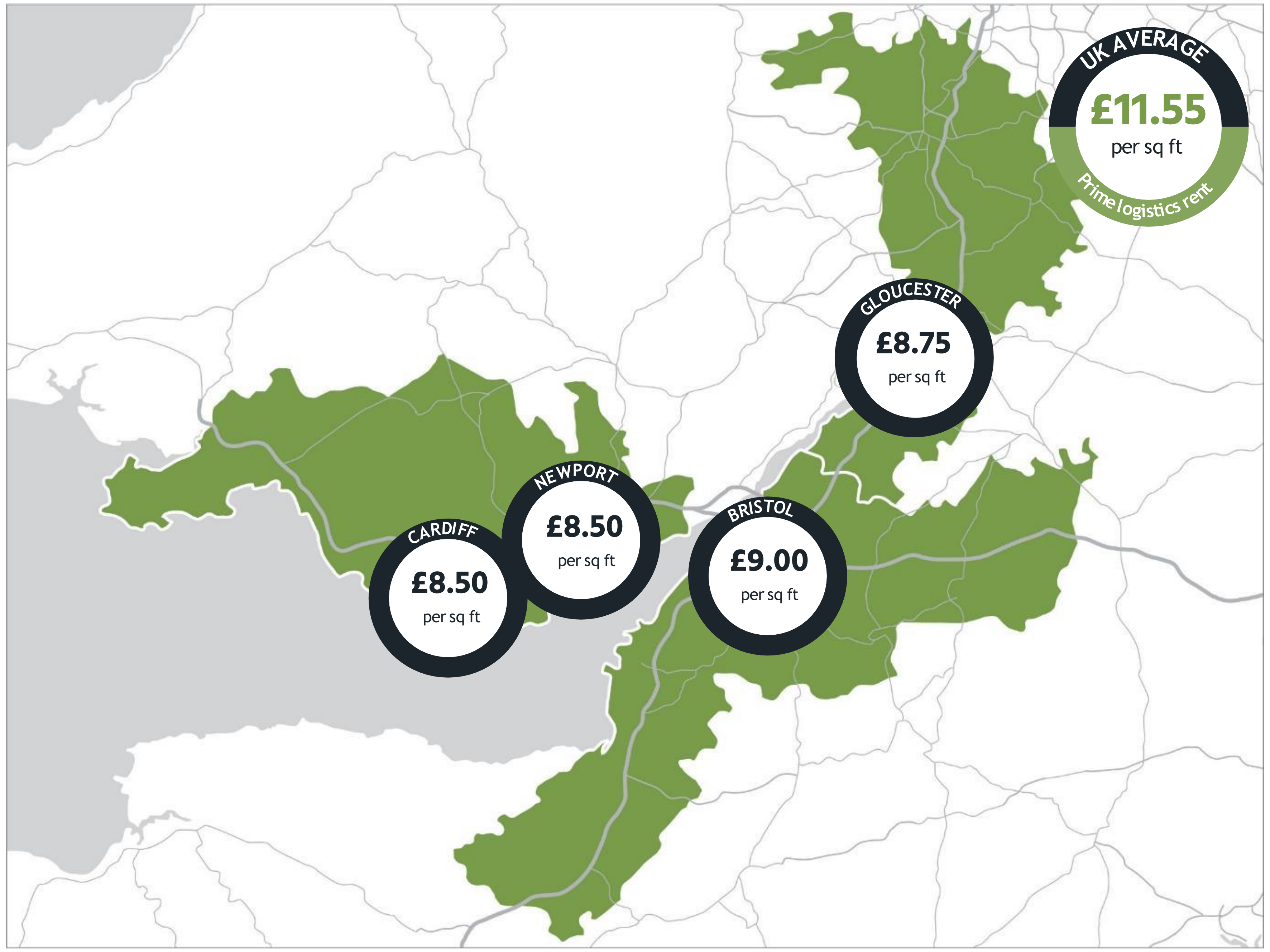


WEST OF ENGLAND AND SOUTH WALES

PRIME LOGISTICS RENTS



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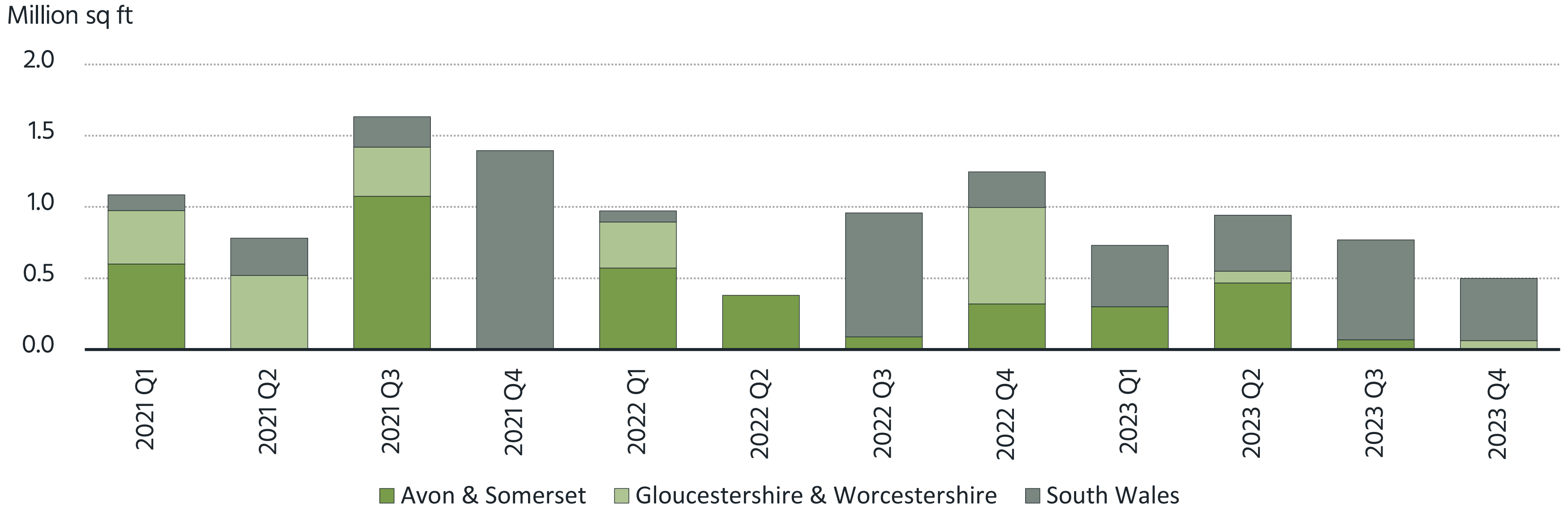
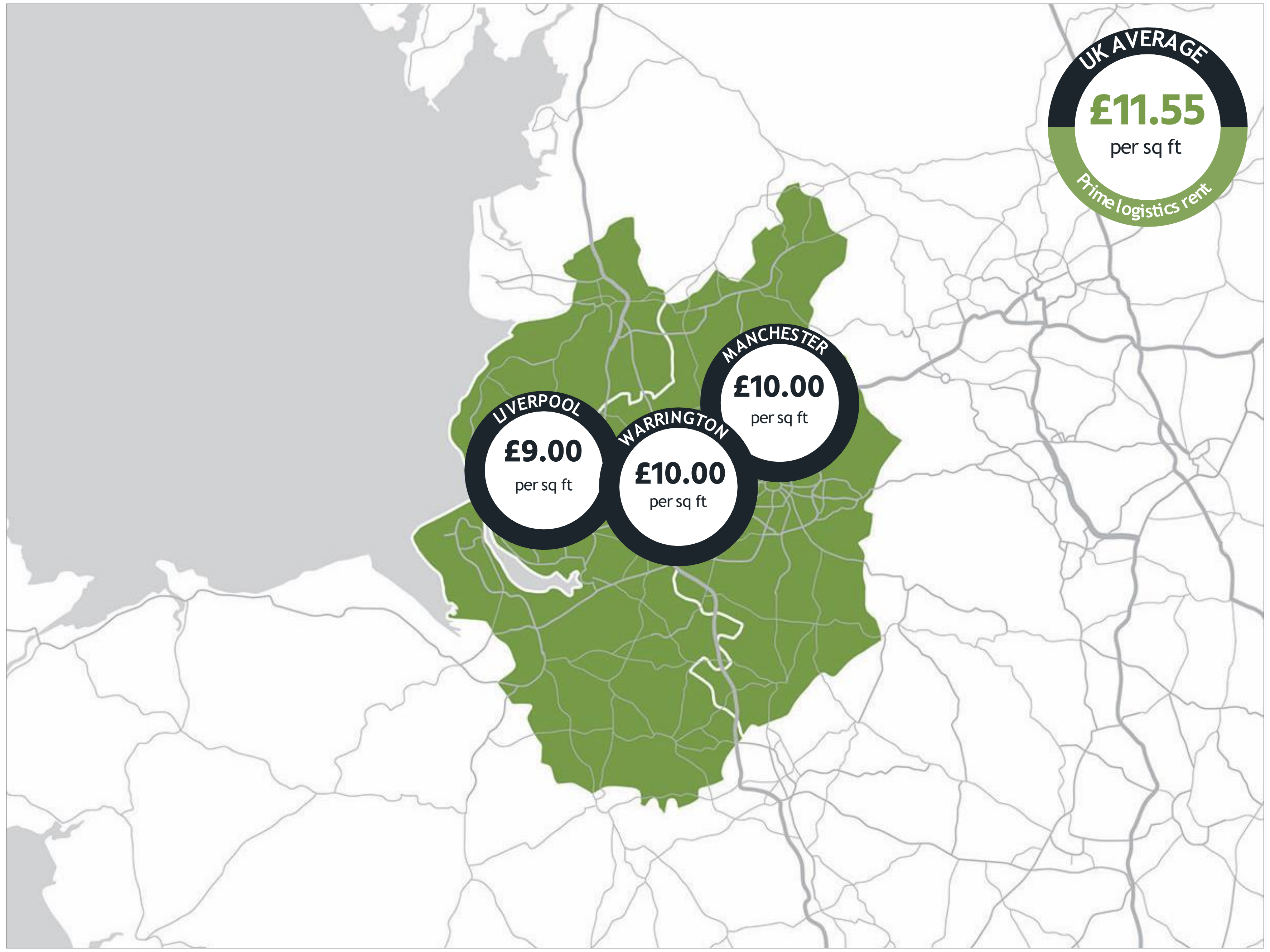


Availability rate by region

Source: Gerald Eve

NORTH WEST

PRIME LOGISTICS RENTS



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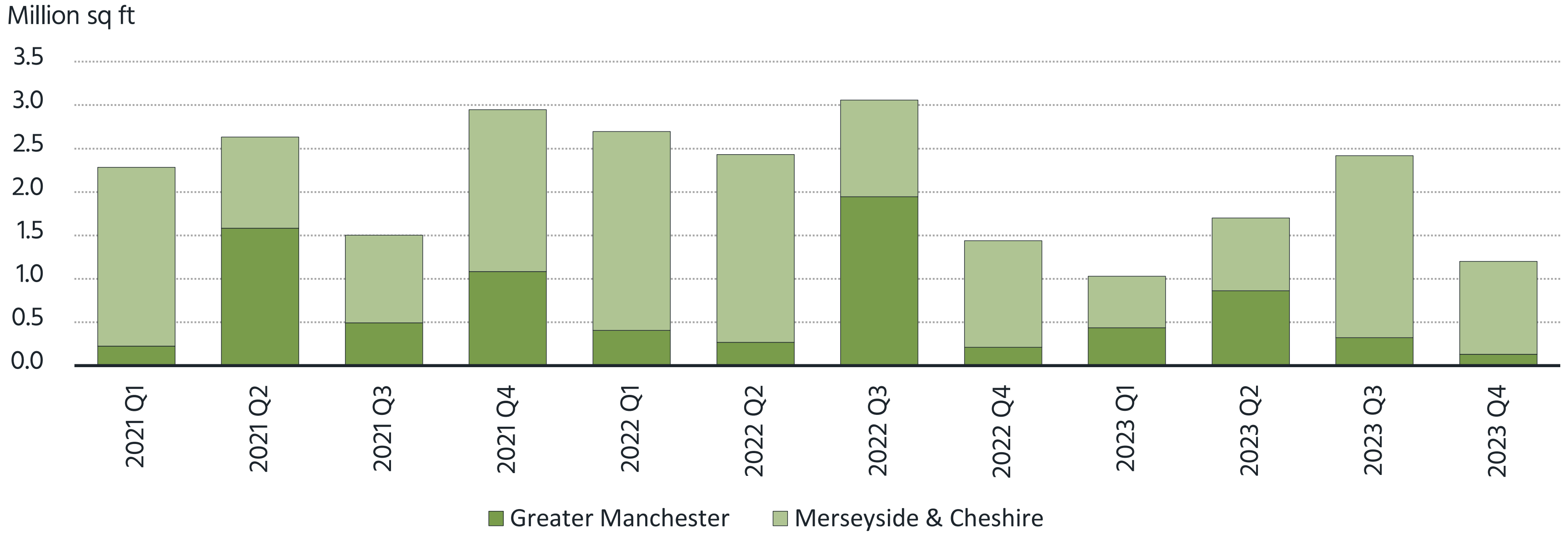
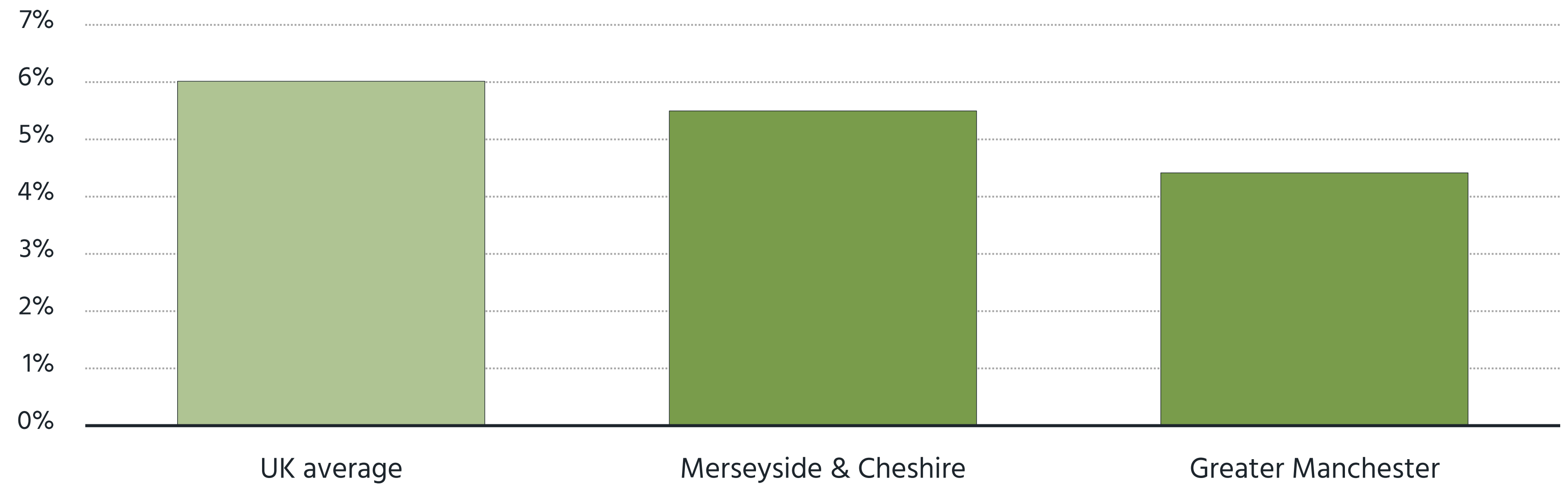


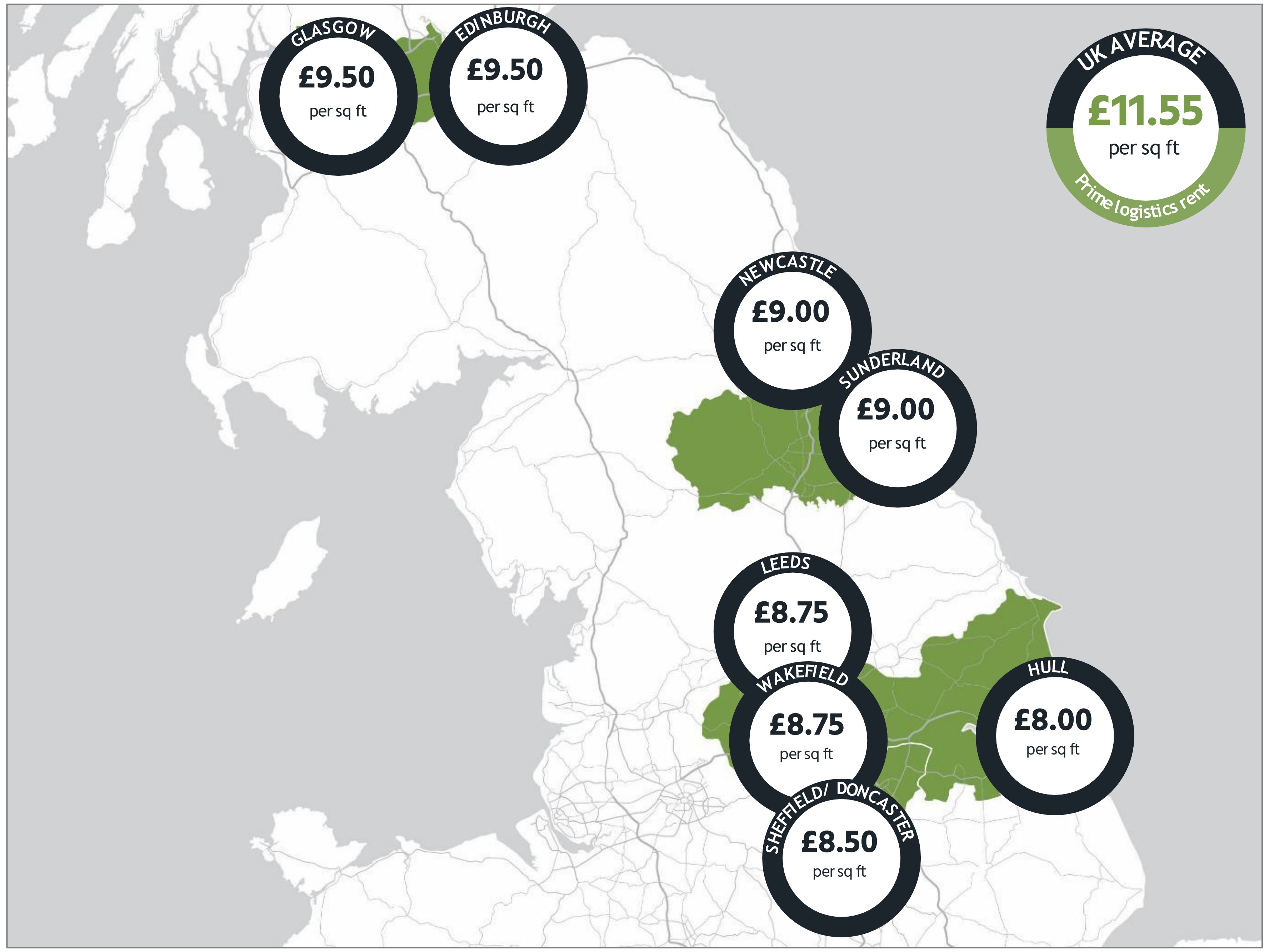
Availability rate by region

Source: Gerald Eve



YORKSHIRE, NORTH EAST AND SCOTLAND

PRIME LOGISTICS RENTS



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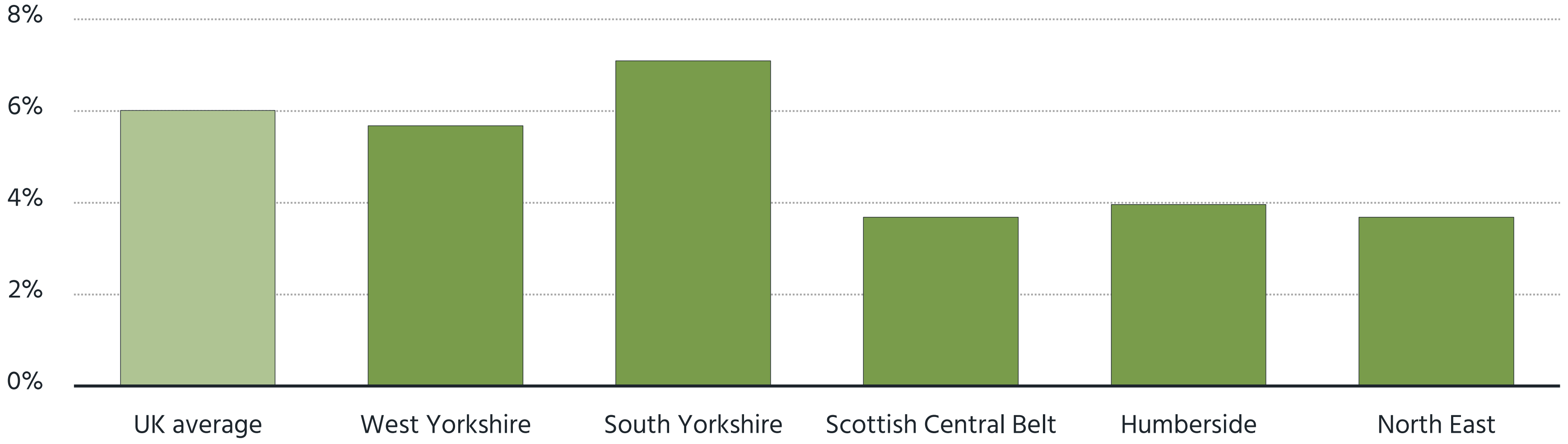

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FURTHER INSIGHT

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December 2023

Multi-let
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Gerald Eve, a Newmark Company, is a firm of international property consultants based in the UK. We operate a national network of nine offices and an international association covering 20 European countries and all major US markets. Whether you are a property owner, investor, occupier or developer, Gerald Eve provides independent, intelligent and relevant advice based on detailed market knowledge and sector understanding. Together we have the resource, experience and relationships to deliver the best property solutions for your business.