GERALDEVE
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PRIME LOGISTICS

The definitive guide to the
UK's distribution property market

Q1 2024

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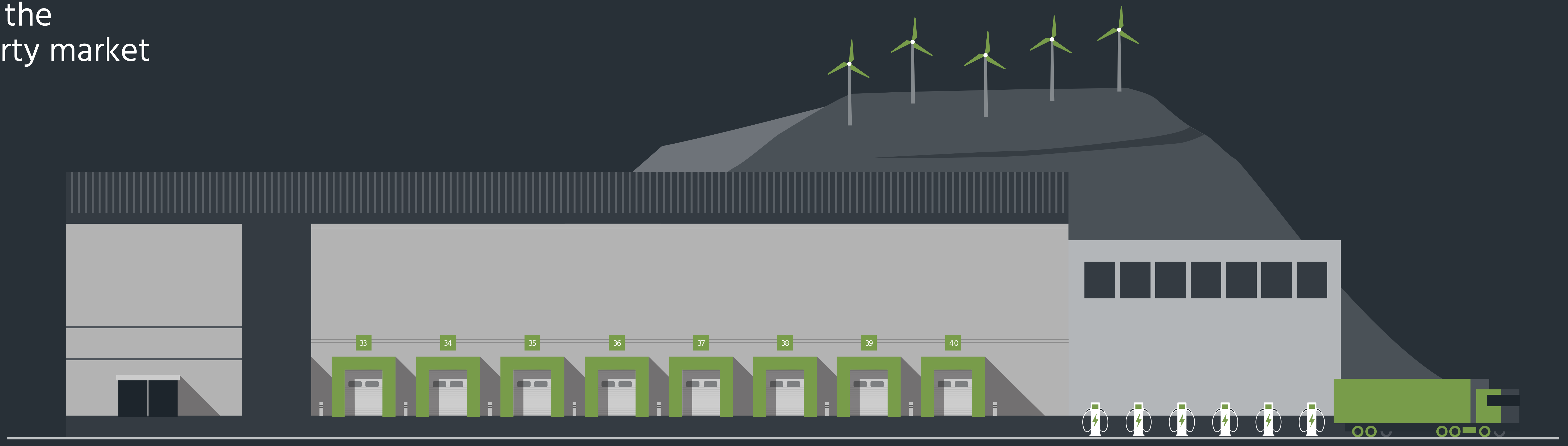


MARKET OVERVIEW

OCCUPATIONAL MARKET SOFTENS IN Q1, BUT FORWARD-LOOKING INDICATORS ARE MORE POSITIVE

Occupier take-up in Q1 was 10.4m sq ft - 14% down on Q4, 12% down on a year earlier and one of the lowest totals of the last five years. In part this is a lagging indicator and reflects decisions made during the period of intensified economic weakness and uncertainty at the end of 2023.

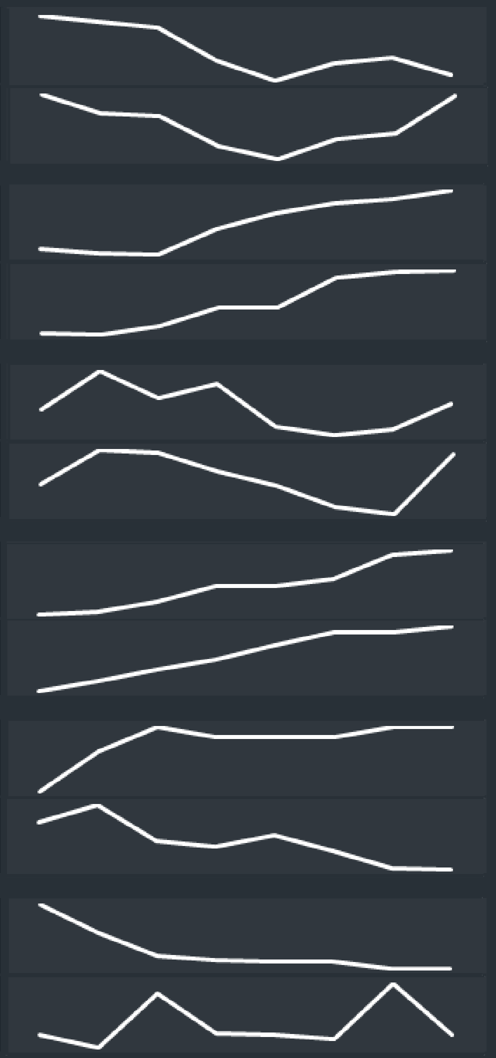
Industrial occupiers have started this year with greater confidence and intention to take space. Inflation has continued to come in under expectations and the technical recession in the second half of last year looks to be over. Geopolitical tensions continue to be a concern, but supply chain volatility is much reduced and most expect cuts in interest rates to support the economy in the second half of this year. The volume of industrial space either under offer or in the planning pipeline has increased and forward-looking business survey sentiment data is at a nine-month high.

This increased optimism was notably evident in the development and investment market in Q1. The volume of speculative development starts in Q1 was the highest in over a year and the number of potential investors continues to increase, although transaction activity continues to be limited by a lack of supply.

Q1 2024 UK LOGISTICS MARKET DASHBOARD

Sources: Gerald Eve, ONS, RCA

		Q1 2024	Two-year trend
OCCUPIER DEMAND	Take-up	10.4m sq ft	
	% new/modern	78%	
AVAILABILITY	Availability rate	6.4%	
	New/modern availability rate	4.7%	
DEVELOPMENT	Development starts	9.8m sq ft	
	Spec development starts	5.7m sq ft	
OCCUPIER COSTS	Average prime rent, sq ft	£11.67	
	Average weekly earnings	£672	
INVESTMENT	Average prime yield	5.5%	
	Transaction volume	£0.8bn	
ECONOMY	Annual GDP growth	-0.2%	
	Retail sales % online	25.7%	



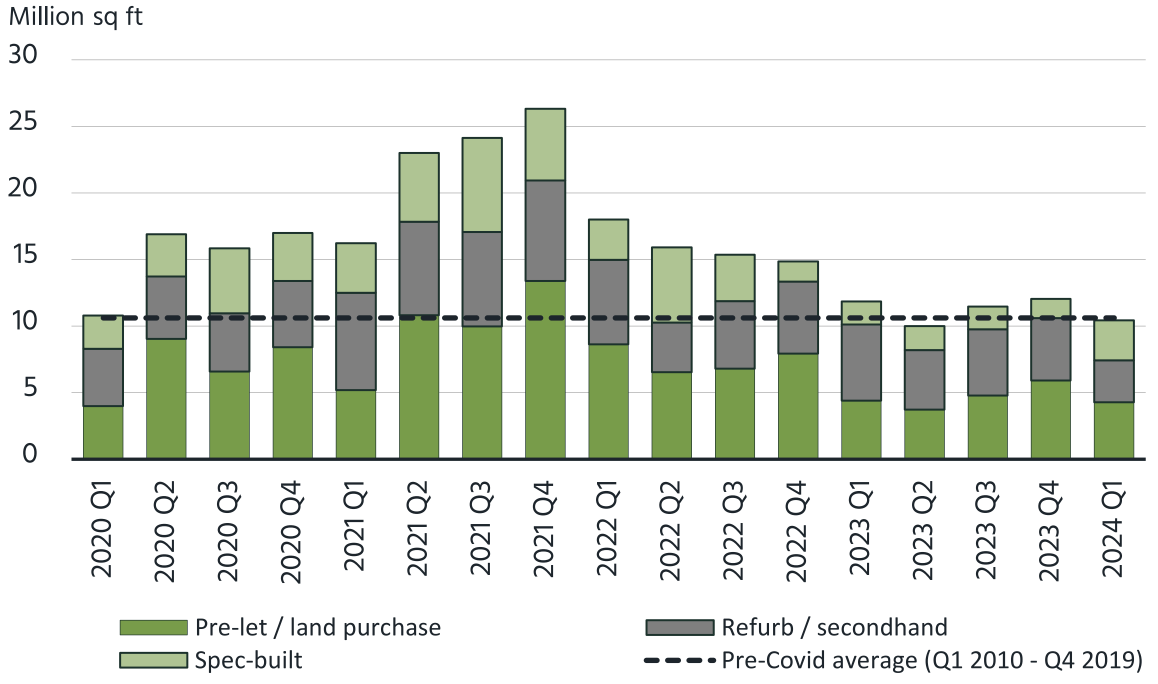
OCCUPIER DEMAND

Q1 DEMAND FALLS BACK TO PRE-COVID AVERAGE

Occupier take-up was 10.4m sq ft in Q1 - down 14% on Q4 and 12% on a year earlier. Overall demand has effectively been around the long term pre-Covid average for the last 12 months as occupiers slowed their expansion plans in accordance with weaker trading conditions. With most occupiers having now made that adjustment and shaken-out any excess space, they can now look to make further lettings with some more confidence. Space under offer either up-and-built or in the planning system has increased. Activity in Q1 continued to be focused on the best quality and most energy-efficient space, and speculatively-developed buildings accounted for 29% of all demand, the highest share of activity in almost two years.

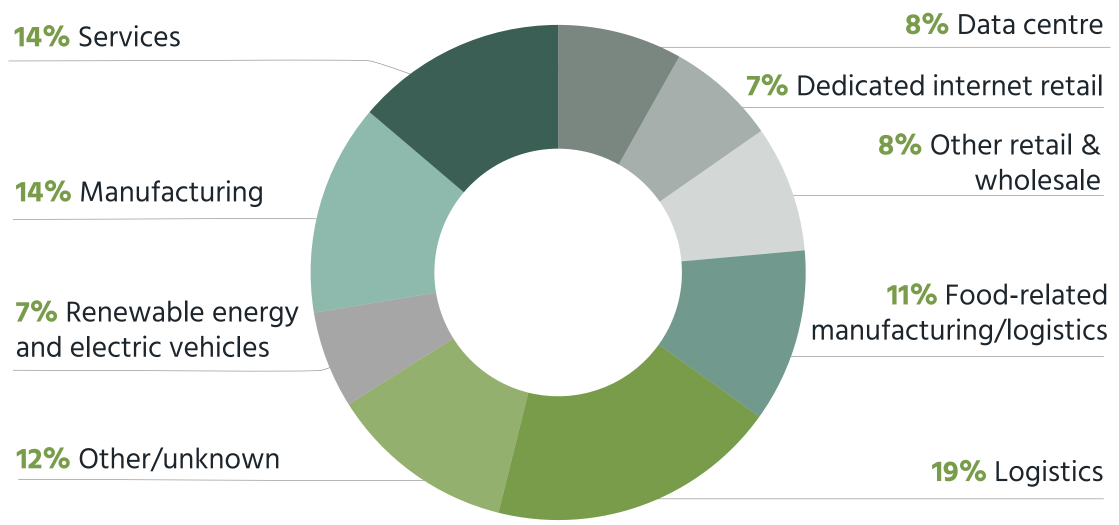
Quarterly take-up by quality and 10-year pre-Covid average

Source: Gerald Eve



Q1 2024 take-up by occupier sector

Source: Gerald Eve

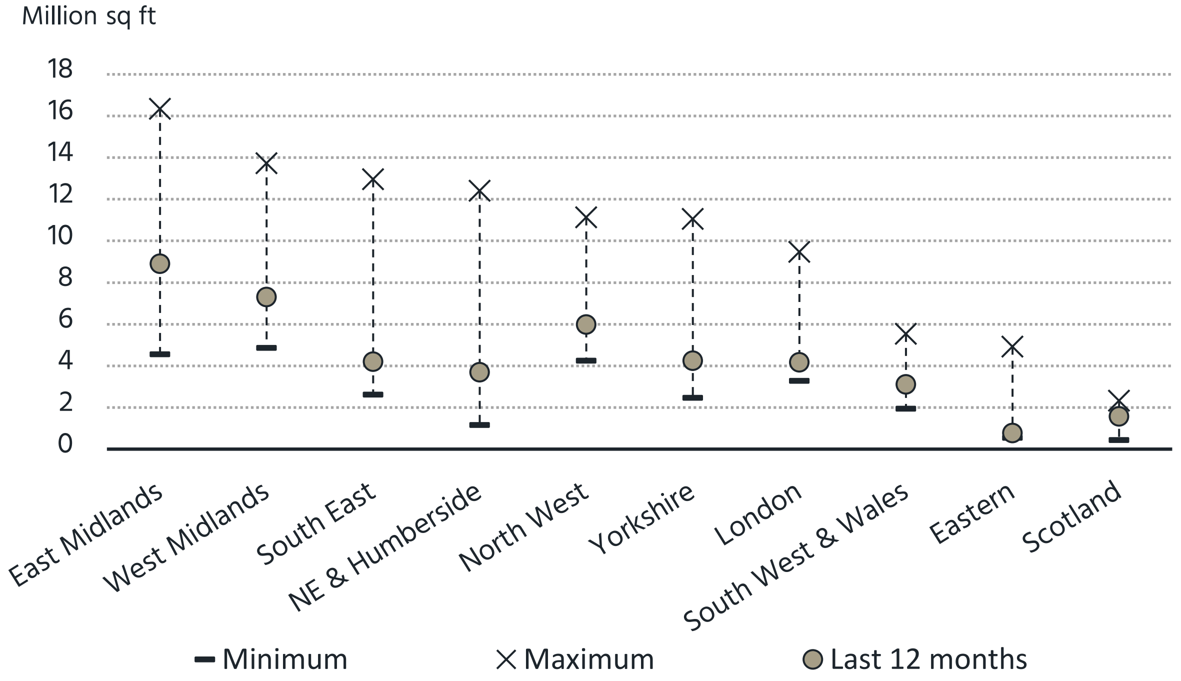


A DIVERSE RANGE OF INDUSTRIES TOOK SPACE IN Q1

Yusen Logistics's 1.2m sq ft pre-let at SEGRO Logistics Park Northampton was the largest deal of the quarter and ensured that logistics was the largest component of demand in Q1. Occupiers from a range of different industries took industrial space in Q1. The sector benefits from established structural drivers, including nearshoring, renewable energy production and storage, e-commerce, technology and data creation. This is driving additional demand for data centres, gigafactories, carbon capture schemes, self-storage facilities, and film studios. This is in addition to onshoring operations to firm up and decarbonise supply chains.

Annual rates of take-up over the past 10 years

Source: Gerald Eve



A SUBDUED LAST 12 MONTHS IN ALL REGIONS

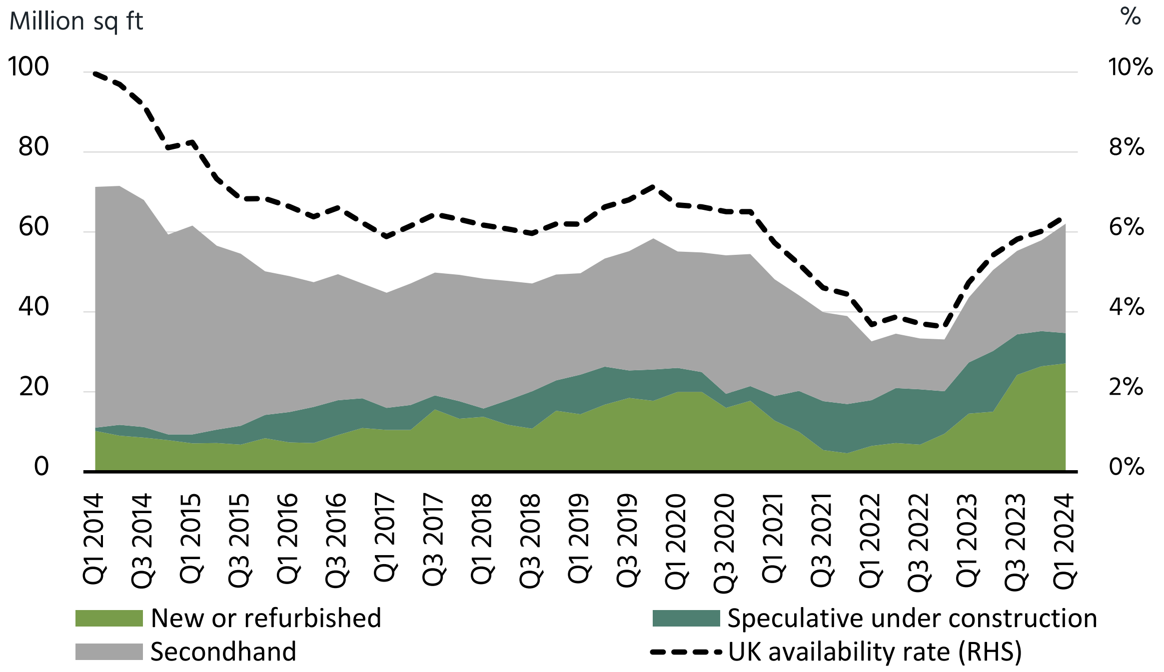
The last 12 months has been relatively subdued compared with the exceptional period between 2020 and 2022 when occupier demand consistently exceeded the long-term average. More recently occupiers have held off from adding to their property footprints to absorb any excess space and adjust to weaker post-pandemic trading conditions. The focus has been on boosting productivity and cutting costs. Looking forward, occupiers are now on somewhat of a surer footing now that some of the uncertainties that clouded decision making over the last few years have eased - such as Brexit, domestic politics, the pandemic and more recently inflation and supply chain volatility.

SUPPLY AND DEVELOPMENT

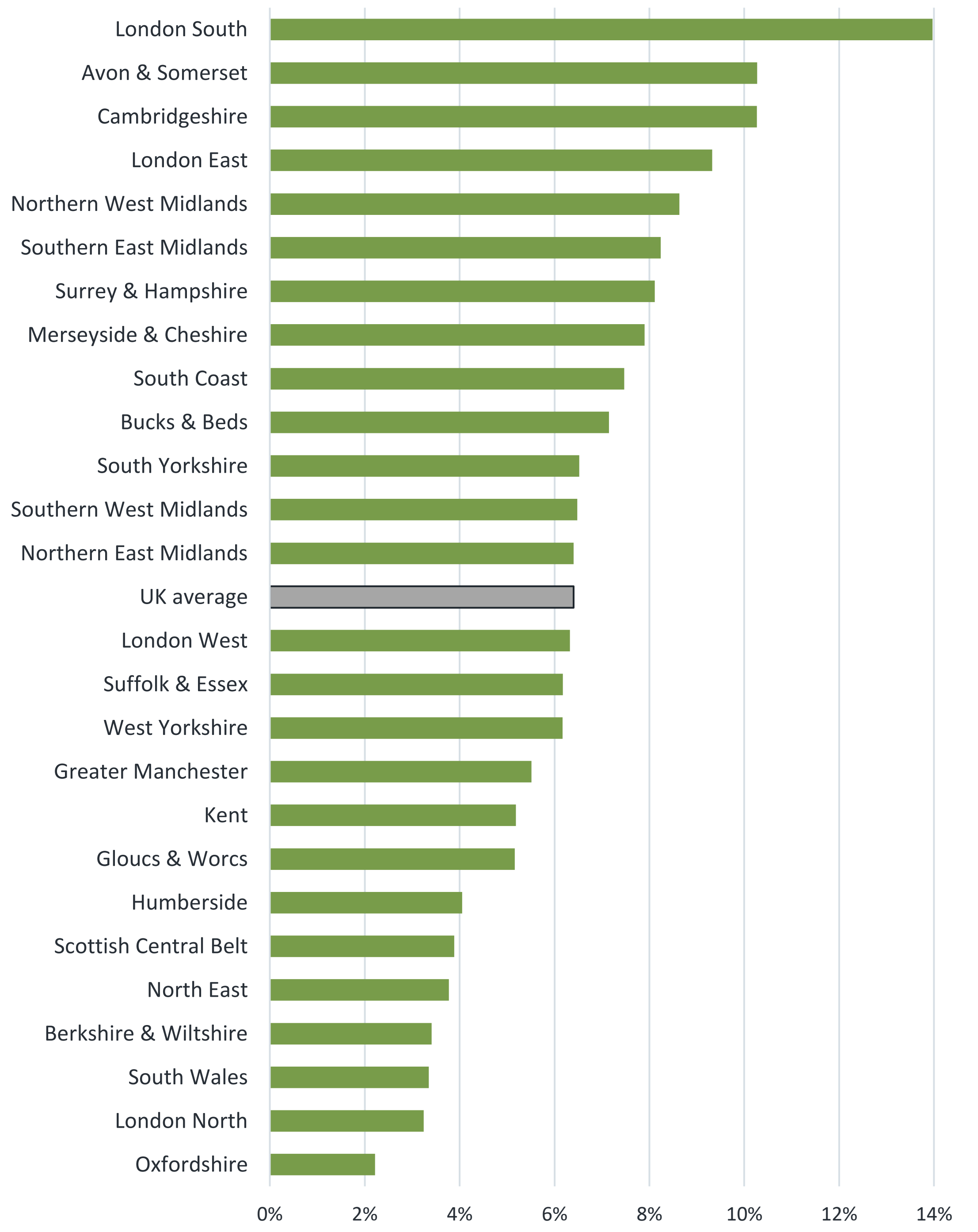
VOLUME OF AVAILABILITY AT A 10-YEAR HIGH

The overall rate of availability increased again from 6.0% in Q4 to 6.4% in Q1, driven mostly by the return of secondhand space. This rate reflects around 62 million sq ft of marketed space, 4 million more than in Q4 and 18.5 million sq ft more than was on the market in Q1 2023. The overall volume of availability has risen to a ten-year high, but the proportion of space that is either refurbished or speculatively developed is much higher than 10 years ago, and the overall rate is lower. The market is slowly adjusting back to normal after the period of unusually low availability during the Covid period. Whilst further increases are likely this year, the maximum point in this cycle is forecast to be a lot lower than previous peaks.

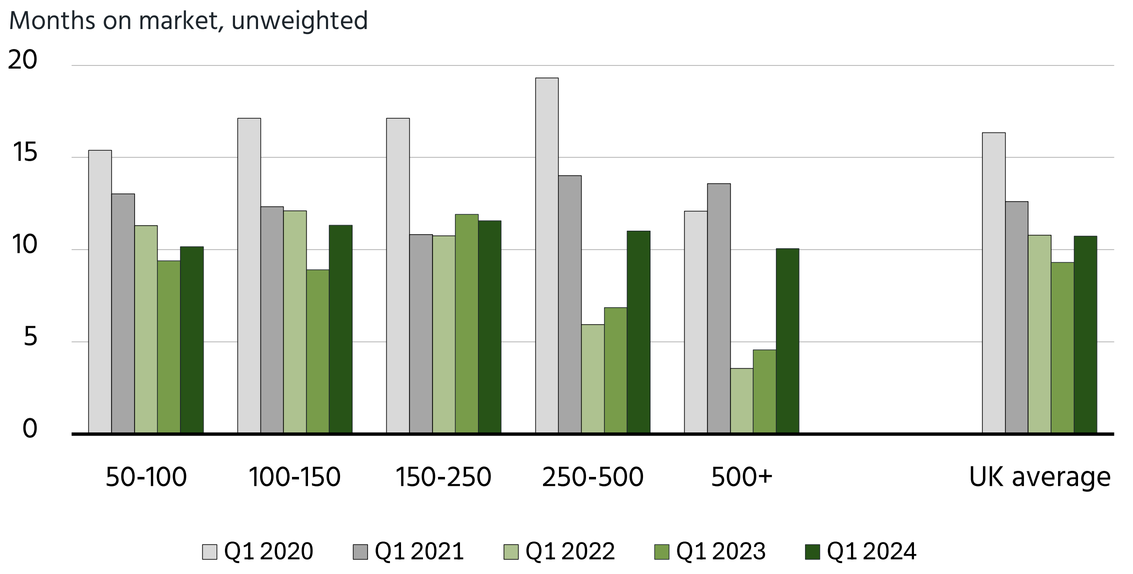
UK logistics availability rate and volume by quality
Source: Gerald Eve



Q1 2024 availability rate, by region
Source: Gerald Eve



Average void period by building size, Q1 2020 – Q1 2024
Source: Gerald Eve



VOID PERIODS UP IN Q1, ESPECIALLY FOR BIGGER BOXES

The average void period fell sharply during the pandemic across most building sizes. Buildings were let quickly, and it was not unusual for speculatively-built buildings to be let before construction had completed. Whilst average void periods have increased over the past year and now average 10.7 months – in part a reflection of the increased decision time occupiers are taking in the current environment - this is still some way off the 16.4-month average recorded in Q1 2020. The average void period on bigger buildings over 250,000 sq ft increased substantially in Q1 as occupiers curtailed the very largest expansionary activity. However, the void period of mid-box units between 50-150,000 sq ft remain low relative to Q1 2020.

SUPPLY AND DEVELOPMENT

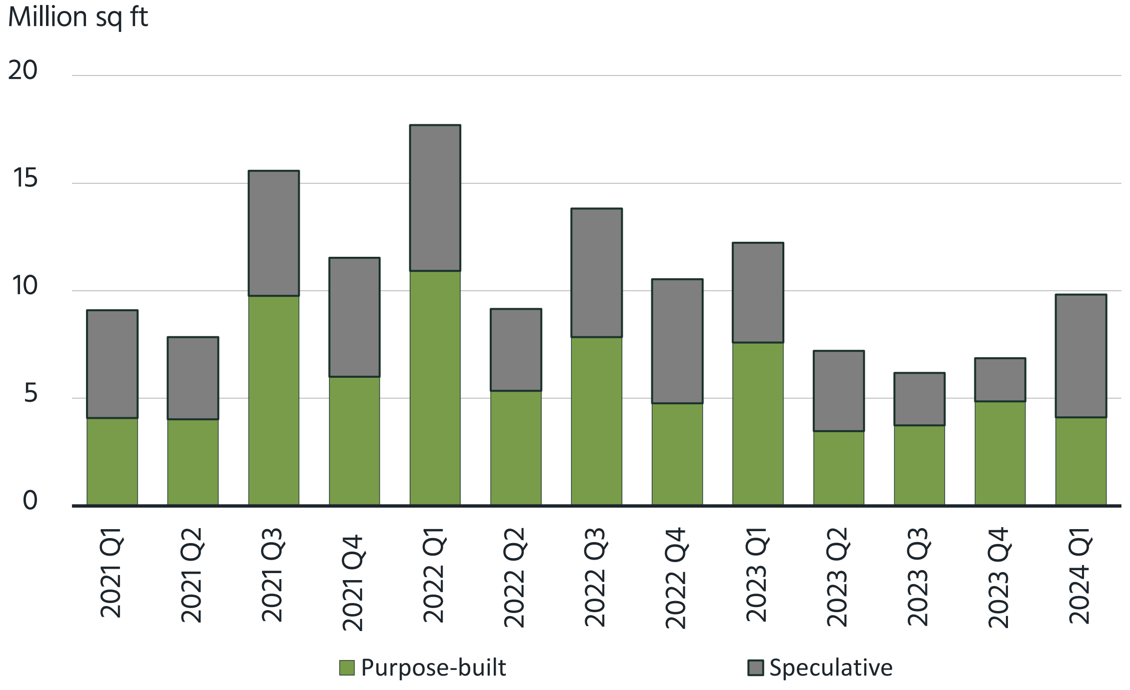
SPECULATIVE DEVELOPMENT STARTS UP 185% IN Q1

Speculative development starts increased in Q1 and were at their highest since Q4 2022. In all, 38 schemes began construction, totalling over 5m sq ft which represented a 185% increase by volume on Q4. Speculative starts in Q1 were focused on prime sites and locations with proven track records in Merseyside & Cheshire, the Southern West Midlands and London North. The improvement in activity was widespread, with around 19 separate developers starting on site in Q1. Meanwhile, the volume of purpose-built development in Q1 was broadly the same as Q4, at around 4m sq ft.

Symmetry Park, Merseyside
Yodel's 162,000 sq ft unit reached PC and the 272,000 sq ft Unit 2 received planning permission in Q1.

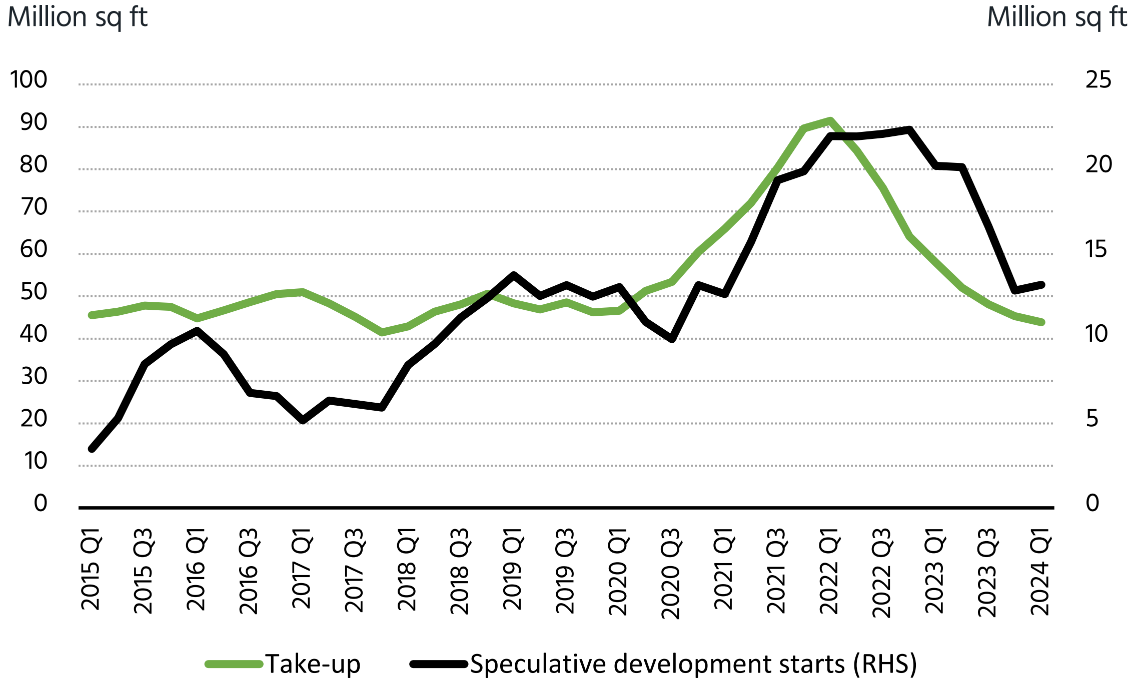
Development starts, by type

Source: Gerald Eve



Rolling annual speculative development starts and take-up

Source: Gerald Eve



DEVELOPMENT MARKET RESPONSIVE TO UNDERLYING OCCUPIER DEMAND

Speculative development activity was subdued last year, given the softened tenant demand profile and increase in build and debt costs that reduced developer margins. This relative nimbleness, which is a feature of industrial compared with other property sectors, to effectively 'turn off the taps' and avoid a glut of oversupply is an important strength for the sector. Given last year's slowdown in activity, the volume of speculative space due to be delivered to the market this year is low. This will in turn alleviate upward pressure on availability and continue to underpin nominal prime rents.

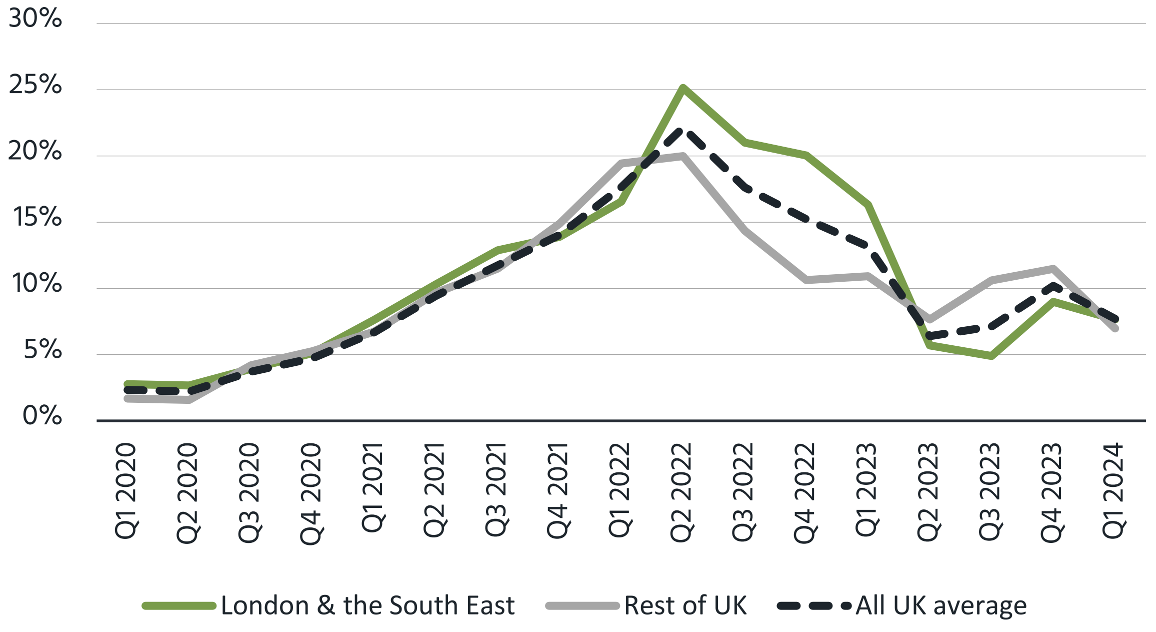
RENTS

ANNUAL PRIME RENTAL GROWTH FALLS TO 7.7% IN Q1

A cooling of the prime rental market following the period of unprecedented growth during 2021-2022 was to be expected. During the pandemic, movements in rents were driven by insufficient supply and the sharp growth in online spending. Now the traditional economic drivers of rental growth such as consumer spending, GDP and employment growth have reestablished themselves. Quarterly prime rental growth slipped to 1% in Q1 but annual growth was sustained at a healthy 7.7%. New developments continued to push on the rental tone and rents grew in 18 of the 53 centres covered by this research in Q1.

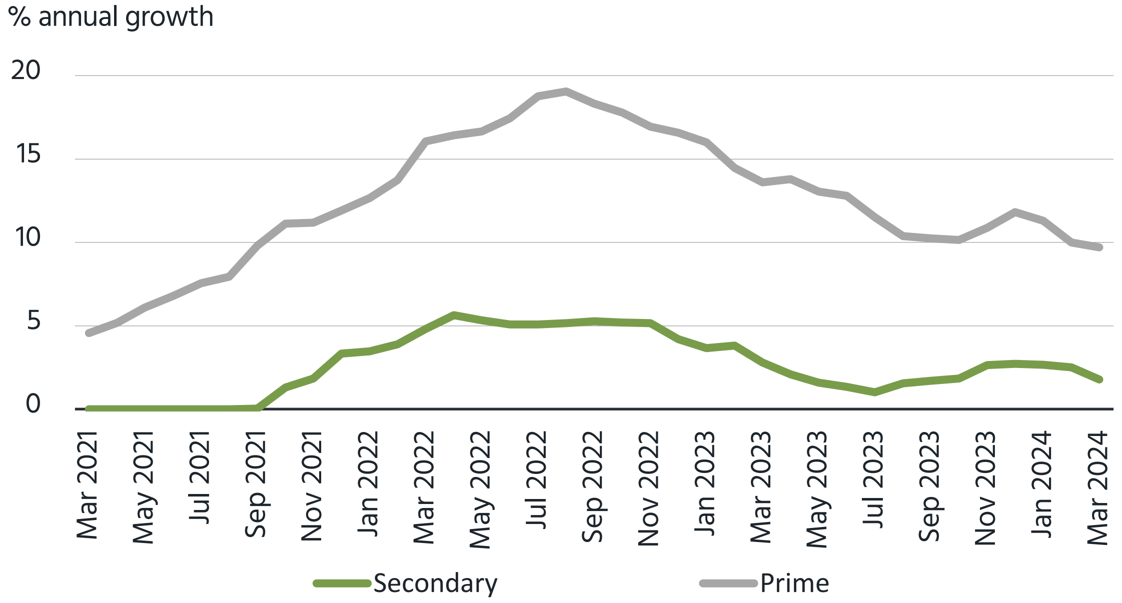
UK prime logistics annual rental growth

Source: Gerald Eve



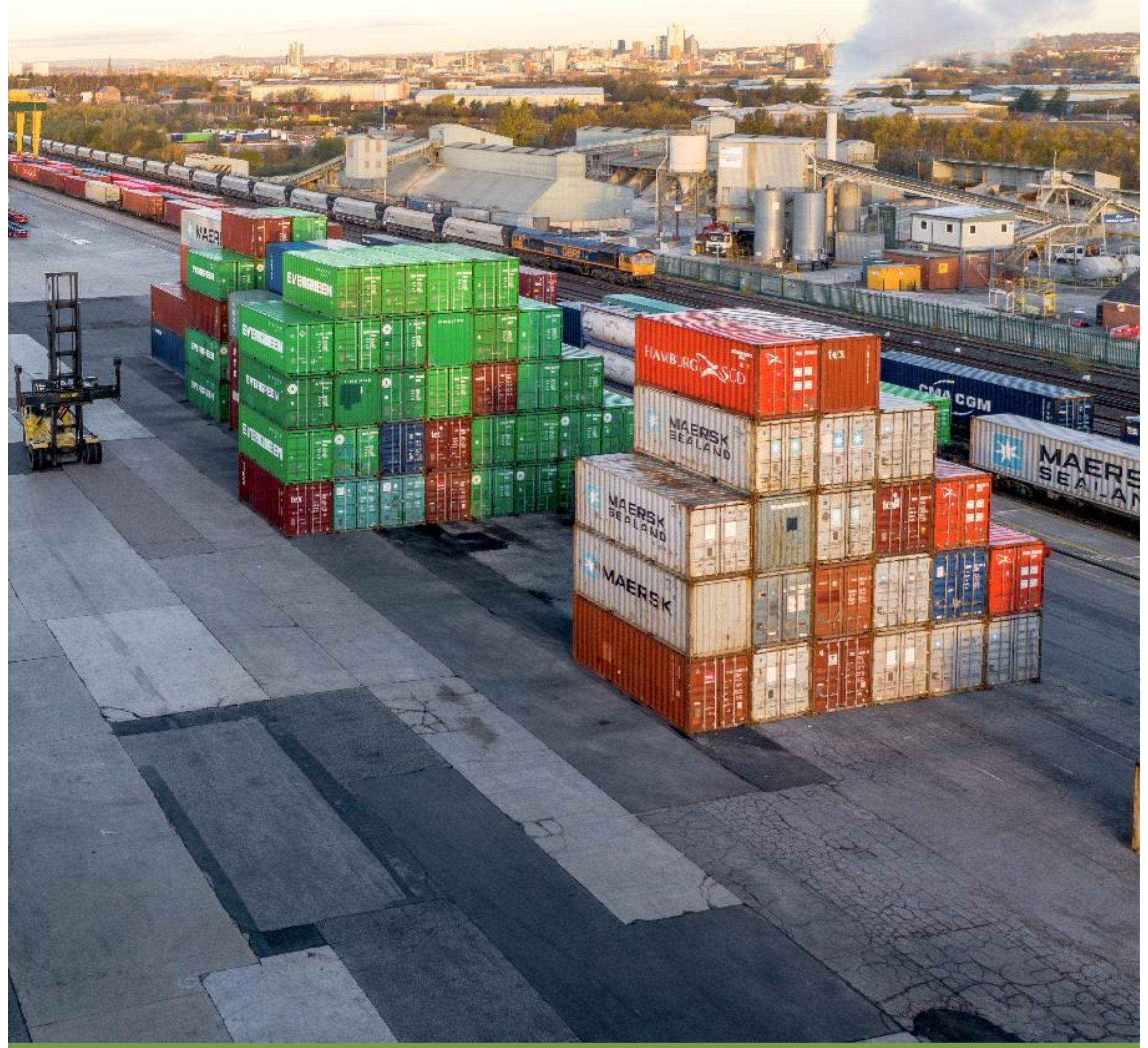
Annual rental growth by building quality

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, albeit at lower growth rates. 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 pre-pandemic averages. Consequently, secondhand space is set to lose more ground against its prime counterparts, especially non-compliant energy-inefficient buildings.



Sites and buildings with strong power provision that support supply chain efficiency and decarbonisation initiatives through renewable energy, multi-modal transportation and EV capabilities are attracting higher rental profiles.

INVESTMENT

INVESTOR SENTIMENT PICKED UP IN Q1, BUT LACK OF STOCK LIMITED TRANSACTIONS

Property investors can take encouragement that the short-lived technical recession in H2 2023 is over and the path for inflation and interest rates is more positive. As one of the few commercial property segments offering meaningful rental growth, there are an increasing number of active purchasers of UK logistics, including sovereign wealth funds and a small number of pension funds. However, the market is defined by a lack of suitable investment stock and thus the volume of transactions continues to be subdued. The cost of debt has fallen and mostly headed off distressed sales and there are few sellers at this point in the cycle outside of DB pension funds and some divesting retail funds.

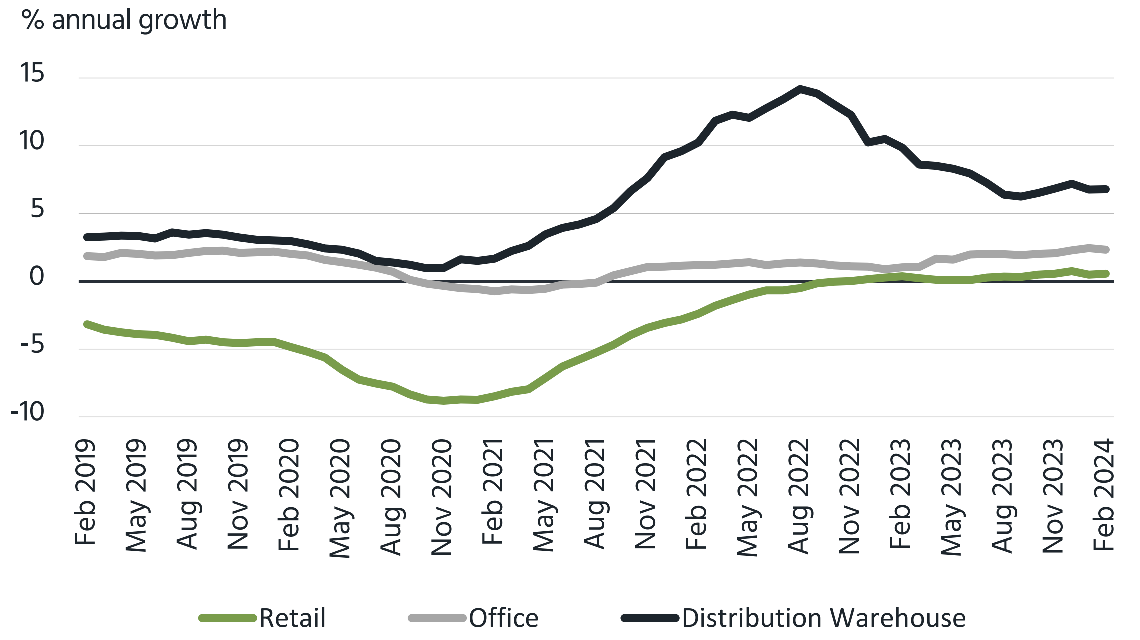
WEAKER INVESTOR DEMAND FOR INDEX-LINKED PROPERTIES

Valuation yields continued to drift out in Q1, though pricing in the direct market has stabilised. Valuations lag the market and a lack of single asset open-market deals makes spot-pricing assets more difficult. There are, however, fewer buyers for logistics assets with index-linked kickers compared with OMRV-linked leases. Industrial ERVs are expected to outperform broader inflation over the next few years and investors are unlikely to be able to materially influence future returns on these types of assets. More generally, any risks or building imperfections are heavily penalised by investors, and underwriters are acting with increased caution.

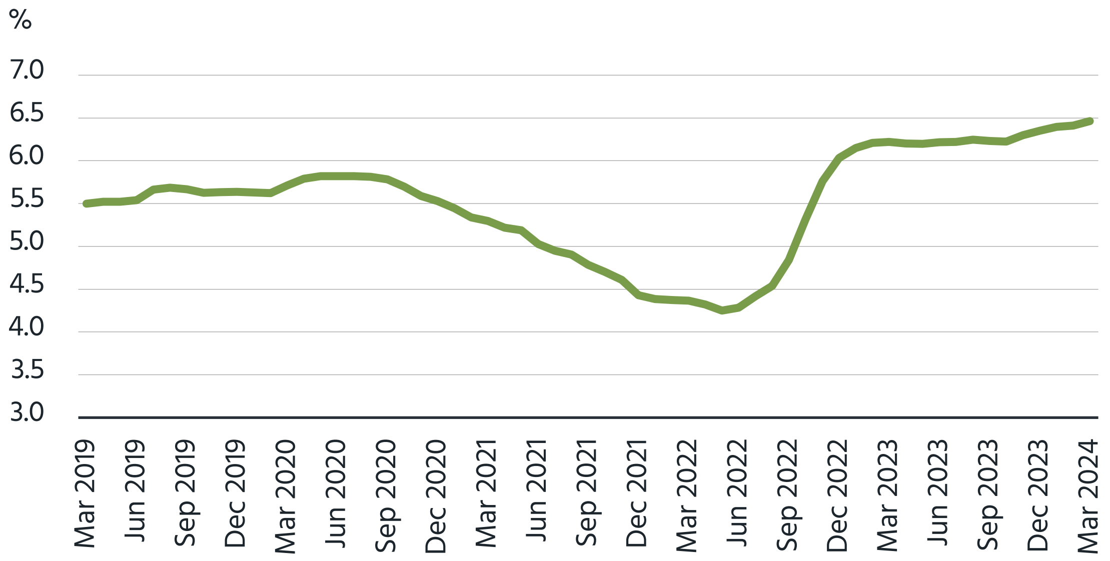
BANK RATE CUTS TO HELP UNLOCK MARKET ACTIVITY

Oxford Economics forecasts a 75bps cut to the base rate to support the economy by year-end 2024 and for the Bank Rate to fall to 3.5% by the end of 2025. Recent inflation data in the US, which surprised on the upside, together with heightened geopolitical instability may have reduced the leeway to cut in 2024 somewhat, but this is unlikely to prevent the Bank of England from acting altogether this year. 10-year bond yields have increased this year and the gap with warehouse property yields is low compared with the long run average. This reduced risk premium has been a barrier to liquidity and one which should be alleviated by cuts to the base rate later this year.

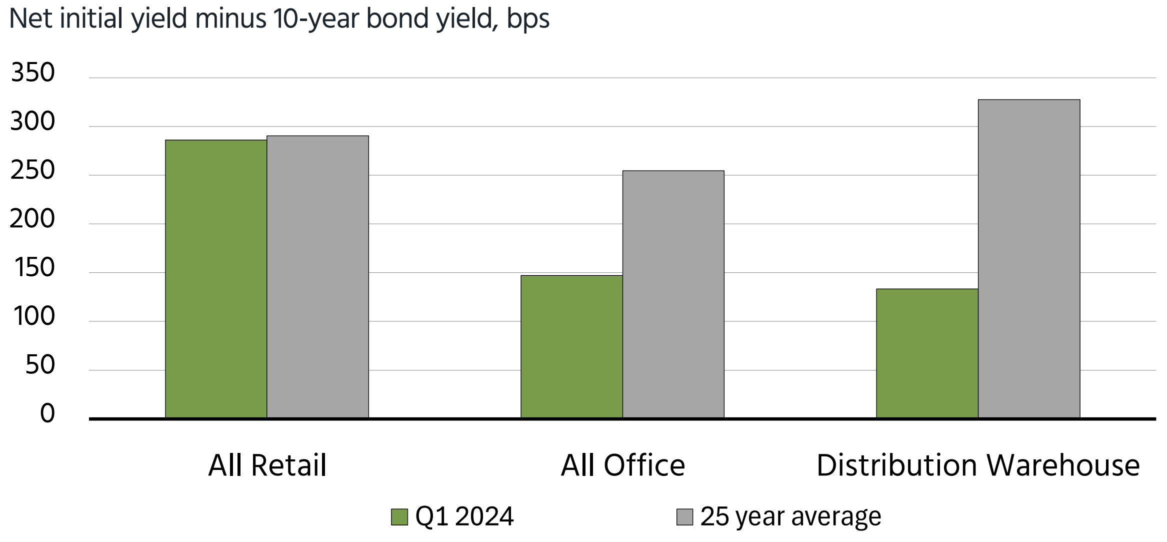
Annual rental growth by main segment
Source: MSCI



Distribution warehouse equivalent yield
Source: MSCI



Risk premia by commercial property sector
Source: Bank of England, MSCI

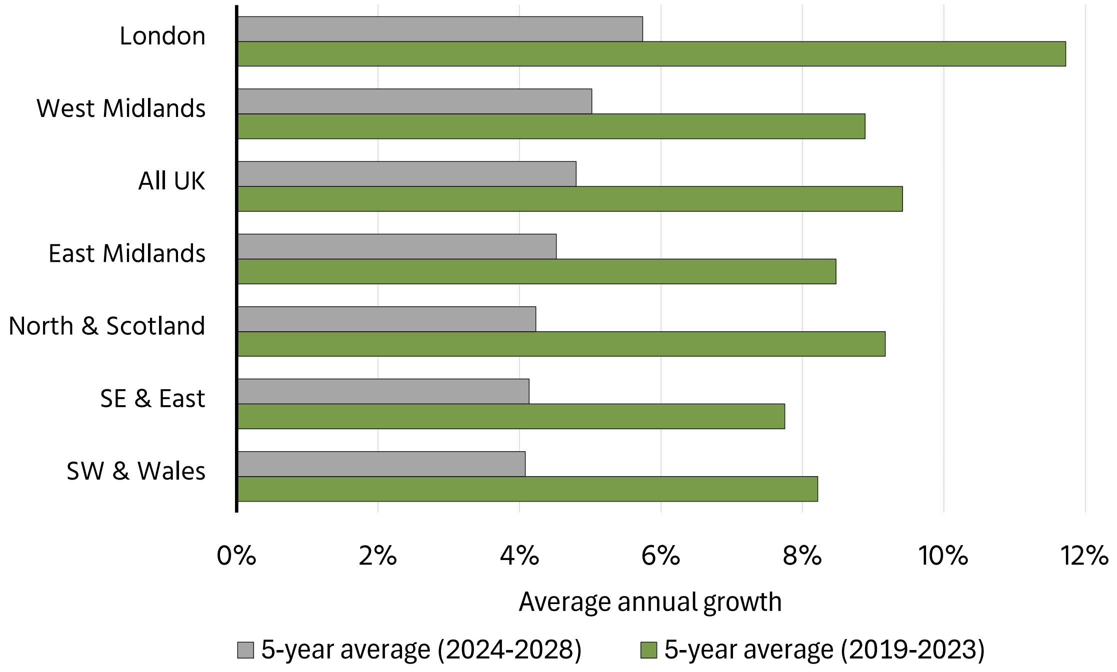


OUTLOOK: PRIME LOGISTICS RENTAL GROWTH

POSITIVE OUTLOOK FOR PRIME RENTAL GROWTH

Nominal prime UK headline logistics rents grew by 10.5% in 2023 and average annual rental growth between 2019 and 2023 was 9.4%. Established relationships between industrial rents and traditional macroeconomic drivers such as consumer spending, manufacturing output, employment and GDP were far exceeded during this period. However, we expect these drivers to be reasserted and the 5-year outlook for rental growth is positive, but roughly half the magnitude of the last few years, averaging 4.8% per year to 2028. A sharp fall in inflation will support real incomes and household spending power – although the pace of any consumer-led upturn is likely to be tempered by tighter fiscal policy and the lagged impact of past interest rate rises.

Annual prime logistics rental growth by region
Source: Gerald Eve



We expect continued robust demand for prime industrial sites, not only for traditional logistics development, but also for large infrastructure projects. The number of planning applications for gigafactories, renewable energy generation, carbon capture schemes and data centres, many of which are on former power station sites, increased substantially in Q1.

DEMAND UNDERPINNED BY ESTABLISHED STRUCTURAL DRIVERS

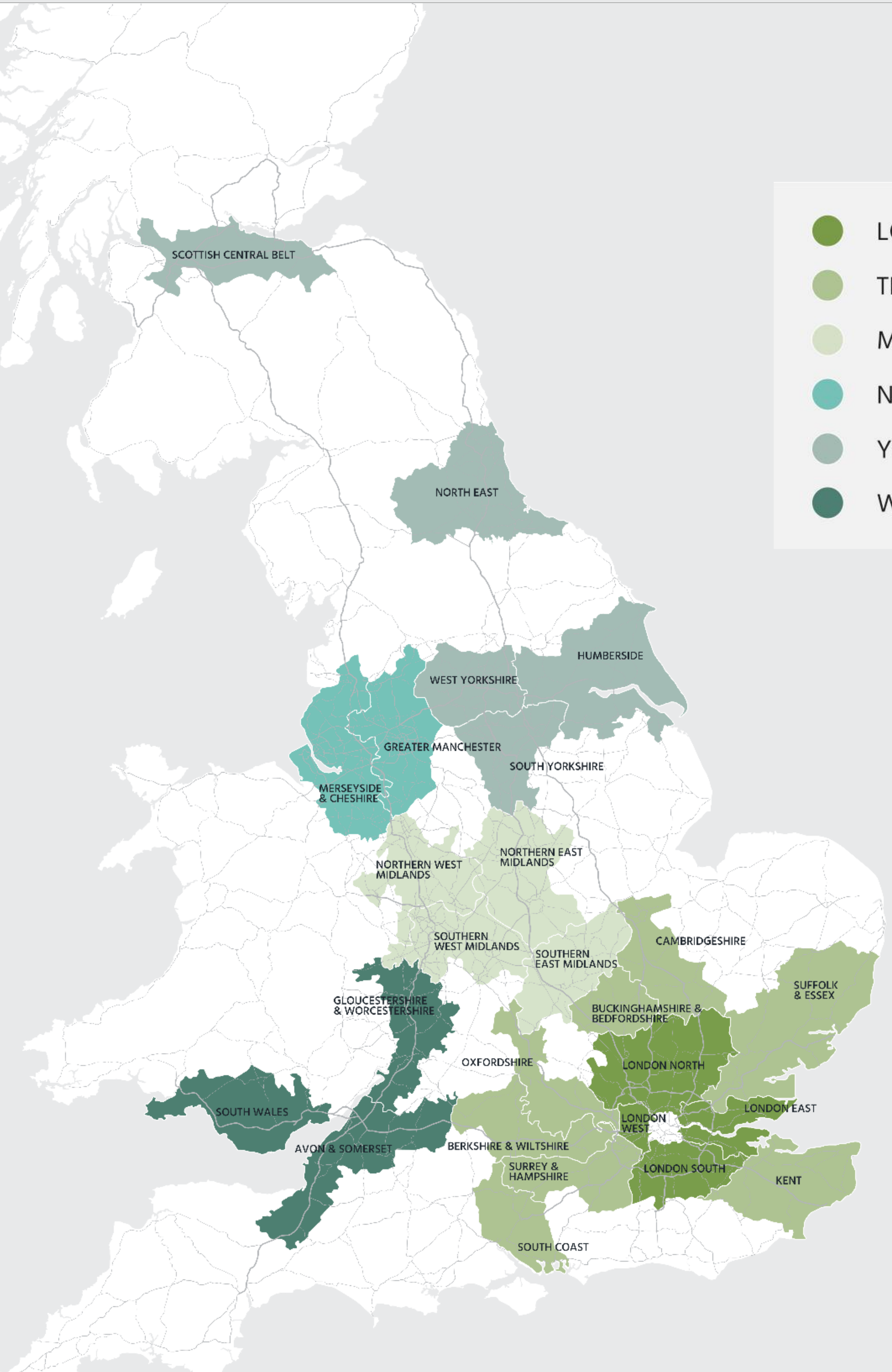
The logistics sector will continue to benefit from established structural drivers including nearshoring, renewable energy production and storage, e-commerce, automation and technology/data creation. In addition to traditional logistics demand, this will drive demand for data centres, gigafactories, carbon capture schemes, self-storage facilities and film studios. Additionally, onshoring operations to firm up and decarbonise supply chains will drive demand for space.

REDUCED SPECULATIVE DEVELOPEMNT PIPELINE IN 2024 WILL SUSTAIN PRIME RENTAL GROWTH

We expect an increased focus on supply chain efficiency over the next few years. This may result in an increase in excess secondhand space returned to the market, which will push up availability. However, we expect these increases to be moderate and for the ‘peak’ in this cycle to be low by historic standards. Occupier demand is expected to continue to focus on prime, well-located, energy-efficient space, which will likely be in short supply given the slowdown in speculative development activity in 2023 and expected weak completions in 2024.

GERALD EVE REGIONS

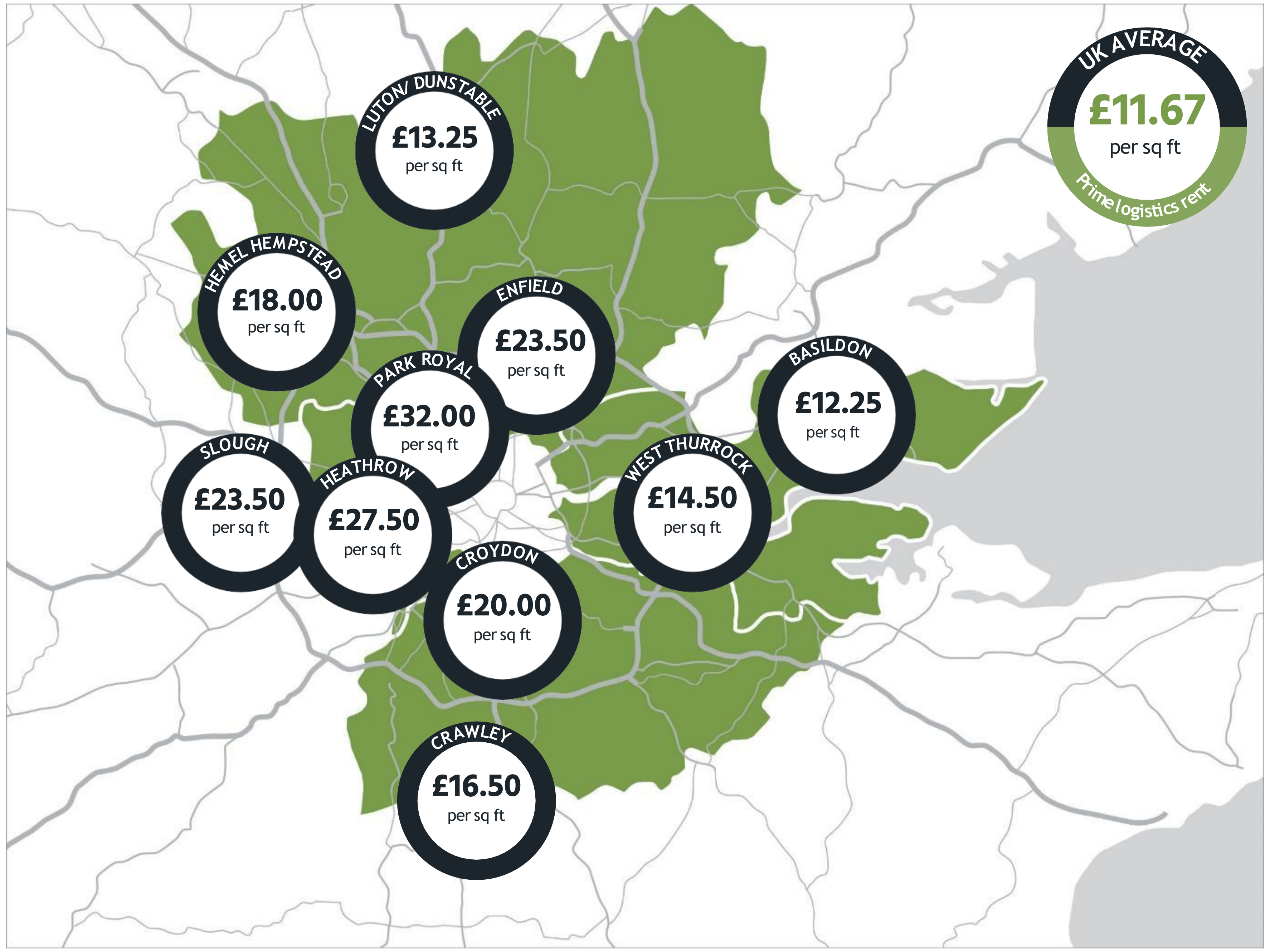
Click here for more detailed regional analysis and insight.



- 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

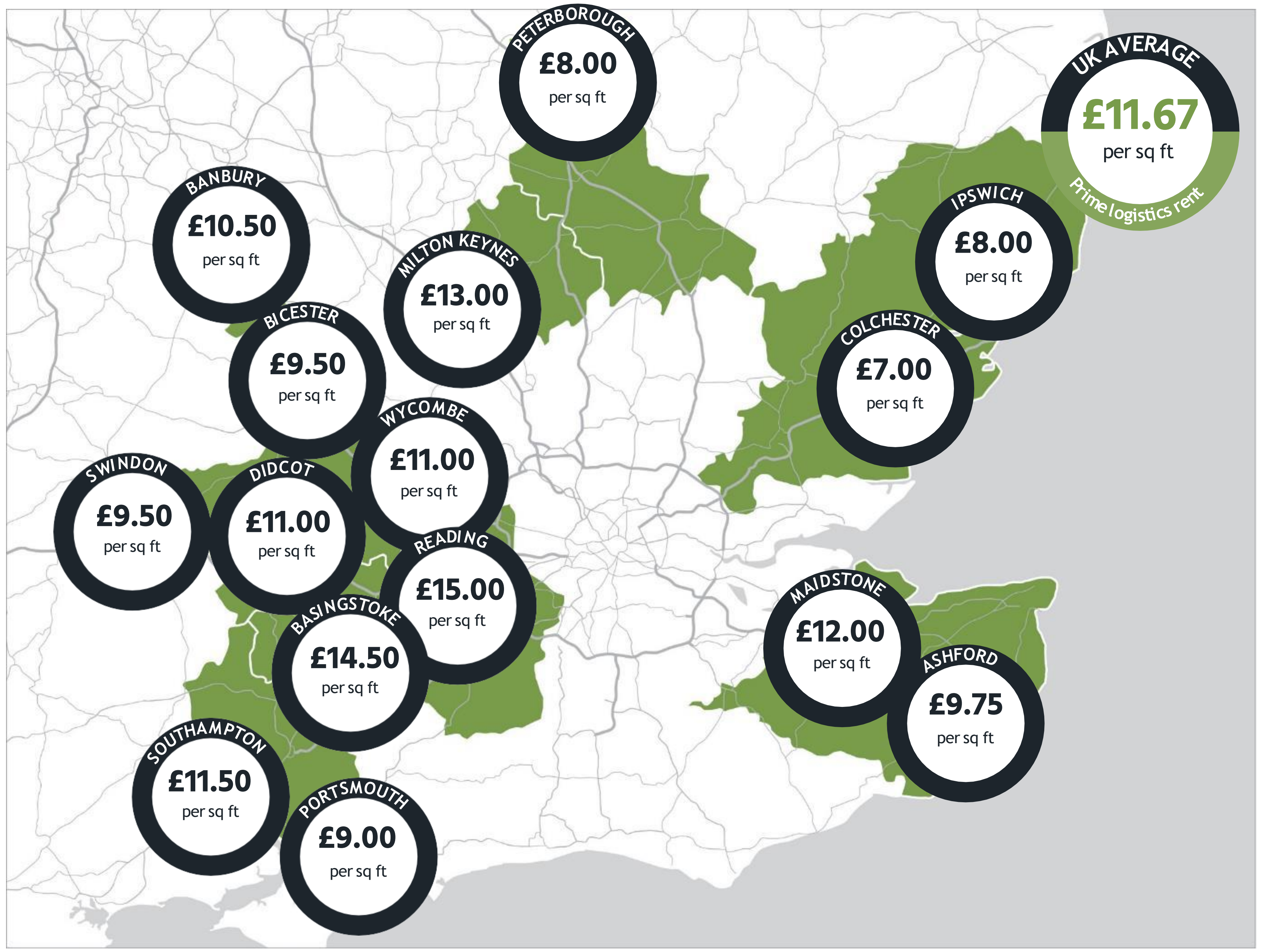
Source: Gerald Eve

Availability rate by region

Source: Gerald Eve

THE SOUTH EAST AND EAST

PRIME LOGISTICS RENTS



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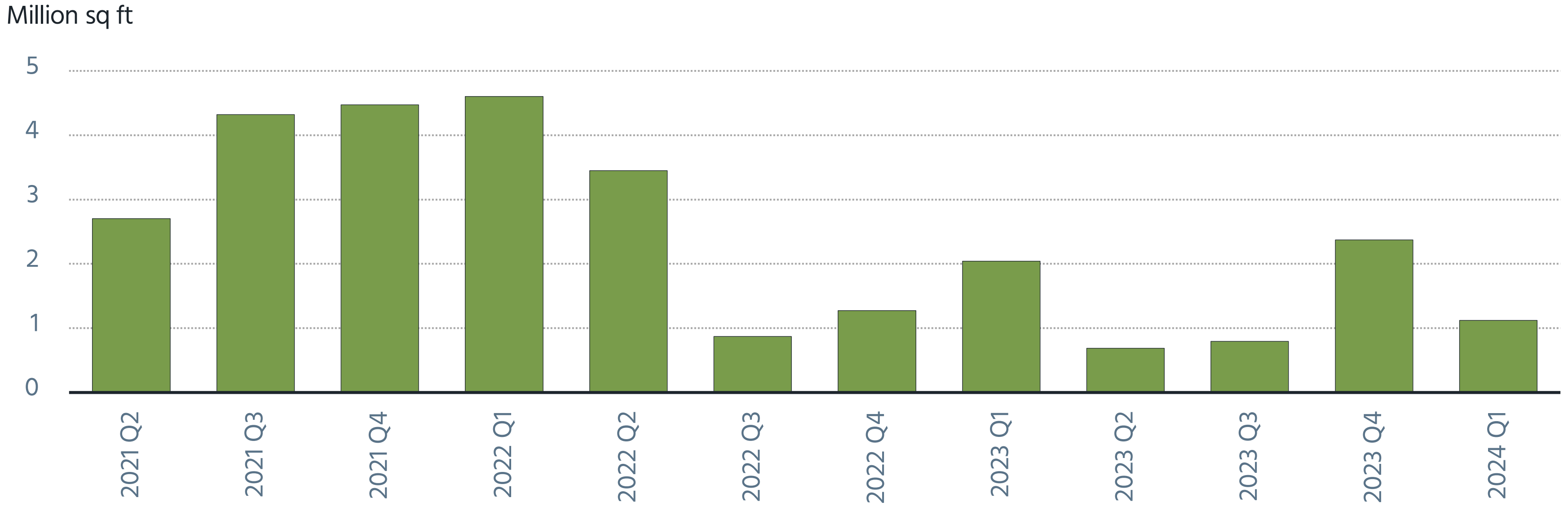
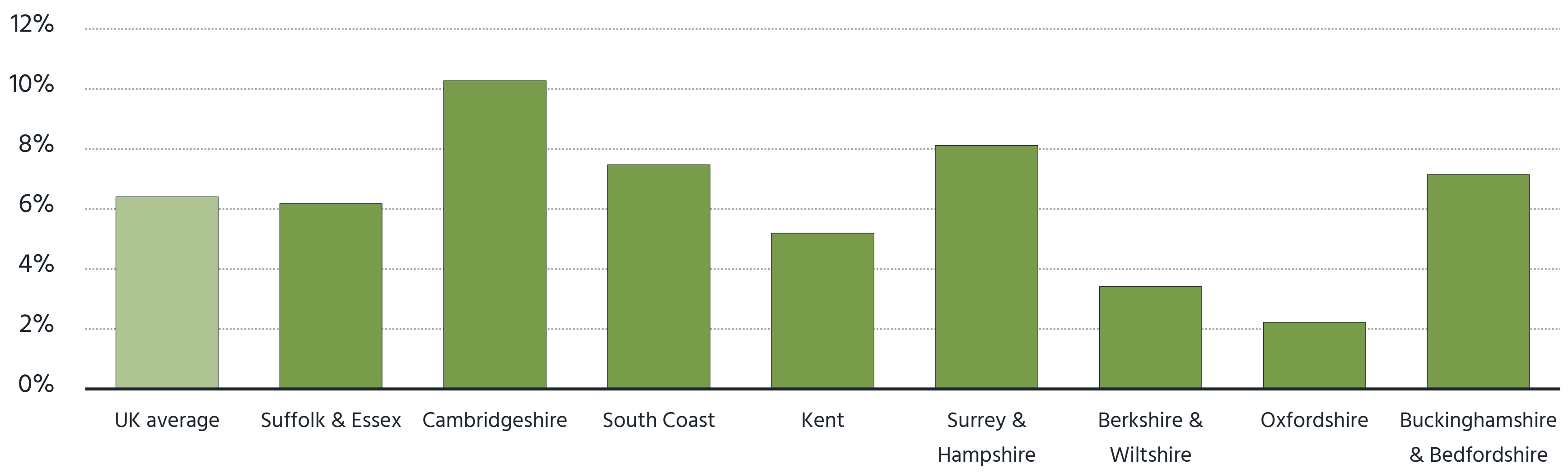


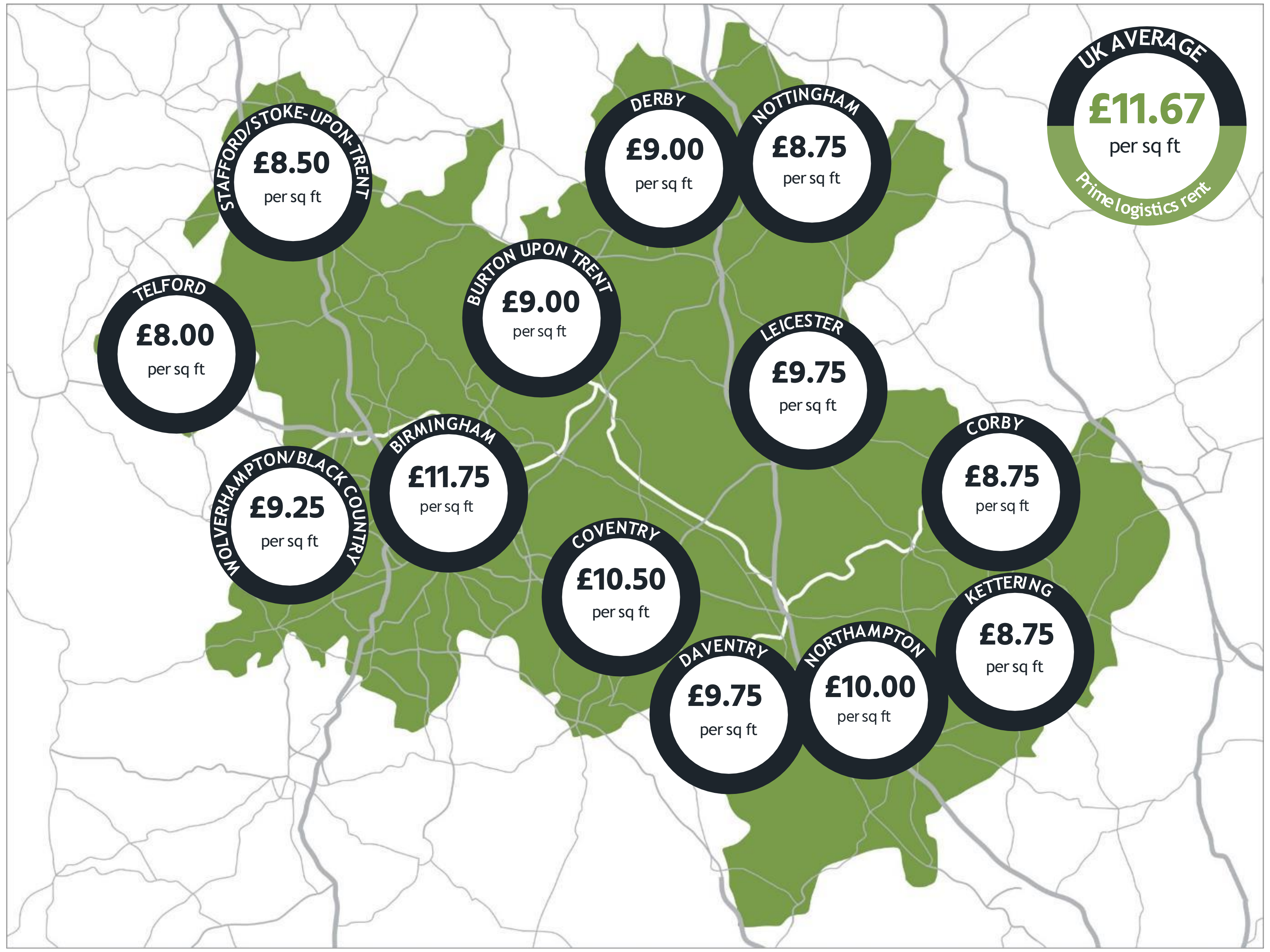
Availability rate by region

Source: Gerald Eve



MIDLANDS

PRIME LOGISTICS RENTS



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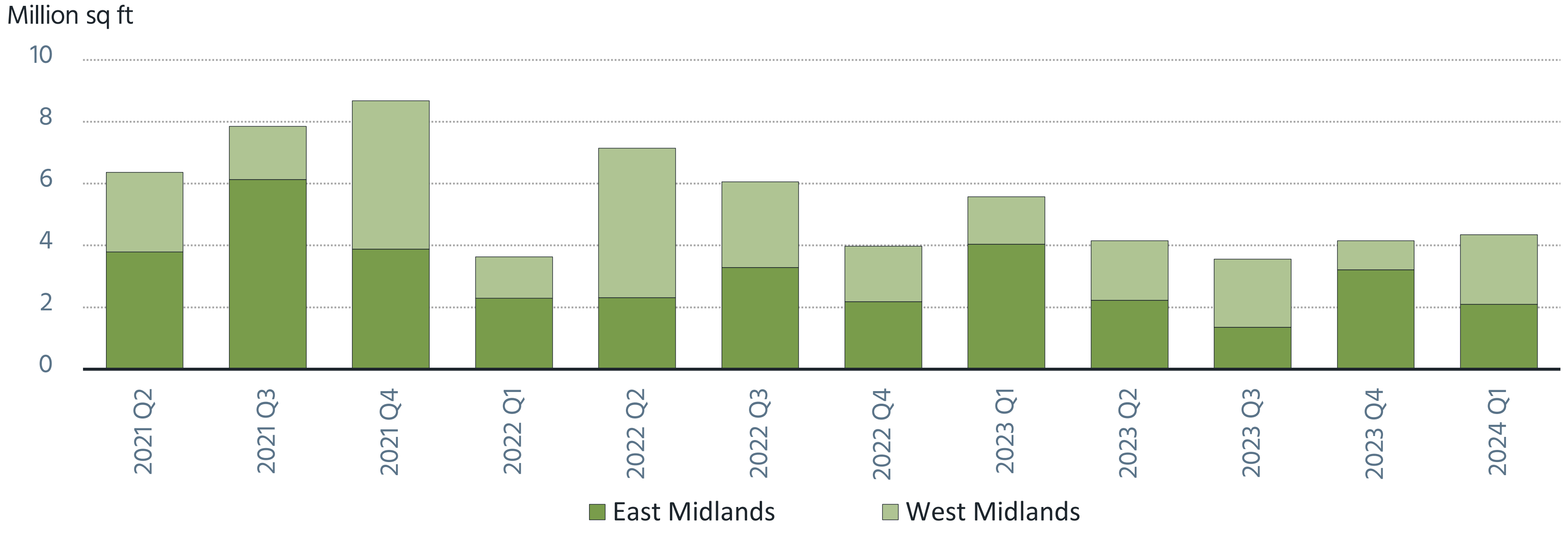
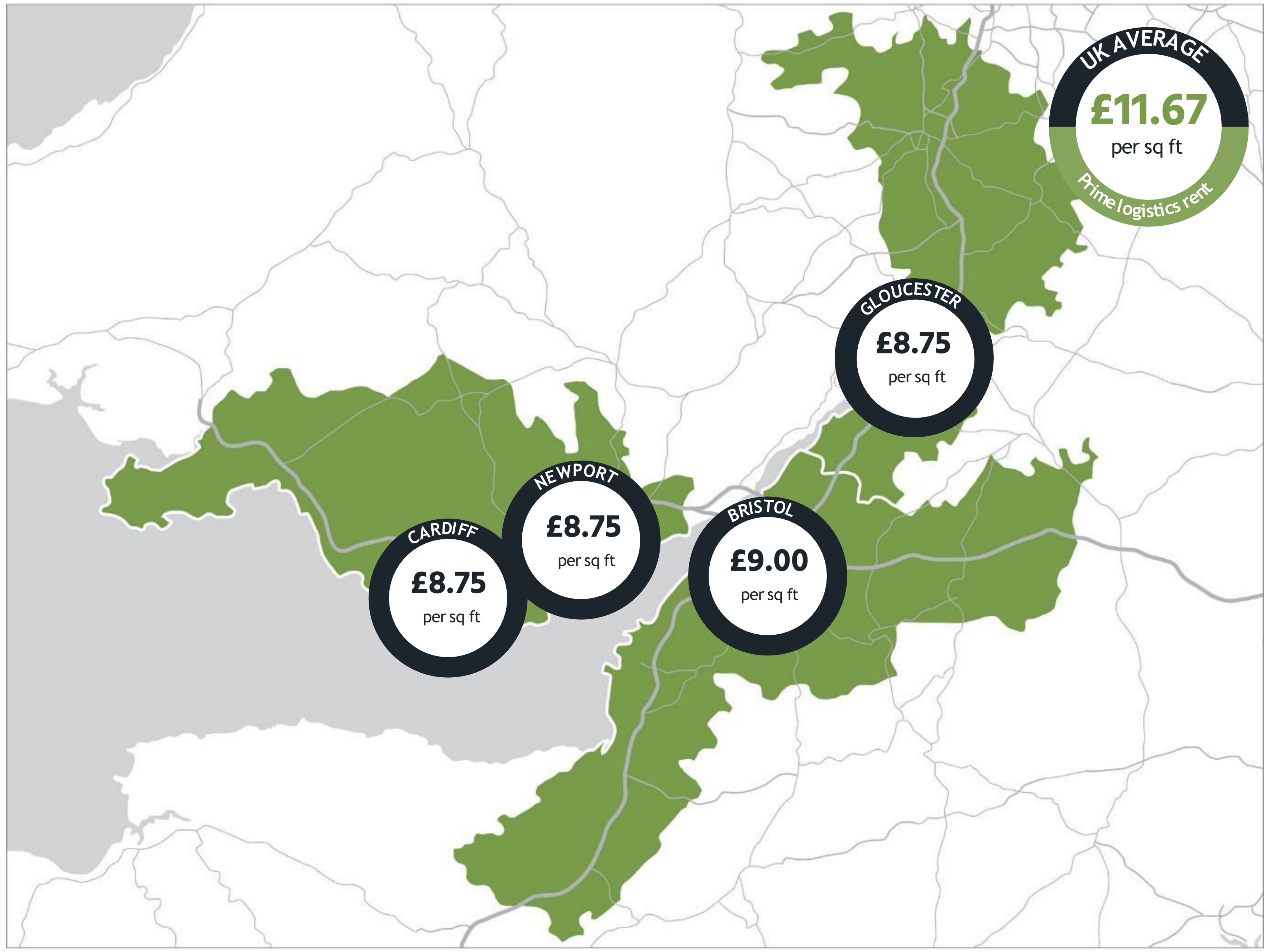


Availability rate, by region
Source: Gerald Eve

WEST OF ENGLAND AND SOUTH WALES

PRIME LOGISTICS RENTS



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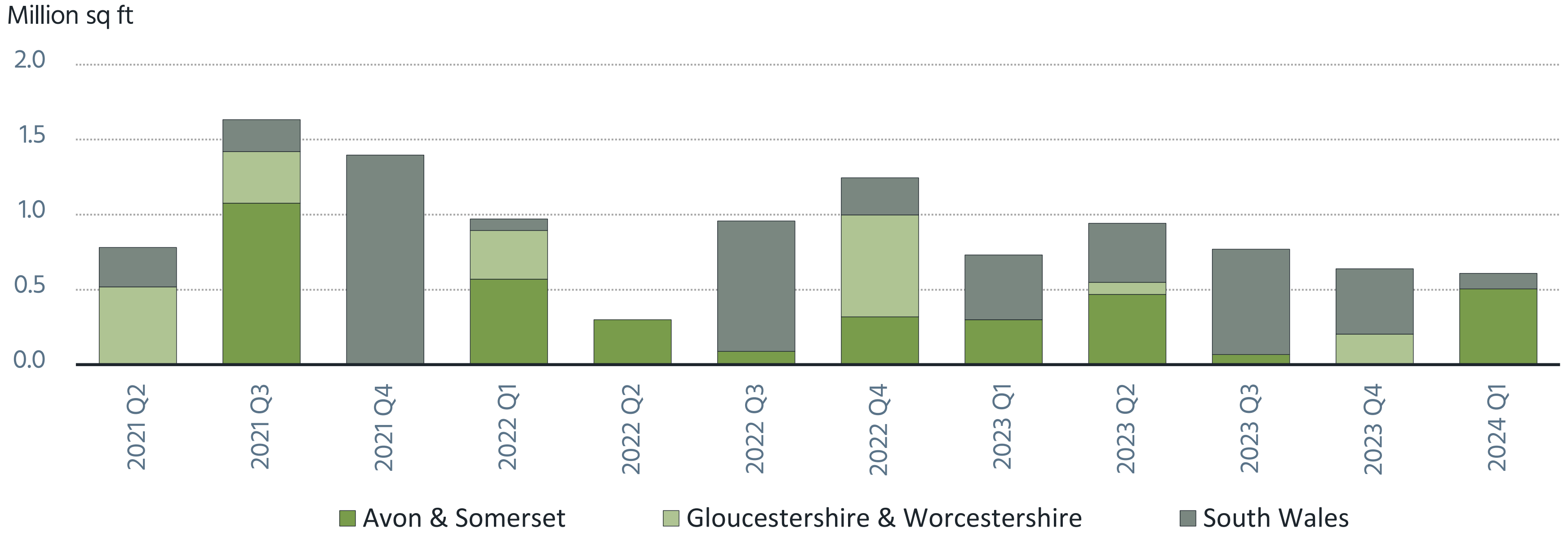
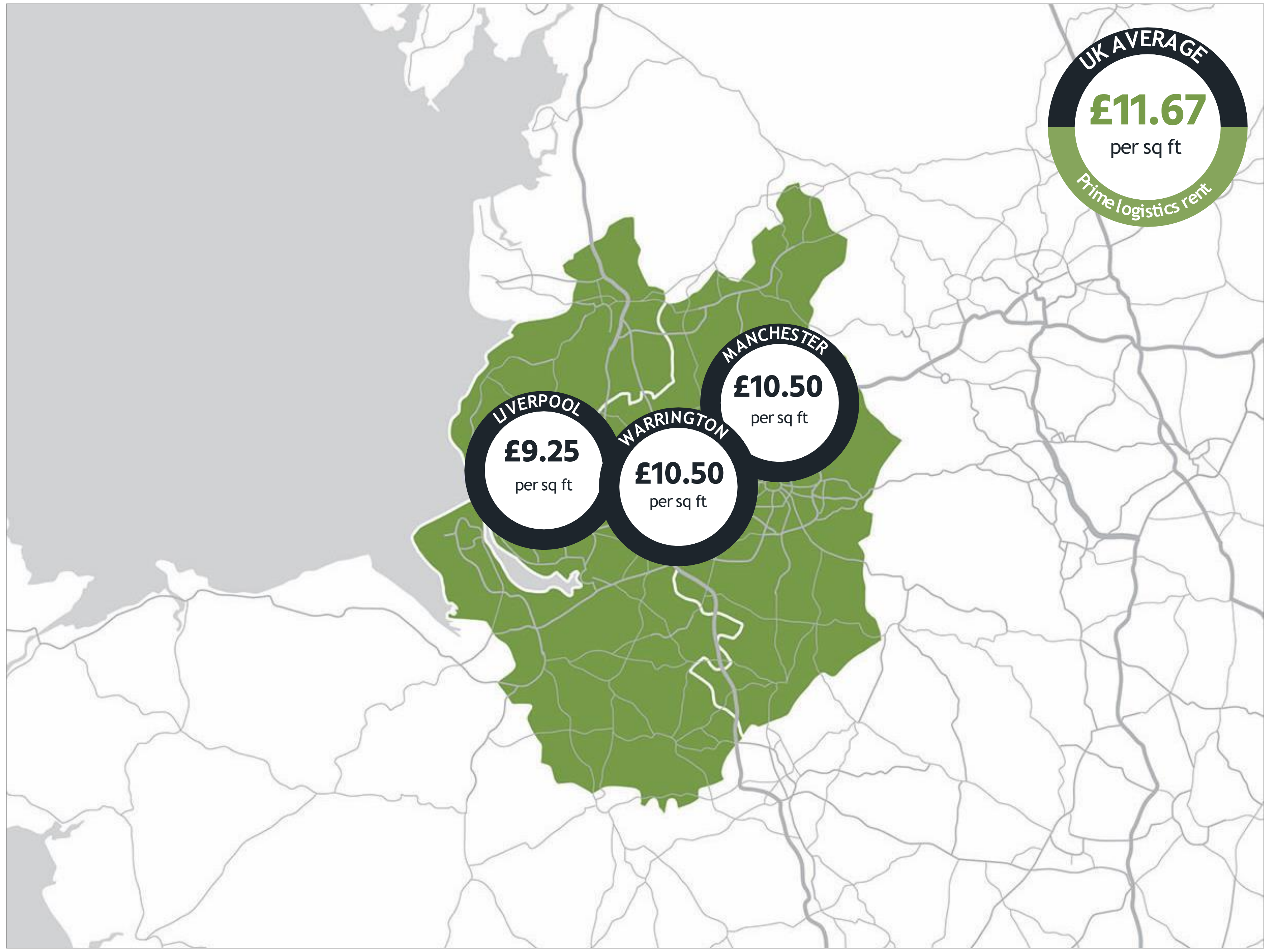


Availability rate by region

Source: Gerald Eve

NORTH WEST

PRIME LOGISTICS RENTS



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Source: Gerald Eve

Availability rate by region

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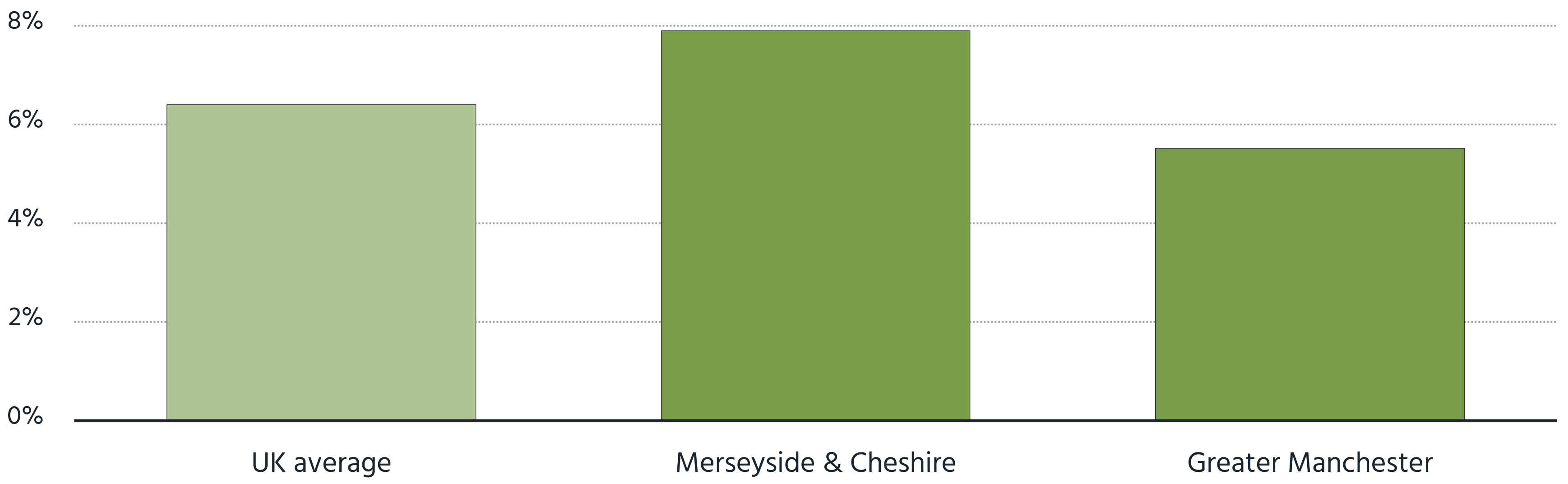
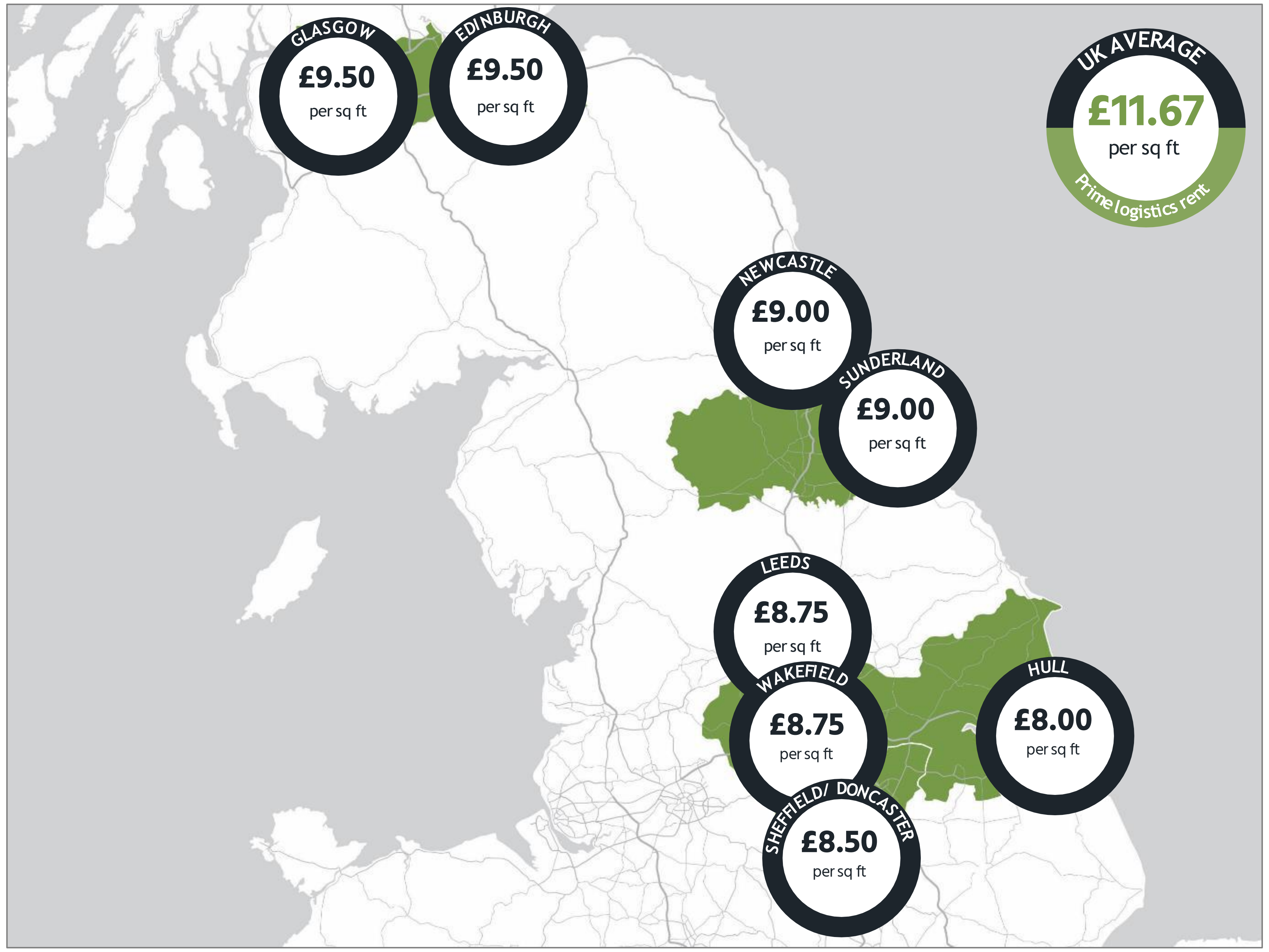


YORKSHIRE, NORTH EAST AND SCOTLAND

PRIME LOGISTICS RENTS



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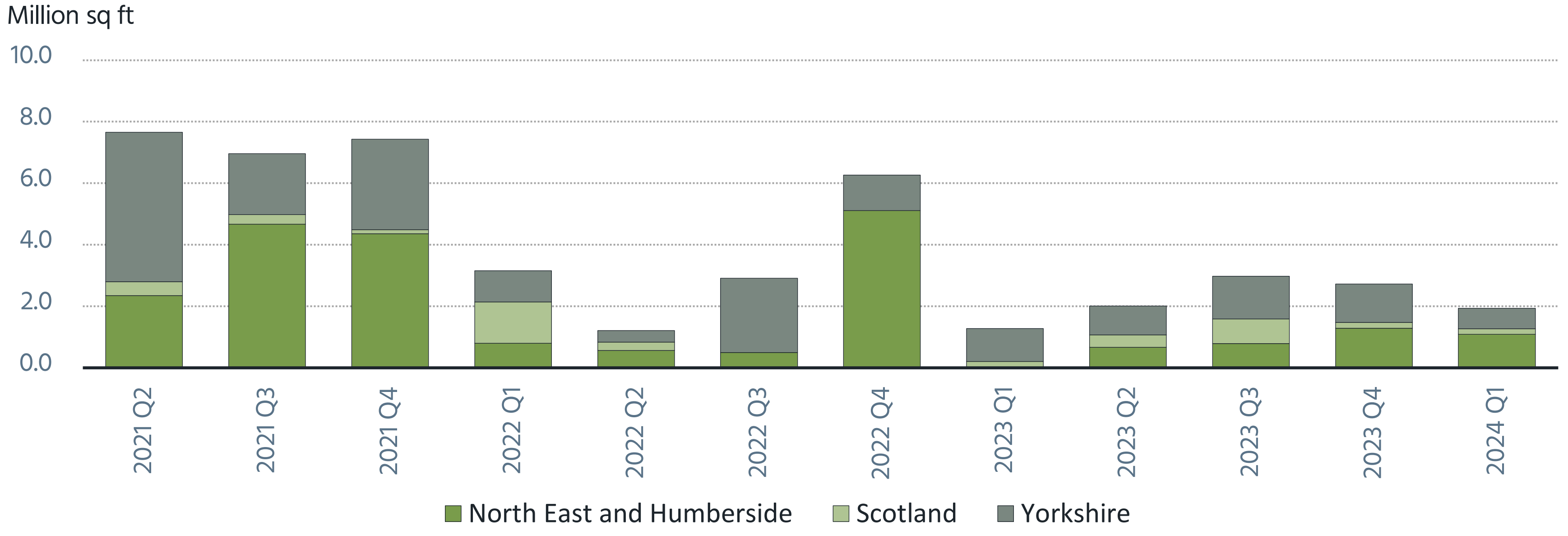

Availability rate by region

Source: Gerald Eve

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FURTHER INSIGHT

In Brief
March 2024

Multi-let
Autumn 2023

London Markets
Q4 2023

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