INDUSTRIAL AND LOGISTICS: AT A CROSSROADS

INVESTORS AND DEVELOPERS STILL BULLISH DESPITE CHALLENGES

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IS THE FUTURE OF INDUSTRIAL STILL BRIGHT?

■ Dentons and *Property Week* recently brought together a panel of experts to discuss what the future holds for the industrial and logistics sector as warehouse take-up reaches an all-time high and vacancy rates hit rock bottom

Our roundtable panel discussed topics including:

- **>> Issue of low vacancy rates**
- **>> Changes to the London Plan**
- **>> Rents reaching unsustainable levels**
- **>> Impact of high construction costs**
- **>> Growing awareness of the climate crisis**

OUR PANEL OF EXPERTS

Jeremy Achkar, vice-president of the UK investments team at Valor Real Estate

Celeste Giusti, team leader of economic infrastructure in the London Plan team at the Greater London Authority

Matt Kuber, vice-president – fund management at GLP

Bridget Outtrim, director of South East industrial at Savills

Liz Peace CBE, until recently chair of trustees at the Centre for London and leader of its Commission on Industrial Land in London

Jon Sleeman, director of UK logistics and industrial research at JLL

Andrew Wadsworth, corporate real estate UK and Ireland property manager at DHL

Mickola Wilson, co-owner and director of Seven Dials Fund Management

Alex Coulter, real estate partner at Dentons

Mitchell Labiak, former news editor at *Property Week* – chair

The industrial and logistics sector is at a crossroads. According to Savills, take-up hit an all-time high of 55.1m sq ft last year, surpassing the previous record, which was set just one year earlier in 2020, of 51.6m sq ft. Meanwhile, property investors spent an unprecedented £18.37bn snapping up warehouse assets in 2021 – driving yields to an all-time low of 3.25% as rents continued to rise.

Even with Amazon's profit warning knocking some of the wind out of the sails of some of the biggest listed property companies and a cost-of-living crisis threatening to dent discretionary spending, investors and developers are still bullish about the sector.

To try and figure out what all this means and where the warehouse market is headed next, Dentons and *Property Week* gathered a host of experts together to discuss the sector's fortunes.

The first question focused on the sky-high take-up and rock-bottom vacancy rates in the industrial and logistics sector.

For Bridget Outtrim, director of South East industrial at Savills, this has become a particularly acute problem in London. She said she was seeing occupiers with requirements out for years and nowhere to go. "There has been good demand from occupiers for several years and what we have today is a supply-side problem, but developers are responding," she explained. "Industrial land values have risen to the extent that developers can outbid other commercial sectors and they are buying office parks, hotels, car showrooms and retail parks to demolish for industrial development.

"In London, the government is relying too much on residential developers to provide small units of 'maker' space in mixed-use schemes and there is not enough emphasis on proper industrial space, which continues to be lost. The planning system is restricting growth in the industrial and logistics sector by not allocating enough land in the right locations."

She added: "The 'no net loss' of industrial land was abandoned from the London Plan, but local planning authorities still want to put it into residential schemes. This is wrong-footed; it should be located away from residential neighbourhoods so as not to disturb nor endanger them and allow uninterrupted 24-hour working.

"The industrial and logistics sector supports our modern lifestyles and the functioning of our economy. It is important that we have warehouses to accommodate many essential services and where there is a focus on providing housing, there also needs to be a commensurate provision of logistics space to support it."


Mickola Wilson


Matt Kuber


Liz Peace CBE


Andrew Wadsworth

Land allocation

Celeste Giusti, team leader of economic infrastructure in the London Plan team at the Greater London Authority (GLA), agreed with Outtrim about the importance of industrial land, but pointed out that the 'no net loss' policy within the plan was removed by the secretary of state. She added that a lot of the decision-making around how to allocate industrial land was ultimately down to the individual London boroughs.

During a *Mayor's Question Time* on the issue in November last year, Sadiq Kahn echoed this sentiment. When asked what impact he was expecting as a result of the former secretary of state's decision to remove the 'no net loss' of industrial land policy from the 2021 London Plan, he said: "While I was disappointed by the former secretary of state's decision to amend the London Plan, it still provides a robust framework both for delivering the housing that Londoners need as well as ensuring the space for employment and strategic uses – eg waste – that our city needs to function and thrive.

"In line with London Plan policy E4, I still expect boroughs to plan to ensure there is a sufficient supply of land and premises to meet current and future industrial demand across London, in line with local and strategic evidence."

Andrew Wadsworth, UK and Ireland

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Celeste Giusti

Jon Sleeman

Bridget Outtrim

corporate real estate property manager at DHL, also felt there was a need for larger warehousing space in London and worried that people in the planning system did not always appreciate how much room heavy-goods vehicles needed to manoeuvre.

Mickola Wilson, co-owner and director of Seven Dials Fund Management, also agreed that London's planning system often failed to account for the needs of logistics operators. "For as long as I can remember, the number-one priority for most occupiers has been to have a warehouse with enough yard depth," she said. "This is something that developers and governments will need to bear in mind when trying to densify space in the capital or in any other city."

Change of plan

One company that knows full well the difficulties in trying to densify space in London is GLP. In March, *Property Week* reported that the developer was considering nixing its plans to build a multi-storey warehouse in Newham, London.

> **It does take time to ensure we are delivering the optimum strategy for all stakeholders**
> **Matt Kuber**

The developer first announced plans to build a three-storey, 425,000 sq ft warehouse on a six-acre site in Silvertown in 2018, but it told *Property Week* at the time that it was reviewing its options for the plot following years of back and forth with the planning system over air quality issues created by the number of HGVs driving to and from the scheme.

Nick Cook, GLP's Europe president, said at the time that in the course of attempting to get planning permission for the site, the developer's thinking had "evolved".

During the Dentons and *Property Week* roundtable discussion, Matt Kuber, vice-president – fund management at GLP, reflected on that change of tack.

"We have looked into building multi-storey in the UK for some years, in line with the GLA's London Plan of innovative industrial intensification. It does, however, take time to ensure we are delivering the optimum strategy for all stakeholders, which may include pivoting to alternative schemes in some sites. To outsiders, this may look like banking strategic land sites, but we really do try everything we can to maximise value – social, economic, environmental and other – with each development we undertake.

"We know multi-storey logistics can work because we've done it successfully in other countries and our global team has the expertise, but doing so in the UK is in some ways unique and local factors must be considered."

Liz Peace CBE, until recently chair of trustees at the Centre for London and leader of its Commission on Industrial Land in London, added that she too believed there was a need for more industrial space in the capital, but she rose to the defence of light industrial and the need for maker space.

"Maker space does exist and it is needed," she said. "I can show you maker space. It's the woman starting her own business making sorbet or the man starting his own business making something else. These people see themselves as makers – they need light industrial space and there is demand for it. There is demand for a mix of uses on industrial parks with a range of different tenants existing alongside each other."

Granular approach

Peace stressed the need for a more granular approach to industrial land. "There was a big difference between heavy industrial processes such as the Tate & Lyle factory in east London and many of the smaller workshop-based businesses on Park Royal, and the boroughs needed to recognise this in their planning policies," she said. "It is, however, also the case that in London in particular finding new industrial space is challenging, especially given the need for housing land, so looking at more creative ways of accommodating employment needs to be encouraged. Again, the boroughs have a big part to play in seeking out and specifying opportunities for intensification."

The depth and breadth of the market was something noted by Alex Coulter, real estate partner at Dentons. He observed that warehouses come in different shapes and sizes and there are submarkets within the sector which could contain different

> **If you were to lift the roof off of a warehouse, you would see that each business is doing something different**
> **Alex Coulter**

tenants using the buildings for a multitude of purposes. "If you were to lift the roof off of a warehouse and look inside, you would see that each business is doing something different even though the buildings look similar on the outside," he said.

High rents

The next question was whether all of this demand for industrial space had pushed rents to unsustainable levels. DHL's Wadsworth certainly felt it had.

"Yes, rent is definitely getting too high," he said. "There's a conception among developers that rents are only a small part of doing business, but along with business rates and increased labour costs it all adds up."

Jon Sleeman, director, UK logistics and industrial research, at JLL, said that its own data also showed that warehouse rents had increased significantly – and added that this was an issue for some occupiers in London.

"For some businesses, the cost of rent has got so high that they decide to move out of

AN ENVIABLE ASSET CLASS

Alex Coulter, partner, real estate, at Dentons says: **"Investor appetite for best-in-class logistics assets will continue, with competition still fierce from global sources of capital to secure large-scale logistics portfolios.**

"Lack of supply has driven some investors to engage at earlier stages of the lifecycle and higher up the development risk curve.

"Investors and financers as well as tenants have a list of requirements in the 'new green world' with new-build and build-to-suit warehouses lending themselves well to green investment compared with some other asset classes.

"Despite macro-economic headwinds starting to blow, occupier demand will continue to be strong for the foreseeable future, and with the fundamentals around consumer trends still compelling, the industrial sector will continue to be an enviable asset class."

AFRICA STUDIO/SHUTTERSTOCK

We aren't averse to getting creative with extrapolation exercises to derive conviction in the rental growth story
Jeremy Achkar


Alex Coulter


Jeremy Achkar

London," he explained. "Rents in Park Royal have doubled over the past five years, with more than half this increase occurring in the past year. Rents in other parts of London have also increased dramatically. However, outside London, while rents have risen by a lot, they remain more affordable for occupiers."

This is reflected in the data. According to JLL's UK Big Box 2021 report from January this year, many core UK regions have seen double-digit percentage increases in prime rents over the past 12 months. Nationally, prime headline logistics rents jumped 15% in 2021. In the report, Sleeman said: "2022 looks set to be another challenging year for occupiers in need of additional logistics capacity, especially for those who cannot afford to wait – and the impetus behind rental growth will continue."

Investment rush

The increase in rents is a big part of what is fuelling the rush from investors and developers to put more money into the sector. Jeremy Achkar, vice-president of the UK investments team at Valor Real Estate, said the company did sometimes make purchases where it factored in the potential for rental growth, but stressed that the company was nevertheless very careful where it invested its money.

"We assess each deal based on its individual merits," he said. "In certain instances where data is sparser, we aren't averse to getting creative with extrapolation exercises to derive conviction in the rental growth story. Research plays a central role in the crafting of our investment thesis, which we update regularly to stay at the forefront of the topic of growth, or lack thereof."

It has been an acquisitive time for Valor. In January this year, it and QuadReal Property Group launched their second joint venture together to invest an additional €3bn (£2.51bn) in urban logistics assets located in the UK, France and Germany. The move increased the size of the partnership's ambitious urban logistics JV to a total of £3.35bn after the launch of an initial £840m JV in November 2020.

Since the launch of the January JV, it has been snapping up warehouses across London and the South East. It acquired two warehouse units in Beckton, east London; two single-let warehouses in Wandsworth, south-west London; a 105,000 sq ft multi-let industrial estate in Mitcham, south London; four units in Watford, Hertfordshire, on a 2.87-acre site; and a 65,000 sq ft industrial estate in Tottenham, north London.

Beyond London, Valor bought a prime last-mile logistics facility in Birmingham for £50m from NFU Mutual in April. "This transaction is the latest demonstration of our forensic approach to sourcing and originating and offers an attractive mix of strong day-one income, with the opportunity to significantly improve the rental tone over the medium term," Achkar said at the time.

"It is our second purchase in a city where we aim to increase our footprint significantly over the coming years."

It is a lot of investment activity and confidence from just one JV, and it is reflective of the appetite throughout the whole of the market. Seven Dials' Wilson said she was not surprised by this eagerness from investors and developers.

"There is a lot of investment, but industrial is just the obvious place to put your money," she said. "Relatively speaking, it's still safer than other property asset classes such as retail. I also believe Amazon's profit warning could end up being a bit of good thing for the sector as it helps to take some of the froth out of the market."

The significance of Amazon's profit

Amazon's profit warning could be a bit of good thing as it helps to take some of the froth out of the market
Mikola Wilson

warning is spelled out by data from Savills that reveals that in 2020 and 2021, the online behemoth accounted for 25% and 24% of take-up respectively as it continued its domination of the ecommerce market. This figure does not include instances where a third-party logistics company has signed a lease in order to service Amazon, meaning the company's overall impact on the leasing market over the past couple of years could be even greater. By contrast, for the first quarter of this year, Amazon has accounted for a mere 3% of take-up – 370,000 sq ft out of the quarter's total of 12.1m sq ft.

Yet, JLL's Sleeman was keen to point out that there was still a lot of occupier demand in the logistics market beyond Amazon. Indeed, the Savills data backs this up as, even without Amazon, the 12.1m sq ft of take-up in Q1 2022 is way above the long-term average.

Amazon's profit warning is also at the forefront of the mind of DHL's Wadsworth. "The Amazon profit warning is a sign that ecommerce businesses generally might need less space," he said. "As an occupier, we are subject to many similar pressures to Amazon right now with the cost of doing business increasing and consumer appetite decreasing."

Construction costs

It is not just the cost of doing business for occupiers that is increasing. The cost of construction is also rising. This is something JLL's Sleeman observed in the UK Big Box 2021 report.

"According to data from the Department for Business, Energy & Industrial Strategy, the average cost of construction materials increased by 23% in the year to November 2021, while the cost of prefabricated structural steel surged by 66%," he said. "Specifically, in the big-box logistics sector we think build costs rose in the region of 20% to 30% over 2021."

He gave cause for some optimism, though: "There are some signs that supplier delays may be easing, as highlighted by the January 2022 IHS Markit/CIPS UK Construction Purchasing Managers' Index. However, securing steel remains an issue and sourcing cladding is a very specific challenge."

The last point was a sentiment echoed by Seven Dials' Wilson during the Dentons and *Property Week* roundtable discussion. She said she had often seen construction cost increases in the past, but that the task of getting cladding for warehouses was particularly tough at the moment.

GLP's Kuber said that the developer had also noticed that construction cost increases were having an impact on the business and wider sector at the moment, and that the company was constantly evaluating how best to react to market changes both locally and globally.

"Construction costs are definitely impacting our business, as well as increasing construction times in some instances, but given our scale in Europe and long-standing relationships with suppliers, we believe we are well positioned to maintain our competitive advantage," he said. "We have to work together with our suppliers, clients and other stakeholders to reach the most beneficial outcome for all in light of these impacts."

DHL's Wadsworth said he was concerned that occupiers would bear the brunt of the increase in construction costs through

If construction costs are impacting development, it shouldn't be the occupier paying that cost
Andrew Wadsworth

increased rents. He argued this would be the wrong decision.

"If construction costs are impacting development, it shouldn't be the occupier paying that cost," he said. "An increase in the cost of construction should already be factored into the developer's plans."

Wadsworth pointed to the cost that occupiers spend on fitting out modern, tech-driven warehouses versus the cost of building the warehouse. "From our perspective as an occupier, the warehouse as built is not as complex as the fit-out on the inside that we deliver as the occupier," he said. "The fit-out cost is sometimes significantly more than the construction cost."

The final question was on the growing awareness of the climate crisis within the industrial and logistics sector. In April, the UN Intergovernmental Panel on Climate Change warned that carbon emissions must peak by 2025 if we were to avoid a climate catastrophe, while UN secretary-general

Antonio Guterres accused business leaders and world leaders who said they were doing enough of "lying".

This raises a lot of questions for the real estate sector. The oft-cited statistic from Climate Crisis Challenge collaborating partner UKGBC is that the built environment represents up to 40% of our emissions in the UK. So, what can and should the warehouse sector be doing? And is there enough demand from occupiers for green sheds at the moment?

Savills' Outtrim said that the message was getting through, but the fundamentals of doing business still topped the list of occupier concerns when looking for warehouse space. "The green agenda is getting higher up developers' list of priorities, although location and rent still come first," she said.

The GLA's Giusti said the government was keen to see action from developers, although she recognised that there was a limit to what the government could demand of the industry.

"We are asking developers to do more," she said. "Embodied carbon is a new policy in the London Plan, but there's only so much warehouse developers can do on embodied carbon because a lot of it comes down to the use of concrete as a building material, which is hard to replace. The London Plan contains a policy on zero carbon, but with the strengthening of the building regulations a lot of these net zero targets may need to be achieved by offsetting."

In the London Plan itself, the GLA says "operational carbon emissions will make up a declining proportion of a development's whole-lifecycle carbon emissions as operational carbon targets become more stringent".

> **The green agenda is getting higher up developers' list of priorities, although location and rent still come first**
> **Bridget Outtrim**

Whole-lifecycle approach

It adds: "To fully capture a development's carbon impact, a whole-lifecycle approach is needed to capture its unregulated emissions [ie those associated with cooking and small appliances], its embodied emissions [ie those associated with raw material extraction, manufacture and transport of building materials and construction] and emissions associated with maintenance, repair and replacement, as well as dismantling, demolition and eventual material disposal."

On the carbon offsetting point, the London Plan urges boroughs to develop "a price for offsetting carbon using either a nationally recognised carbon pricing mechanism or a price based on the cost of offsetting carbon across the borough."

It adds that "a nationally recognised non-traded price of £95 per tonne has been tested as part of the viability assessment for the London Plan, which boroughs may use to collect offset payments".

GLP's Kuber said the company was continuously taking action to tackle the climate crisis and enhancing the social aspects of its real estate portfolio. The company said it was the first developer to achieve net zero for construction at Magna Park 314 using the UKGBC framework.

Achieving this milestone allowed GLP to leverage its expertise for ongoing and future development projects – GLP is actively introducing measures to minimise carbon emissions during the construction phase via alternative use of sustainable materials and transition to renewable energy on site for its assets under management. In addition, in 2018, Altitude, Magna Park Milton Keynes, became the world's first WELL-accredited logistics building. "We're moving ahead of where the regulation says we need to be", added Kuber.

JLL's Sleeman highlighted that whereas the initial focus of developers was on improving the energy efficiency of buildings, the focus had now shifted to reducing embodied carbon in construction. He also highlighted growing interest in carbon-negative measures, such as solar panels on warehouse roofs.

DHL's Wadsworth had a different perspective on warehouses' carbon emissions. "DHL is trying to reduce its carbon emissions, but property is actually only a small part of our emissions," he explained. "Our transport is where we emit the most carbon and our emissions by plane are by far the biggest part of that. It is the area that we're focused the most on trying to reduce, and it is one of the most difficult to reduce."

Like so much else in the industrial and logistics sector, the climate crisis means uncertainty, but it also means opportunities for the businesses that can take advantage of the need for industrial and logistics space.

ABOUT THIS FORUM...

This event was chaired by former ***Property Week*** news editor **Mitchell Labiak**

If you are interested in hosting or participating in future events, please contact **Sian Wilde,** head of projects, ***Property Week.***

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