BE NEWS

Sponsored by DENTONS

FROM REVOLUTION TO EVOLUTION – WHAT NOW FOR THE INDUSTRIAL AND LOGISTICS SECTOR?

INDUSTRY GUESTS

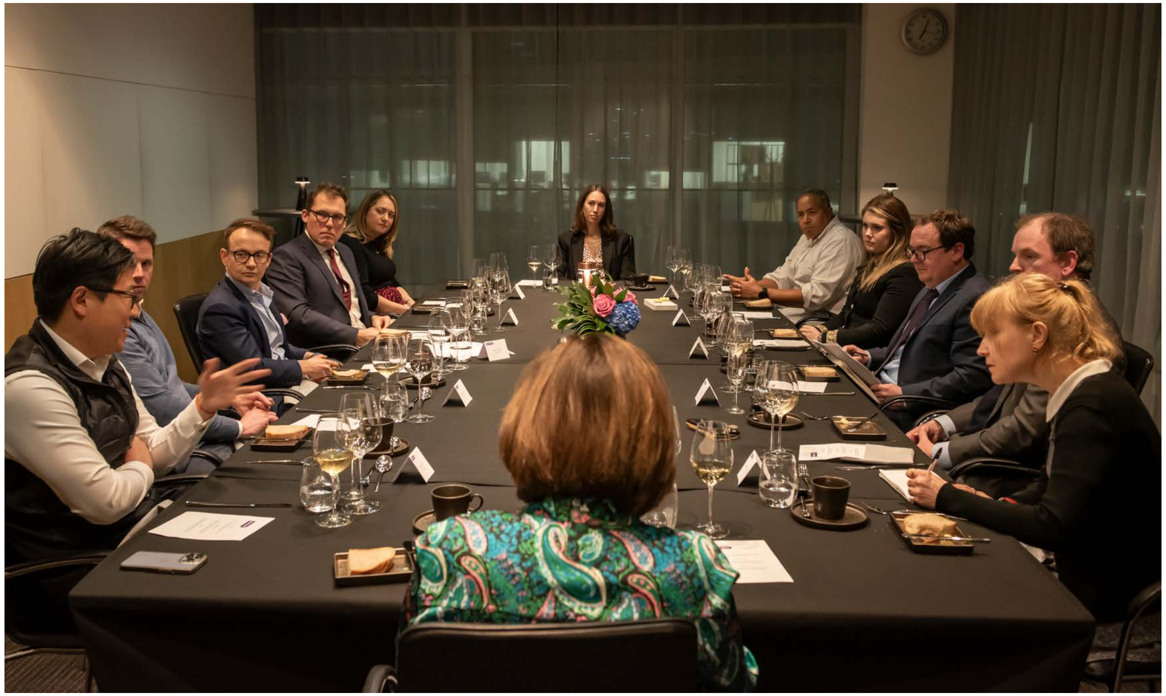
Alex Coulter, real estate partner, Dentons
Angie Fenton, director, Quod
Fiona Kilian, chief financial officer, Mirastar
Holly Mozley, senior asset manager, St Modwen Logistics
Bridget Outtrim, director, South East industrial team, Savills
Simon Perks, director, capital deployment and leasing, Prologis
Nick Preston, head of investment management, Panattoni
Cen Shen, head of Europe, JD Property
Otis Spencer, chief investment officer, P3 Logistics
Henry Stratton, head of research, Tritax Management

The industrial and logistics sector peaked during the pandemic, when leasing and investment activity hit new heights, driven in large part by the rapid growth of ecommerce businesses and third-party logistics providers.

But all good things come to an end. Last year, according to Savills' Big Shed Briefing, the take-up of larger units was 40% down on 2022 levels, vacancy rates reached 7.15% and logistics investment volumes fell 54% to £3.1bn.

These figures were still better than pre-Covid levels, showing just how much the pandemic boosted the sector. So, what does good look like in the post-Covid world?

Senior industry figures representing landlord, agency and investment companies joined *BE News* head of content Simon Creasey to discuss the outlook for the sector at a roundtable debate sponsored by Dentons.



QUESTION: How was 2023 for your business?

SIMON PERKS: It probably wasn't what we were expecting. A lot happened during the year, both at a government level and globally, and there were things outside our sector that were beyond our control.

As a result, we didn't see the levels of take-up we might have been anticipating. What we did see – and continue to see – is strong rental growth mainly underpinned by a lack of new construction during that period.

NICK PRESTON: There's been a recalibration over the last 12 to 18 months driven primarily by capital markets, in terms of interest rates and inflation. Therefore, yields have adjusted and markets have changed on both the investment and occupier side.

There is a scarcity of supply and so I see this as a settling-down period. But as ever in real estate, as the markets recalibrate, things don't settle quickly – it takes time to wash through.

I remain confident about the logistics sector, and although we've had some choppy waters to ride through in the short term, fundamentally we're in a good place.

HOLLY MOZLEY: One positive for our business is that there has been a much higher level of tenant retention than before across our built stock and tenants are also taking more space across our existing estates. However, in general, 2023 was much slower than we anticipated.

> ***Although we've had some choppy waters to ride through, fundamentally we're in a good place***
>
> *Nick Preston*

OTIS SPENCER: The dislocation in the market that started off in 2022 created an opportunity for us – as new entrants into the UK – to come and get exposure to one of the most robust, transparent markets in Europe.

We are quite optimistic for the UK in 2024. The yields you can get, and the repositioning opportunities out there, mean there is a lot of potential for capital deployment.

QUESTION: Looking at this year so far, has the market changed at all compared with 2023?

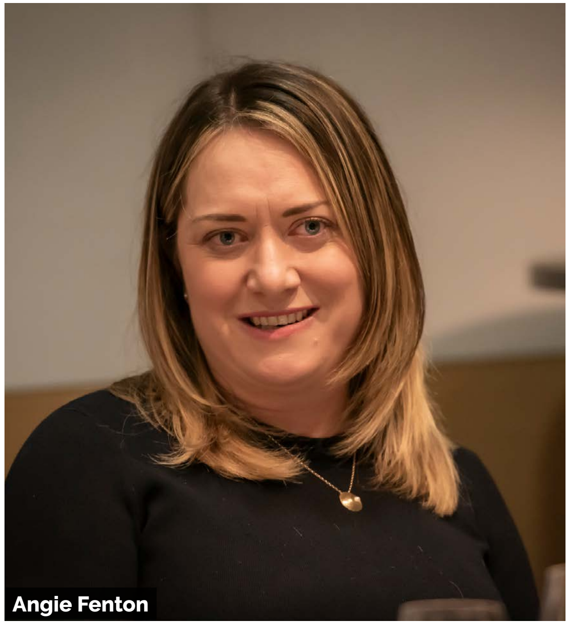
BRIDGET OUTTRIM: Since Christmas, we've been pleased with the number of enquiries we have received. What we're experiencing now are normal market conditions, whereas before we had abnormal market conditions. In terms of take-up, we're still above pre-Covid levels and there's still a good upwards trend that's focused on ecommerce.

In my market, in the South East, we've been squeezed from different directions, with residential, data centres and film studios all taking space from conventional industrial occupiers. They've got deep pockets and high margins and they pay more. This has put upward pressure on rents, which is good news for landlords around the table.

But today, I'm operating in a market that I recognise much more than I have done in the last two or three years, so I'm optimistic about the future.

> ***In terms of take-up, we're still above pre-Covid levels and there's still a good upwards trend that's focused on ecommerce***
>
> *Bridget Outtrim*

Alex Coulter



Angie Fenton

QUESTION: Is it taking longer to get investment and leasing deals over the line than it would have done a few years ago?

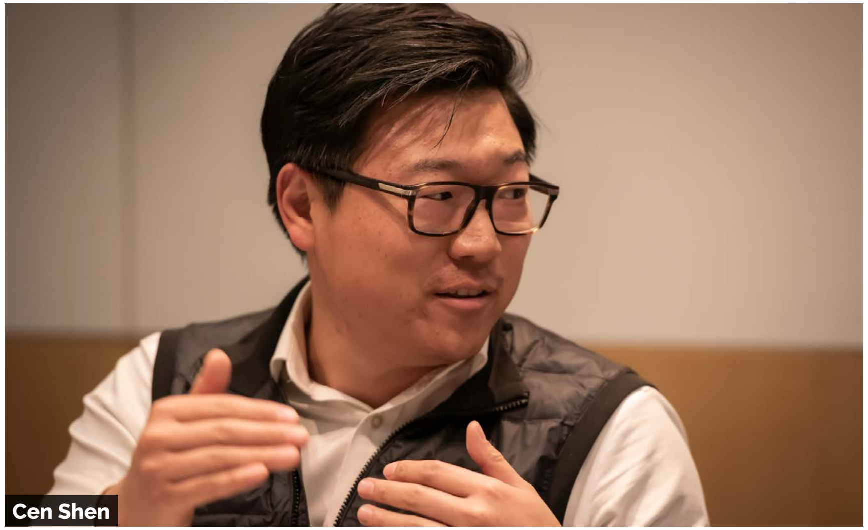
ALEX COULTER: Sophisticated occupiers do care, the industry does care, but agreeing who pays for it in the chain is still in flux. You've got the developer, the investor, the tenant; you've got the planning authority; you've got the bank – it's that virtuous circle, but the cost has got to come out somewhere, hasn't it?

ANGIE FENTON: While I'm not involved in the commercial side of things, clients do need reassurance on the planning side. Recently I was asked about a very low-risk site in a great location and the funder wouldn't give the developer the money until we proved there were no better planning permissions nearby coming forward that might compete with the development in the future. I found that level of risk aversion very surprising, given it's an interesting, existing industrial site.

QUESTION: On funding, is there good availability of capital debt for industrial and logistics developers currently? Where's this cash coming from, and are banks willing to lend to the sector?


Henry Stratton


Nick Preston


Cen Shen

HENRY STRATTON: The increase in cost of debt, and cost of capital in general, has been a challenge for all real estate sectors – and logistics is not immune. Debt is available, but it is more expensive, which, alongside the increase in market yields and reset in demand, has resulted in fewer new projects being started. This has impacted the supply picture, which, like demand, has reset through 2023. Well-funded organisations can still move projects forward and will continue to do so.

PRESTON: Banks have money to lend – it's just a recalibration. We've had these huge capital market movements over the last couple of years and they're anxious – they never know how to price everything.

But they love the sector. Relative to retail and offices, people get industrial and logistics. They can understand that the fundamentals are in the right place and where the performance is likely to come from.

QUESTION: Is the UK still an attractive proposition for overseas investors?

SPENCER: From our perspective, definitely. There's an efficient tax structure here that you can take advantage of and the liquidity is generally much higher. Even though investment volumes are down, this is one of the most liquid markets when you do want to exit, which is a key point.

Couple that with attractive yields and the rental growth you were seeing in the UK – that was unheard of elsewhere in Europe. Although it is now coming to the continent and slowing down a little here, it's still phenomenal growth. And the UK is an island with supply constraints, so there are a lot of different factors at play.

CEN SHEN: In the UK, prices adjusted quickly early in the cycle and now pricing is fair and the value is good for UK warehouses compared with other countries in Europe.

Also, the UK economy is generally doing better than other European economies, which is another positive. Added to that, the market here is very transparent, making it very easy for foreign capital to enter.

QUESTION: Where is occupier demand coming from and what are the new sectors to look out for?

OUTTRIM: The continued growth of ecommerce and the need for more resilient supply chains will underpin future demand.

New emerging sectors include life sciences where they are moving towards production. We are also seeing more nearshoring and onshoring of food production in the UK including the growth of vertical farms, and we are seeing more requirements from manufacturers. ▷

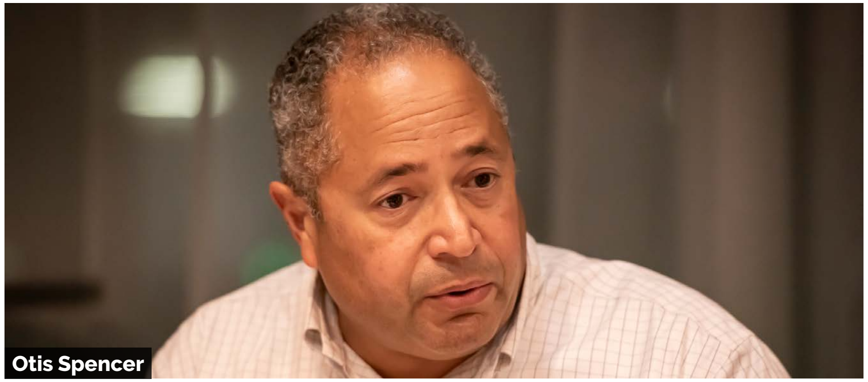
PERKS: Vertical farming business Harvest London took a circa 140,000 sq ft building in Croydon from us last year. We're excited to see how that's going to work out as it's an interesting sector.

QUESTION: Do industrial and logistics occupiers care about the green credentials of their buildings?

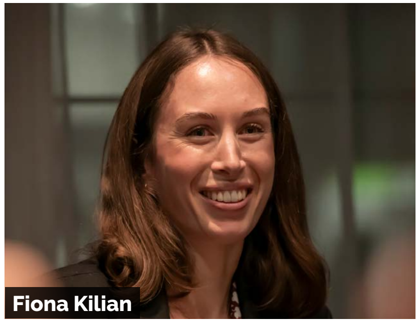
SPENCER: People used to ask me about sustainability and I'd say the one thing I care about is sustainable rents, but that narrative has changed 180 degrees. It's high on everyone's agenda. One of the biggest challenges is understanding how much capex you are going to need for that asset to maintain your green credentials, as well as positioning it correctly for sale.

FIONA KILIAN: This feels like one of the biggest assumptions, or the different assumptions, people are making now on acquisitions. Everyone needs some element of ESG, or an ability to bring that asset up to a certain ESG standard, but no one knows exactly where they want to be, or exactly what that's going to cost. This is one of the biggest differentiating elements of how people are underwriting new deals.

COULTER: Who is going to pay for it in the chain? You've got the developer, the investor, the tenant; you've got the planning authority; you've got the bank – it's that virtuous circle, but it's got to come out somewhere, hasn't it?


Otis Spencer


Simon Perks


Fiona Kilian

QUESTION: Are we seeing more green leases in the industrial and logistics sector?

COULTER: I talk about green leases a lot – every day. We were giving legal talks on green leases back in the 2000s and then everyone threw them in the bin when the global financial crisis hit.

No one cared about green leases then, but over the last five to 10 years the industry has been much more interested and engaged; for example, I've got many clients who ask me what percentage of the leases they've got in their portfolio are green leases, and how many are dark green or light green. Almost all new leases have some sort of sustainability provisions. Today, it's a topic we talk about all the time, and certainly in my legal world it is on everyone's lips.

> ***We were giving legal talks on green leases back in the 2000s***
>
> *Alex Coulter*

MOZLEY: It's non-negotiable for us and is something we won't budge on because it's that important going forward. Larger occupiers understand it; they get it – they've got their own requirements they must hit. For smaller tenants, we've got a problem because it isn't the main focus for them. Their focus is the rent, their total occupancy costs and how are they going to run this business.

KILIAN: It's about bringing the tenant on the journey as well, because with grade-B stock you have to work with them to say "this is the green lease; these are our non-negotiables".

If just one tenant in the portfolio is not on a green lease, that can have a catastrophic effect on the overall ESG picture.

QUESTION: What about rental growth in 2024? Do you think it will be on a par with last year or will it be higher/lower?

PERKS: Our forecast for the year is somewhere between 2.5% for the South

East, 3% for London and probably similar for the Midlands.

MOZLEY: We're probably slightly more aggressive in our rental growth forecasts. There is still that low vacancy rate. There are still people who need to move and, crucially, people who need to move are going to move to better-quality buildings.

PRESTON: As a fund manager, it's all in the stock-picking – get the right building in the right location and you will see strong rental growth.

OUTTRIM: It's not an answer that can be given with one number. In my market there are some prime rents that are coming under pressure, with occupiers now pushing back. Rather than paying for a brand-new, £35/sq ft space, they prefer to go to a secondhand building, which was left behind when the prime rates shot up. However, rents for secondhand buildings are now rising.

I've never seen such a wide gap between grade-A and grade-B buildings, but it's a gap that is closing and I see the growth in the grade-B sector, more than the grade-A.

QUESTION: Looking ahead through the rest of 2024, what changes need to happen to enable the sector to continue to grow?


Holly Mozley

STRATTON: Planning is still the fundamental issue. Then we've got those extra elements around power supply, and the supply of labour, which is still very much an issue in the UK, where location, skills and availability are still a challenge. These issues aren't going away. They are multi-year problems and our sector is trying to find innovative solutions to help solve them.

FENTON: Labour leader Sir Keir Starmer has alluded to releasing the 'grey belt' – these are basically brownfield sites in the green belt. If grey-belt sites are released – subject to them not being allocated just for housing – there could be a good opportunity to get a lot of these sites allocated for industrial schemes. We also need more investment in infrastructure to support the industry and that's a nationwide issue.

In London, we have a supply issue, but the London Plan and the Greater London Authority are just looking to prevent a net loss of industrial land.

We're talking to them about needing to actually allocate more sites for industrial development in the future. You need to look at unused areas and things like unused retail parks. There are a lot of options.

SHEN: From the investor's perspective, we need more positive news on the economy and interest rates and that will help the demand from occupiers. Once we see demand there, the capital will flow into the sector. We just need more positive macro-economic news.

COULTER: For sustained growth in the industrial and logistics sector, it's imperative to prioritise strategic investments and developments in infrastructure and technology, aligning with ESG principles, attracting occupiers with long-term sustainability goals. □