savills

THE IMPACT ON THE UK LOGISTICS MARKET

Brexit Briefing

BREXIT BRIEFING

REASONS TO BE CHEERFUL.....

SUMMARY

Robust occupier take-up and low vacancy rate will keep sector attractive for investors

■ Since the result of the referendum very little official data has been released to help us form a view on how the UK logistics sector will be impacted. It will however be crucial to monitor consumer confidence, retail sales (online in particular) and automotive export figures.

■ Fundamentally the supply and demand dynamic in UK logistics is robust. Half year take-up for 2016 is on par with 2015 and even taking into account the committed development pipeline supply is at an all time low. This contrasts dramatically to 2009 when supply was 94m sq ft, compared to 30m sq ft now.

■ The initial response in the investment market has been mixed and greater clarity will emerge in the coming days and weeks. Core active buyers remain in the market and post Brexit transactions are now starting to complete, we are also seeing competitive bids for prime logistics units.

■ Should the development market slow down in the second half of the year, as we suspect, then construction contracts could be priced more competitively. In turn this could create an opportunity for occupiers to commit to build-to-suits and developers to build speculatively at lower costs.

"Generally, we expect speculative development activity to slow in the second half of 2016. Combined with continued strong demand for warehouse space we therefore do not foresee a supply side shock adversely impacting rents and investment volumes"

Kevin Mofid, Savills Research

The impact of Brexit on all of the UK's property markets will be very dependant on the macro-economic background, and this in turn is dependant on how the UK consumer responds to the news and the evolution of the story over the next two to three years.

This paper is our first analysis of how this new world might affect the UK logistics market. It, and its sister papers on other UK and European asset classes, will be updated on a regular basis over the following months as hard data, anecdotal news, and our forecasts evolve.

Macro factors & the logistics impact

Since the result on the 24th of June official data has been in short supply. In the immediate aftermath of the result currency and equity markets have performed erratically and very little has transpired as to how the consumer is responding.

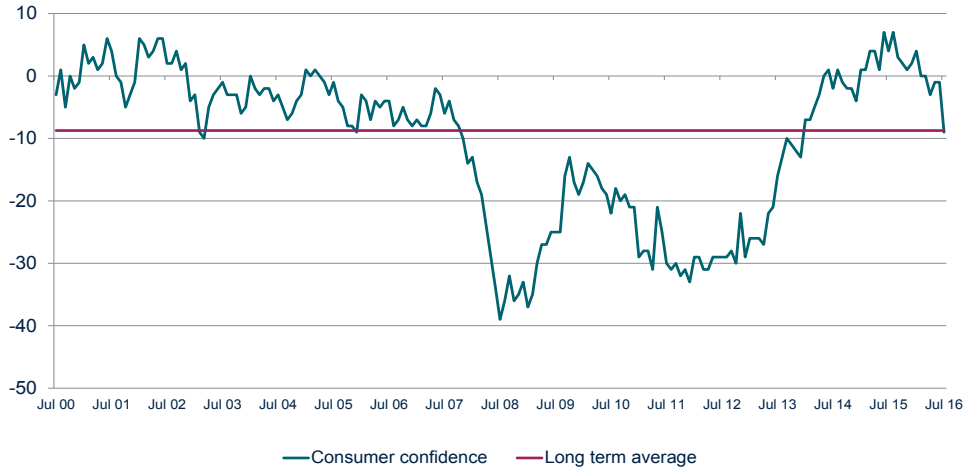
Any tangible impact on the UK logistics property market will take time to become visible but to guide our views there are a number of data points worth mentioning.

The first is consumer confidence. Data from the OECD shows household expenditure accounted for 65% of GDP in 2015. Over the last ten years the retail sector has accounted for 43% of all the warehouse space transacted, the fortunes of both sectors are clearly intertwined. The first indicator of consumer confidence came on 7th July when GfK released their initial post Brexit index, demonstrating the sharpest contraction for 22 years. We will be watching with interest as we suspect this will rebound over the summer.

Secondly, the shift to online retail is well documented and currently accounts for 14% of all sales. In economically uncertain times will the consumer look to online retailers for cheaper products? Forecasts vary but Verdict predict that online sales will account for 17% of retail sales by 2020, reaching £67.2bn. This will help to keep demand for new warehousing high as research by Prologis suggests that for every extra €1bn spent online an extra 775,000 sq ft of warehouse space is required. Therefore we will be tracking the official monthly ONS retail figures.

FIGURE 1

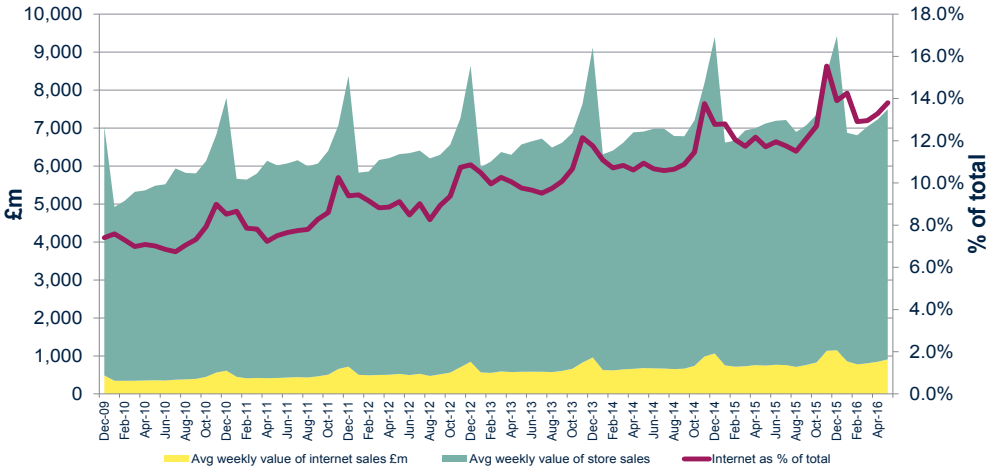
UK Consumer Confidence falls in the aftermath of Brexit



Source: GfK

FIGURE 2

Online retail sales continue to climb



Source: ONS

▼ Amazon defies the news

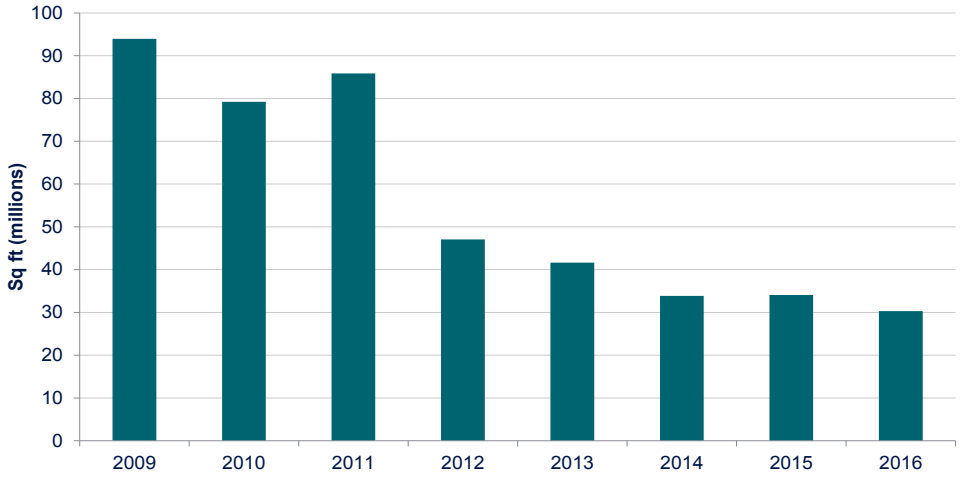
It will also be vital to monitor closely the performance of retailers in the run up to Christmas 2016, and then as trading figures trickle in during January and February 2017. Once those figures have been digested by retailers, 3PL's, parcel delivery companies and the investment market the path for UK logistics will become much clearer.

Whilst the importance of the retail sector is not to be underestimated another key part of the market is the manufacturing sector and within that the automotive sector. This has gone through somewhat of a renaissance in recent years, which in turn has had a ripple effect for the property market. In parts of the West Midlands for example take-up related to the automotive sector rose from 9% of the market in 2011 to 50% in 2014. We will therefore be tracking data from the The Society of Motor Manufacturers and Traders who release monthly manufacturing numbers along with the proportions for export. We will then be able to ascertain if any uncertainly surrounding trade negotiations starts to impact this sector, which could in turn impact the logistics sector.

Lastly we will be watching for announcements on key infrastructure projects. A decision regarding airport capacity has already been delayed "until at least October". The construction of Hinckley Point Nuclear Power Station, the HS2 line and rolling stock and a new runway in the South East all have the potential to create localised pockets of warehouse demand as existing occupiers are displaced and construction supply chains require additional warehouse space

FIGURE 3

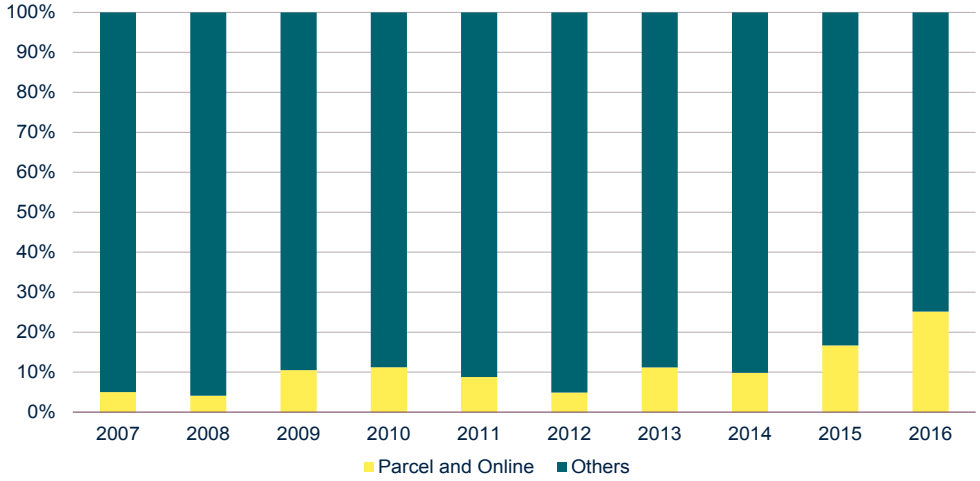
Logistics supply has fallen dramatically



Source: Savills Research

FIGURE 4

Online retail & parcel delivery proportion of market increases



Source: Savills Research

The occupational market

Since the last down-turn new development in the logistics sector has generally been constrained as just 13.65m sq ft has been delivered since 2012 compared to 40.47m sq ft from 2005-2009.

Combined with strong recent levels of take up this has ensured that supply has decreased from 94m sq ft in 2009 to 30m sq ft in July 2016 which gives a national vacancy rate of just 7.1%, significantly below long term averages.

Savills are tracking 5.9m sq ft across 32 schemes for delivery in 2016/17 and we envisage that speculative announcements will reduce in the second half of 2016 until the political and economic situation stabalises. However, it should be noted that since the referendum result development activity has not halted. Funded by M&G, The Rigby Group has confirmed speculative development of 575,000 sq ft across 3 units in Coventry, due for completion in June 2017.

Given the continued shift to online retail we believe that logistics take-up levels will remain robust. Indeed in just 5 years the average amount of space transacted across the country has increased from 19.5m sq ft per year to 22.4m sq ft year. Crucially too, the volume of deals has also increased standing at 121 per year over the last 3 years, an increase of 44%.

Since the result of the referendum two bell-weather occupiers have committed to new warehouse space. Automotive manufacturer Jaguar Land Rover (JLR) has taken two units at Prologis Park Ryton which total 470,000 sq ft and we are aware that online retailer Amazon have committed to a further 555,000 sq ft. The importance of these two occupiers should not be understated. Continued investment by JLR will require their suppliers to locate nearby and the continued roll-out of Amazon Fresh and Prime Now will not only require new warehouse space, but will also force other retailers to adapt their supply chains to compete.

Combined, the strong levels of take-up and low vacancy will ensure rents maintain their upward trajectory.

The investment market

The initial response in the investment market has been mixed but we expect greater clarity in the market once the financial turbulence and the noise around the retail fund closures has quietened. Thursday 14th July will also see the Bank of England's MPC meeting where further clarity and forward guidance regarding the base rate will be offered.

Over the past five years investors had become increasingly comfortable with logistics as a global asset class, driven by the shift towards online retail and the long term secure incomes the sector offers. Indeed in 2016 so far two of the three keenest net initial yields paid have been for Amazon units, 4.5% at Bardon and 4.66% at Airport City, Manchester, both to overseas investors. Given the fact that we expect the occupier market to continue to benefit from the shift to online retail, opportunities for investors should continue to present themselves.

Indeed, the continued relative attractiveness of the industrial sector, as a whole, has continued into 2016 with, at the half year point, investment volumes down just 11% on 2015 volumes totalling £2.6bn, a smaller decrease than any other sector.

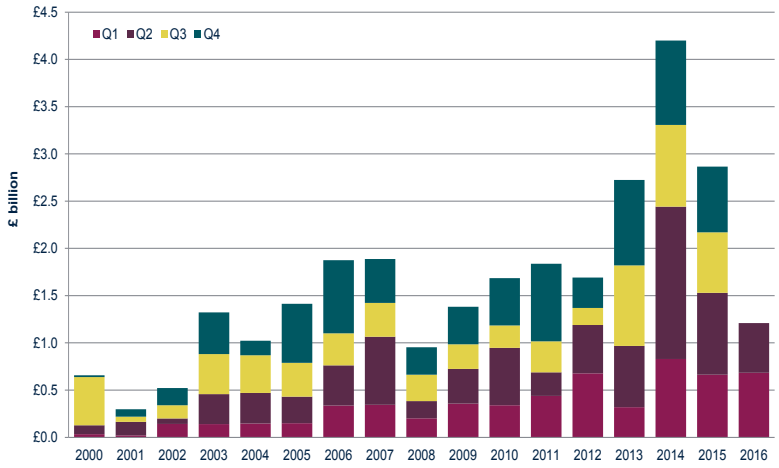
Whilst we do not expect many immediate distressed sales in the sector the key point to note is that there remain active core buyers, which was not the case at the start of the GFC in 2008/9. In particular, given the current value of sterling, overseas investors may start to make up a greater proportion of the market.

By way of example, we are aware that since the referendum a number of industrial deals have completed or exchanged including the sale of Chrome 102 in Minworth at a net initial yield of 5.05% and there is competitive bidding on other prime logistics units.

Key to continued liquidity in the sector however will be how pricing stablises. Any occupational requirement over 420,000 sq ft will have to be serviced by a pre-let, which typically have been financed by an annuity style deal (for strong covenants), where we expect little or no discount in the future.

FIGURE 5

Logistics investment volumes remain strong



Source: Savills Research

Build costs and Programme

The latest indicators from the recently launched Savills ProgrammE and Cost Sentiment Survey (S.P.E.C.S) demonstrate that build costs and programme delivery time scales have had an upward pressure throughout 2016. If the development market does slow down in the coming months this will have an impact on build costs as tenders and contracts are priced more competitively, although we are yet to see any evidence for this.

This could be timely for both occupiers and developers as given the lack of supply in the market for larger warehouse units any occupier requiring a larger units will have to commit to a build-to-suit, potentially now deliverable at a lower cost.

On the other hand developers and investors higher up the risk curve may also choose to develop warehouse space speculatively, in the hope of delivering product to the market without competition, again at a lower cost and also in a quicker time frame.

£32-37

Cost per sq ft for constructing warehouse space between 400-000- 600,000 sq ft

MORE ON BREXIT: We will be publishing further reports on specific topics, see our website for details

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