E-commerce tilts the investment balance toward logistics and away from retail

**Full convergence of logistics and shopping centre yields**

Historically industrial has been the highest yielding sector of the three established commercial sectors. However, since 2013 industrial yields have been compressing, initially in line with office and shopping centre (SC) yields, but since 2017 at a much faster pace, driven by investor demand for logistics assets in particular.

The historic average spread between prime shopping centre and prime industrial yields was at 143bps, quite stable until 2018, when it dropped to 108 bps. to 54bps in 2019 and in Q1 2020 for the first time, prime industrial yields were 9bps lower than prime SC yields, at 4.95% vs 5.04%. This rapid convergence has also been the result of a gradual softening of shopping centre yields over the past two years, by 40bps.

Prime retail park yields have moved out by only 10bps over the past two years (Q1 2020 average at 5.58%) showing more resilience to the impact of e-commerce, as in most cases they are convenience destinations and their structure and layout facilitates omni-channel strategies, including click and collect and product returns. These characteristics also bode well for social distancing and open air shopping, currently required as measures against the spread of the pandemic. Nevertheless, also in this case, the spread with logistics yields has been narrowing over time and since last year reversed from a historic 48 bps to -63bps in Q1 2020.

**Rising allocations in the industrial sector - driven by logistics**

This convergence of prime industrial (mainly logistics) and retail (SC) yields reflects the shift of investor interest into logistics properties and away from physical retail, along with the rise of e-commerce and the growing demand for warehousing space by 3PL providers and retailers. Our analysis shows that the higher the online sales penetration, the larger the share of industrial investment, with the split between industrial and retail to be as high as close to 60:40 in the more developed markets, such as the UK and Sweden. On average, the share of industrial in the overall European industrial/retail investment allocation has shifted from 25% to close to 47% (2019) over the past five years. In the first and even second quarter of 2020, retail transactions experienced a boost, due to the exchange of some sizeable portfolios and malls. At least one third of the number of properties exchanged involved groceries stores and we have similarly observed a marked increase in the proportion of sale and leaseback transactions in the retail sector.

In the remainder of the year, we anticipate the industrial sector to pick up strongly, driven by logistics transactions. During the pandemic investor sentiment for logistics assets has remained positive, while retail has been disproportionally hit by the lockdown, with the exception of supermarkets. Market evidence and ongoing transactions demonstrate...
that pricing of prime logistics assets is likely to remain resilient this year, due to positive performance outlook, rising investment allocations in the sector (from a normal 10% now up to 20% of a portfolio) and competition for good quality product.

**Strong fundamentals will drive outperformance**

Rising allocations in logistics have been supported by strong performance metrics, with the industrial sector returns outperforming all property returns over the past three years across most markets (MSCI). This pattern should continue over the next five years, with Industrial properties projected by Capital Economics to achieve a total return of 6.6% vs 2.7% for Retail and 4.6% for All property in the Euro zone countries.

This positive performance will be supported by the growth of e-commerce, which is generating demand for logistics warehouses as well as by the rising weight of capital in the sector. Limited speculative development will sustain the demand and supply balance and drive some modest rental growth in the locations that offer what occupiers are looking for, namely low energy costs, labour availability and well connected infrastructure. Higher rental growth rates could be achieved for urban logistics properties, where transport savings are of great value to last-mile logistics companies.

Besides, the pandemic could force companies to reassess their regional supply chains and near-shoring, it could create some new manufacturing hubs, especially in Eastern Europe, boosting further the overall industrial investment volumes.

**OUTLOOK FOR LOGISTICS VERSUS RETAIL**

Our latest Market Sentiment Survey shows that prospects differ between the retail and logistics sectors. The majority of markets do not expect to see any sustained recovery in retail transaction volumes until 2021, when 50% of respondents anticipate volume increases, compared to 13% who still expect decreases and 38% who expect volumes to remain unchanged.

Given the scale of investor demand and low vacancy rates, the prospects for logistics are the most positive, with 79% expecting an increase in transaction volumes in the second half of 2020. This is a trend expected to be sustained into 2021 and 2022. Logistics capital values are anticipated to increase accordingly, with 47% of markets predicting increases from H2 2020.

**Omni-channel investment allocation** the share of logistics expected to rise

![Graph showing Omni-channel investment allocation]

20% has become the new normal portfolio investment allocation target in logistics

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