European Commercial – December 2020

SPOTLIGHT
Savills Research

# European Logistics Outlook 2021

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• Occupational Demand • Investment Outlook • COVID-19

# Surging online retail sales

**Economic overview**

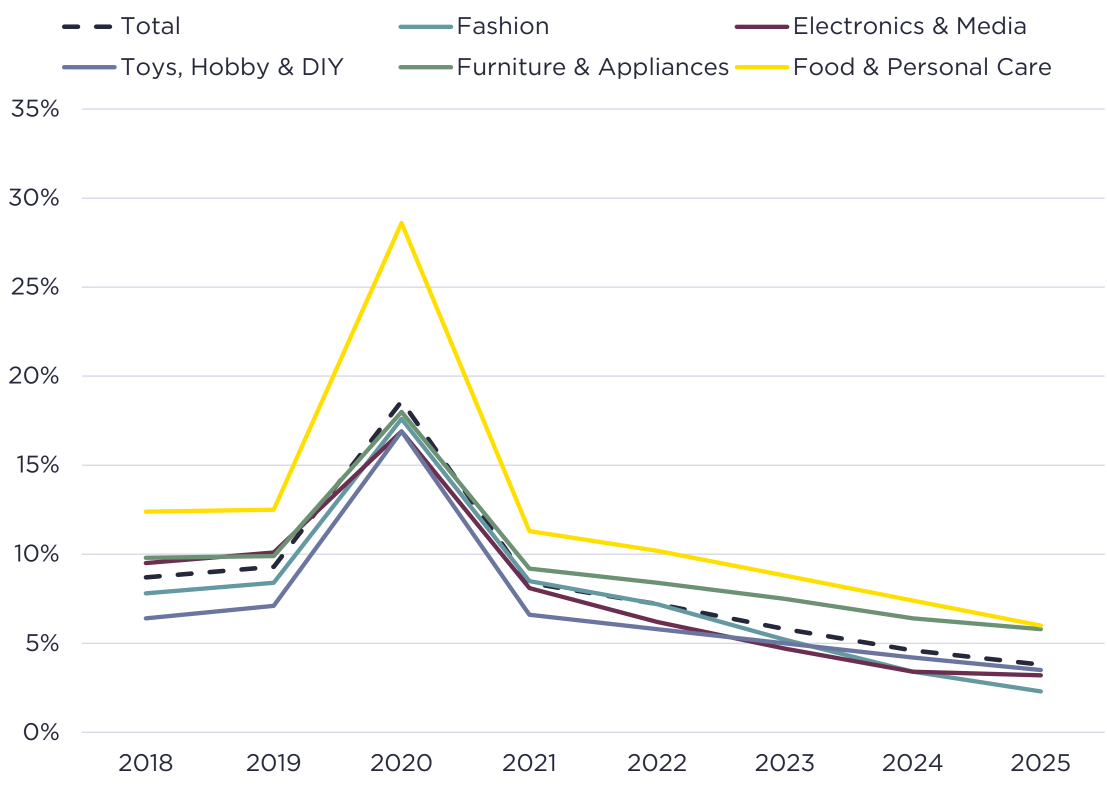
Eurozone industrial production fell during September, latest data shows, and remains 5.8% below the level in February 2020. However, this was due to a fall in Italy, whereas production in Germany, Spain and France all rose. Production however may shine through as one of the more resilient sectors given that the latest lockdown measures will not impact the industry to the same extent as retail and leisure. President-elect, Joe Biden's recent US election win may provide an additional boost to European export markets with seemingly more outward looking trade policy.

Eurozone consumer confidence again dropped in November from -15.5 to -17.6 and well below the long term average of 9.7 as a result of reinstated lockdowns and gloomier sentiment over the economic outlook, hindering planned retail expenditure. Despite the extension of a number of Europe's furlough programmes and increased Eurozone household savings ratios during Q2 2020 to 25% of income, the potential for a consumer bounce-back appears limited. The retail sales rebound has been supported to some extent by online activity, as consumer footfall still remains markedly down on pre-Covid levels.

Online retail penetration generally peaked during the April 2020 lockdown in Europe, although with the usual Black Friday, Singles Day and pre-Christmas boom in online sales, online penetration could compare with levels seen during the first wave. Adopting the Centre for Retail Research's forecasts, the Covid impact is anticipated to speed the ecommerce shift by circa 12 months, albeit, the downside of a second wave is likely to amplify the effect. Of course however, it is the quantum of online retail sales rather than just the proportion, which will buoy the logistics occupier markets. Absolute online retail sales could decrease if overall consumer spending drops significantly.

Although more timely analysis from Statista's Ecommerce Outlook report indicates online retail sales growth to continue into next year, taking Germany as an example (Chart 1). The speed of consumer behavioural change will largely be influenced by government policy and distribution of a vaccine, from which more evidence will arise early next year.

**Chart 1: Germany online retail sales growth by sector**




**Source**: Savills, Statista

# 2020 take up on course for a record year

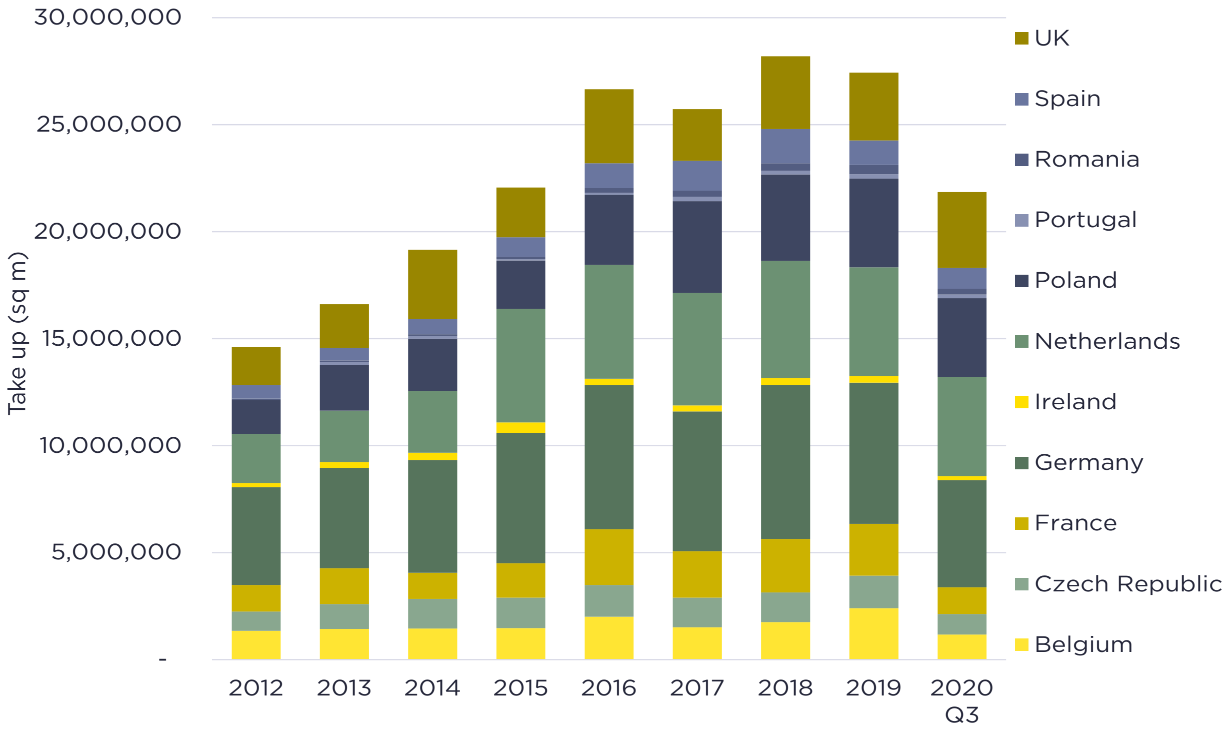
**Occupational markets**

Logistics take up has remained resilient for the first three quarters of 2020, reaching 21.8m sq m, rising 10% above the equivalent level for this stage last year (Chart 2). The Netherlands (4.6 sq m, +56% yoy), Poland (3.7m sq m, +33% yoy) and the UK (3.5m sq m, +46% yoy) accounted for the majority of the overall increase. It should be noted that 2020 already marks a record year of take up for the UK, exceeding the 3.5m sq m of take up achieved in 2016. Germany (5.1m sq m, +1% yoy) has remained the dominant market this year.

Logistics demand in Iberia grew markedly on the previous year, as Spain (+7% yoy) and Portugal (+35% yoy) recorded resilient annualised growth, given rising ecommerce penetration rates. A comparable story towards Europe's eastern extremity, where Romania's 270,000 sq m (+23% yoy) logistics demand recorded an annualised increase.

The final quarter has traditionally provided a boost in leasing volumes as the year draws to a close. We anticipate Czech Republic (958,000 sq m, -13% yoy), Ireland (188,000 sq m, -12% yoy), France (-31% yoy) and Belgium (1,168,000 sq m, -35% yoy) will end the year around their 2019 levels which could push Europe into a record year of logistics take up in what have been extraordinary circumstances. We anticipate that 2021 will follow suit in many respects as retailers have more time to fully consider their omni-channel strategies.

**Chart 2: European logistics take up**




**Source:** Savills

# Vacancy rates hold steady at 5.3%

Europe's average logistics vacancy rate held steady at 5.3% in the third quarter of 2020, with a number of markets now extremely undersupplied (Chart 3). Minor increases in Poland and Madrid were recorded due to the delivery of new speculative space. In the UK, Savills have observed a 12% equilibrium vacancy rate for stable rents, so should any second hand space from distressed retailers return to the market in 2021, this should not stunt the positive rental trajectory projected pre-Covid.

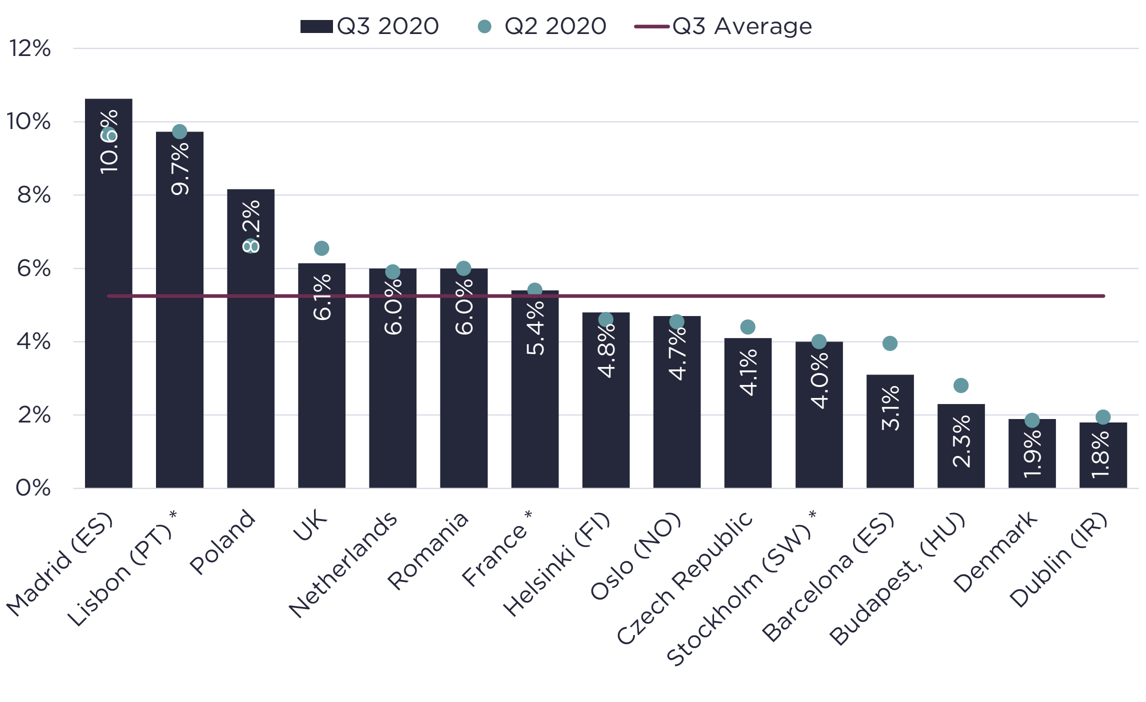
**Prime Rents**

Prime headline rents have remained fairly stable during the six month period Q1-Q3 2020, with only Central Poland (+5%), Warsaw City (+5%) and Dublin (2.3%) markets observing an increase in prime rents, which is not entirely to be unexpected during the pandemic.

In fact, alleviated fears of secondary space returning to the market from the pandemic has applied upward pressure on secondary rents. Dublin's secondary rents rose 8% over the past six months, while Budapest's secondary rents grew by 7%.

As a result of the undersupply, we anticipate rental growth to resume across the core mainland European markets from 2021, given the structural undersupply of prime last mile facilities compared to the UK.

**Chart 3: European logistics vacancy rate**




**Source:** Savills, *=indicative vacancy rate

# Development pipelines appear restricted and mainly prelet

Increased developer caution since Q1 2020 has led to pipeline completion dates being extended into 2021. However, based on chronic shortages of supply, developers are generally still keen to push the button on new schemes (Chart 4).

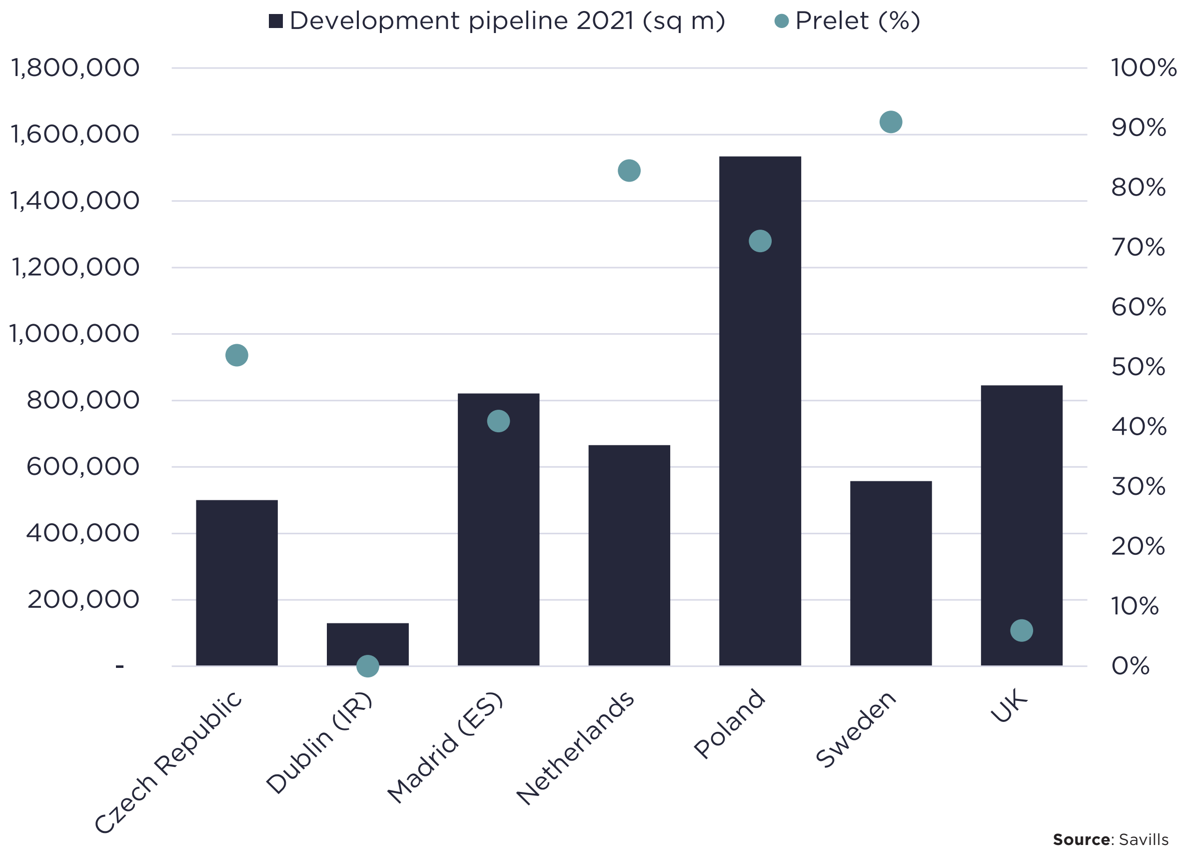
In Dublin for example, 130,000 sq m of new stock will be brought to the market speculatively of which half is currently under construction. Of all the new schemes planned pre Covid, all are still expected to go ahead. One obstacle for developers is that banks remain cautious on lending to spec schemes, so developments are equity driven. In the UK, there is currently 845,000 sq m under construction speculatively, of which 6% has been let before practical completion.

Northern Europe remains among the most constricted markets within Europe. 91% of Sweden's 557,000 sq m pipeline is already pre-let for next year, whilst only 161,000 sq m of new space is expected to complete in Helsinki next year. With most of the Nordic markets ecommerce penetration hovering around the 10.7% tipping point (where we observed a marked increase in logistics demand in the UK), we expect occupier options to remain limited.

Despite 1.5m sq m of space under construction at end Q3 2020 in Poland, 71% of this is already pre-let which should allay developer concerns, and remains below the five year average level of 1.9m sq m of development completions. The majority of the pipeline development will complete in Warsaw and Central Poland, although Upper Silesia has recorded strong development completions so far during 2020. A similar picture is evident in the more land-constrained Czech Republic- of 500,000 sq m anticipated for delivery next year, 52% is pre-let. The 200,000 sq m of space under construction in Romania is likely to maintain vacancy rates around the current level of 6%. One problem for CEE development may arise from a shortage of bank lending to spec schemes in 2021.

821,000 sq m of space is on course to complete in Madrid next year, of which 41% is pre-let. Although with 654,000 sq m already signed for in the market this year, leasing momentum remains strong. Barcelona's vacancy rate is likely to remain around the 3% level, with 61% of the 281,000 sq m forecast 2021 completions already pre-let.

**Chart 4: European logistics development pipeline 2021**




**Source**: Savills

# Unwavering investor demand for core into 2021

**Investment transactions**

European logistics investment transactions reached €22bn during the first three quarters of 2020, fractionally below the level recorded at the same time last year, although we anticipate to end 2020 in line with the five year annual average of €29bn (Chart 5).

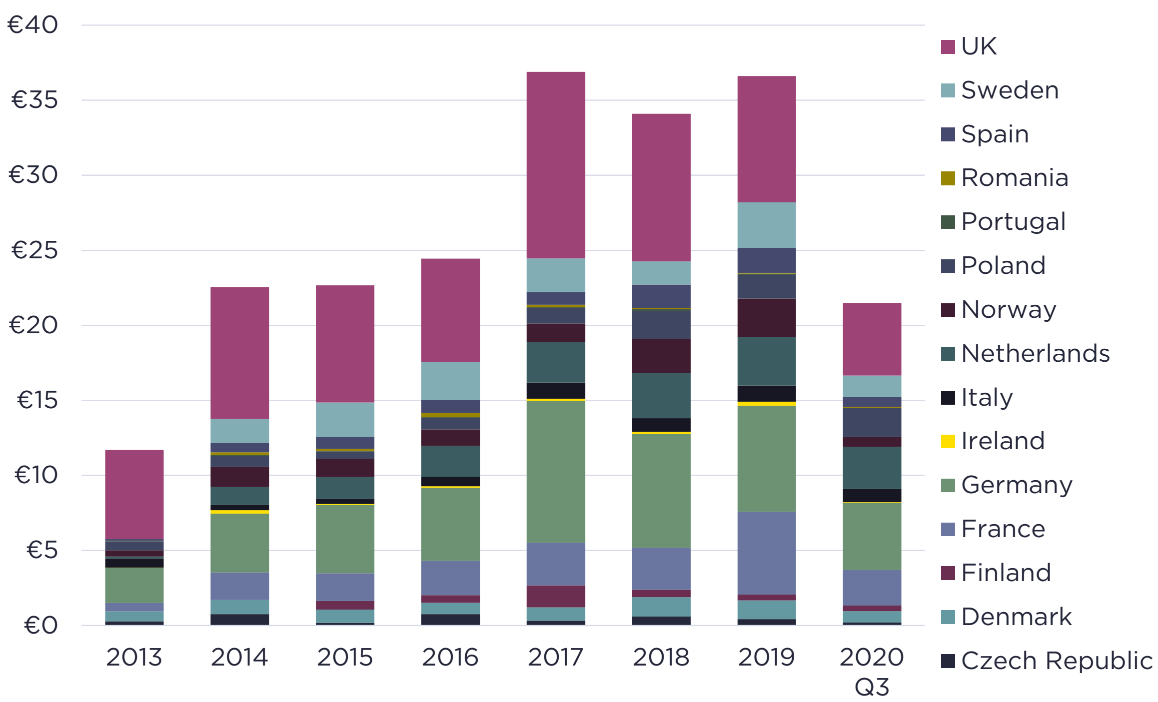
2020 has been a remarkable year for the Polish industrial investment market, with investment volumes 368% above the five year average for the respective period, as investors look further east for more attractive yields. France has recorded YTD transaction levels 25% above the five year average, although the UK has had a relatively quiet year, with volumes down by 26%, as Germany marked a modest 3% decline. The impact of the increased stamp duty at end 2020 in Netherlands has ensured a steady flow of deals this year, up by 59% over the same period, and we anticipate this to continue into the final quarter.

European logistics continues to shine through amid times of adversity, where we have observed average prime yield compression over the last six months of 7 bps to 4.84%. Compression was observed within the Czech Republic (-25 bps to 4.25%), Germany (-20 bps to 3.5%), Norway (-30 bps to 4.25%), the Netherlands (-15 bps to 4.10%) and Spain (-30 bps to 4.85%). Finland prime logistics moved out 10 bps, in line with the trend observed in the offices sector. Denmark (5.00%), France (4.25%), Ireland (4.75%), Italy (4.75%), Poland (5.00%), Portugal (6.25%), Romania (8.00%), Sweden (4.50%) and UK (4.00%) all remained stable.

We have since observed prime logistics yields in the UK compress to 3.75% in October, sharper than London City offices for the first time. Prime yields continue to fall and we have seen examples of 50-100 bps compression in core western European markets since March 2020. For core mainland European markets, we anticipate the spread between prime office and industrial yields to fall closer to zero in 2021.

In several instances, 2020 has

**Chart 5: European logistics investment €bn**




**Source:** Savills

driven investors to double up on their target portfolio allocations to logistics to circa 30-35%. We anticipate this could drive prime yields below 3% for ultra-core markets let to ecommerce operators on long leases in 2021, when you consider the lowest cost of capital showing interest and actively acquiring in the sector. Deals which are re-setting prime yields and achieving sub 4% are generally let to online retailers on single-storey premises, where covenant strength is becoming the main differentiator for pricing.

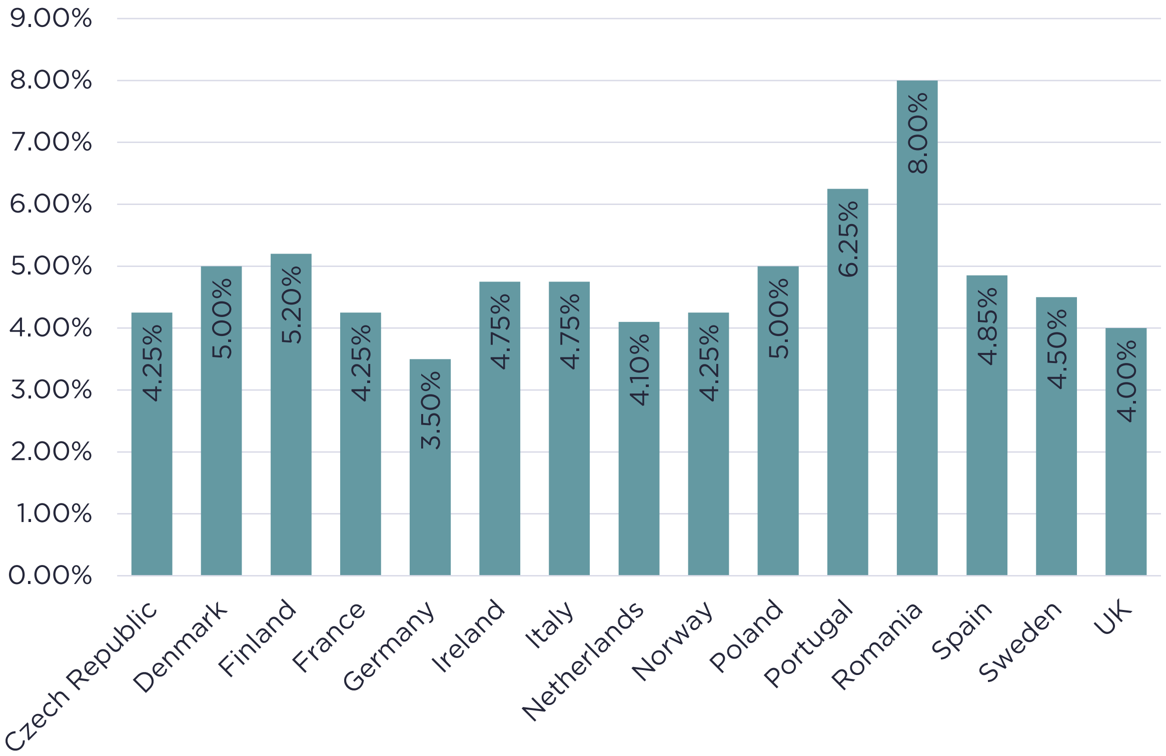
Signs of a polarisation in pricing for ecommerce led covenants vs automotive/ other manufacturing are becoming apparent. Online grocery sales growth is piquing investor demand for logistics facilities let to supermarkets across most of western Europe, particularly given the strong covenant and long lease terms.

As investors seek to deploy capital by year end, Savills have seen scores of interested parties reviewing opportunities for some portfolios, with portfolio premiums achieved of between 5-10% and these are increasing. Debt terms remain favourable for the logistics sector, albeit there is less depth to the market than pre Covid.

More frequently, international developers are looking to build to hold, which would arise as a threat to investment volumes next year. For developer holders who are willing to test the market, bidding will remain competitive.

However, the recent announcement of a vaccine may help to temper some of the pent up investor demand for prime logistics facilities across Europe. We have observed an initial some drop off in some of the logistics REITs as a result of the news (although many have since rebounded), and conversely a surge in investor demand for listed retail and office investment vehicles. As offices has traditionally accounted for 40% of total commercial volumes and logistics 10-15%, we expect to see some capital reallocation into 2021.

**Chart 6: European logistics prime yields, Q3 2020**




**Source:** Savills

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## Investment and Agency

**Marcus De Minckwitz**
Regional Investment Advisory
+44 (0) 207 409 8755
MdeMinckwitz@savills.com

**Will Percival**
Regional Investment Advisory
+44 (0) 207 330 8628
will.percival@savills.com

## Research

**Mike Barnes**
European Commercial
+44 (0) 207 075 2864
mike.barnes@savills.com


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