European Commercial – February 2022

SPOTLIGHT

*Savills Research*

# European Logistics Outlook

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● Occupational ● Investment ● Outlook

# E-commerce boosted by pandemic

A rise in new Covid infections dampened the economic recovery during the final quarter of 2021, however, the euro area economy grew by 5.1% for the full year 2021, up from -6.5% during 2020. Southern Europe continues to lag behind the European recovery, although most economies are expected to have registered positive real GDP growth relative to pre-pandemic levels by end 2022. The latest Eurozone Manufacturing PMIs reached 58.7 in January 2022, indicating continued expansion in the manufacturing sector, with production, new orders and employment all registering increases.

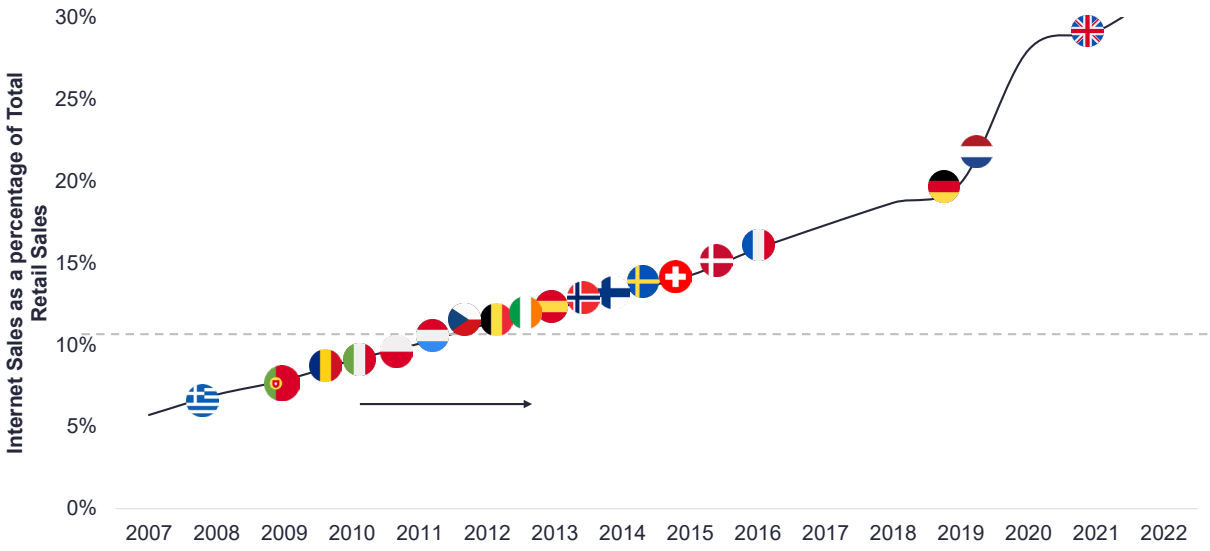
Employer hiring intentions remain 13% above the long-term average, as indicated by the European Commission's Employment Expectations Indicator (EEI), although this has fallen for two consecutive months. This has become particularly pertinent for the logistics sector with shortages of HGV drivers, pushing overall euro area job vacancy rates to 2.6%, the highest level on record.

Inflation increased to a record high of 5.1% in the eurozone according to the January 2022 data. Economists expect headline inflation to ease off as energy prices stabilise later in 2022 averaging 4.5% and falling back to 2.5% in 2023, as core inflation remains around the 2-2.5% mark. Savills Programme and Cost Sentiment (SPECS) report indicates there has been little in the way of news that would point to a let-up in the pressures currently being faced by the construction sector. As inflation remains fairly supply-driven, economists anticipate the deposit rate will not necessarily have to move above zero, and not to the same extent as is expected for the Federal Reserve or Bank of England.

Following the Bank of England's base rate increase, Capital Economics now forecast the ECB to raise interest rates by 50 bps this year and 50 bps next year. Since the ECB's February press conference, Italian bond yields have risen by 20 bps, whilst German bond yields have risen to their highest level since end 2018. Speculation of an interest rate rise has subsequently increased EURUSD from $1.11 to $1.14, which is likely to impact the level of non-European capital targeting European logistics this year.

In the UK, online retail sales as a % of total retail sales rose from 28% to 29% between 2020 and 2021, despite the expectation that the removal of lockdowns could see e-commerce spend fall. Although there is often a lag in the mainland European data, we expect average Western European e-commerce penetration to be hovering around 15-18%.

**Chart 1: European online retail penetration rate by country, 2021 (%)**




**Source**: Forrester

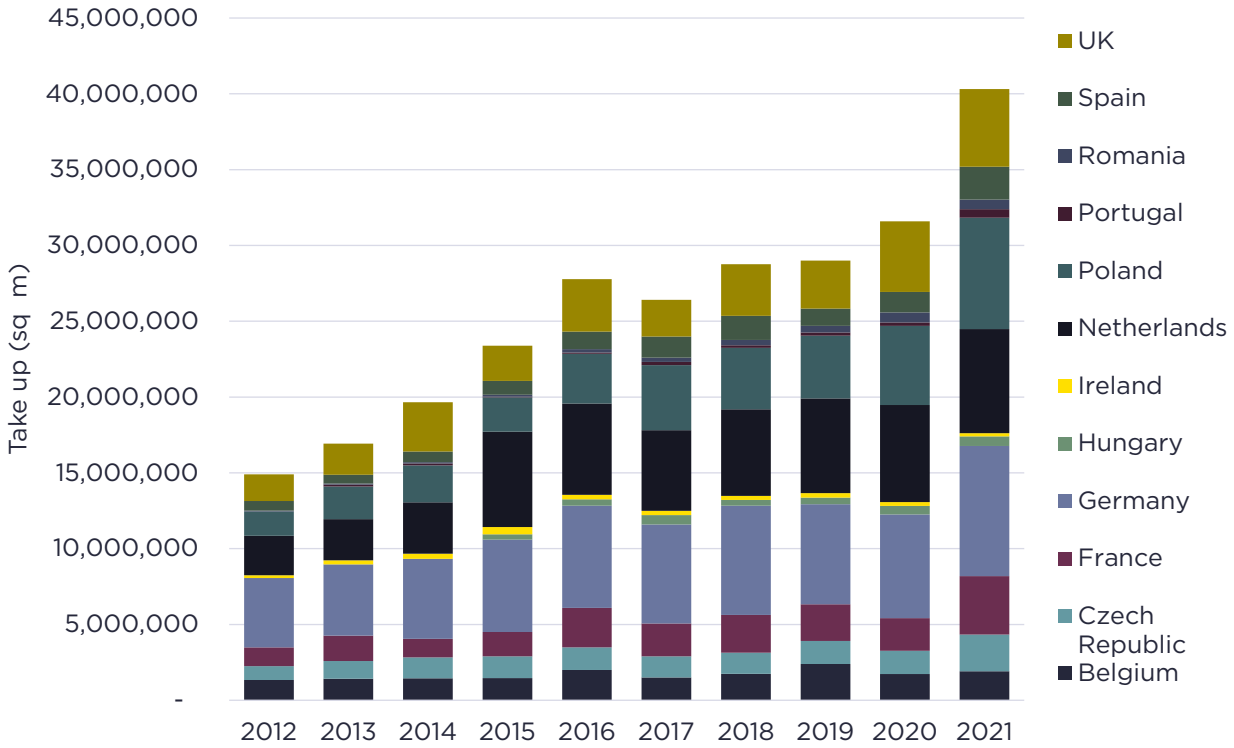
# Record logistics take-up in 2021

A flurry of end Q4 deals revised final European logistics take-up to reach 40m sq m in 2021, marking a record year of leasing activity and 40% ahead of the previous five-year average. Germany (8.6m sq m), the Netherlands (6.9m sq m), the UK (5.1m sq m) and Poland (7.3m sq m) drove leasing activity, whilst Romania (+63%), France (+63%) and Spain (+62%) performed the strongest against their five-year averages.

Savills European Logistics Census 2021 indicated that the biggest change occupiers anticipate as a result of the pandemic is the shortening, or reshoring, of supply chains, which has helped to drive demand to record levels in Poland. Likewise, Brexit-induced delays have been amplified due to increasingly stringent border checks and customs declarations, requiring more time for mainland European companies to adjust to new arrangements.

Companies are seeking to hold more inventory to mitigate risk, increasing demand for space. Astonishingly, 46% of European occupiers anticipate that they will increase their warehouse floor-space over the next 12 months, among the highest in the online retail sector.

**Chart 2: European logistics take-up (sq m)**



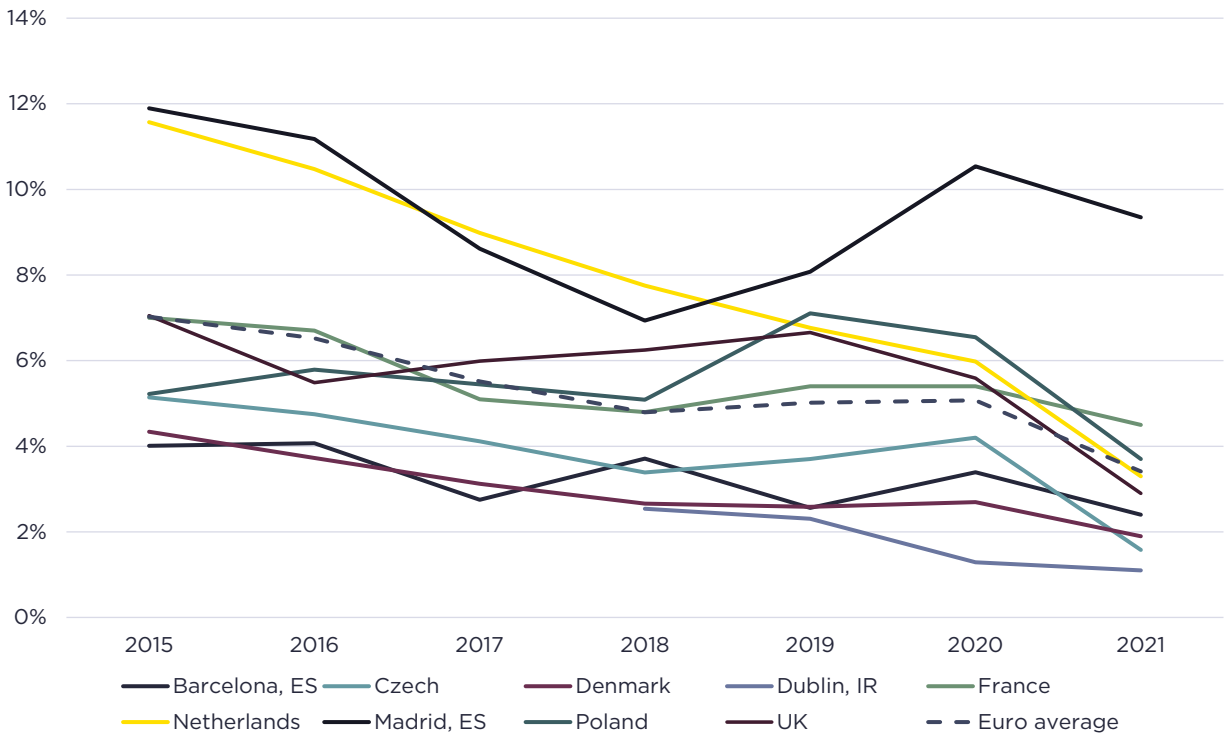

**Source:** Savills

One of the main issues will be the availability of space, however. European logistics vacancy rates fell from 5.1% to 3.5% over the course of 2021, marking a record average low as Dublin (1.1%), the Netherlands (3.3%), the UK (2.9%), the Czech Republic (1.7%) and Denmark (1.9%) remain among the most undersupplied markets.

We have observed strong levels of deliveries of new stock across the European markets in 2021, with Dutch logistics stock increasing by 10%, Madrid by +9%, the UK by +6% and Poland by +13% (latest data to Q3 2021). In Poland, approximately 3.7m sq m of new development is in the pipeline, although 56% of this is already pre-let, whilst in Madrid, approximately 1.2m sq m of new development is scheduled for delivery in 2022.

A shortage of prime stock has ultimately applied upwards pressure on prime rents, rising by 5% YoY. London (+25%), Dublin (+17%) and Prague (+12%) were among the fastest- growing markets as we are seeing lease incentives withdrawn and landlords even seeking to avoid signing long-term, index-linked leases in the expectation that market forces will lift rents above already unprecedented levels of inflation.

**Chart 3: European logistics vacancy rates (%)**




**Source:** Savills

# Yields continue to harden

European logistics investment reached a record €62bn in 2021, a 79% increase on the five-year average. The UK (€19.5bn) boosted volumes, marking a record year, accounting for 31% of activity, whilst Germany (€8.6bn), France (€6.5bn) and Sweden (€5.8bn) and the Netherlands (€5.7bn) also recorded strong levels of activity. Logistics accounted for 66% of European omnichannel investment in 2021, up from 47% in 2019, as investors were willing to pay premiums to gain exposure to the sector and are now becoming less sensitive to location. According to RCA, logistics sale and leaseback transactions have risen by 115% against the five-year average as occupiers seek to free up capital, including ASDA (UK), FIEGE Logistics (Germany) and Auchan (France).

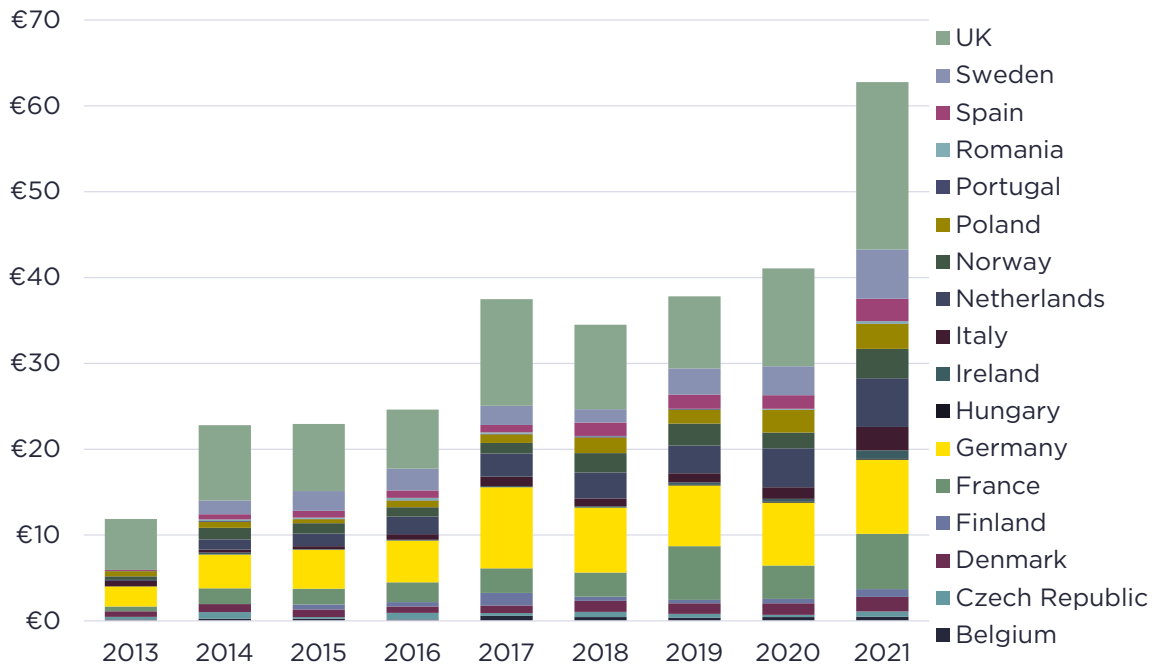
The weight of capital targeting European logistics has compressed average prime yields by 27 bps to 4.20% over the last six months. Portugal, Spain and Finland hardened by 50 bps each, whilst Belgium, the Czech Republic, the Netherlands, France, Ireland, Italy and Sweden all moved in 25 bps. The UK and Romania were the only markets to remain stable.

Value add investors are now turning their attention to secondary assets in order to ride the yield wave. Average secondary yields hardened by 34 bps over the past six months, with Germany and Ireland compressing by 89 bps and 75 bps, respectively.

Despite rising development costs, the yield spread between new development and existing stock continues to close, below 100 bps in some instances. Land prices continue to rise in major urban areas too, adding upwards pressure on capital values.

Capital allocations towards the logistics sector remain strong, and despite rising construction costs, we anticipate speculative development in the sector will rise during 2022/23

**Chart 4: European logistics investment volumes (€bn)**



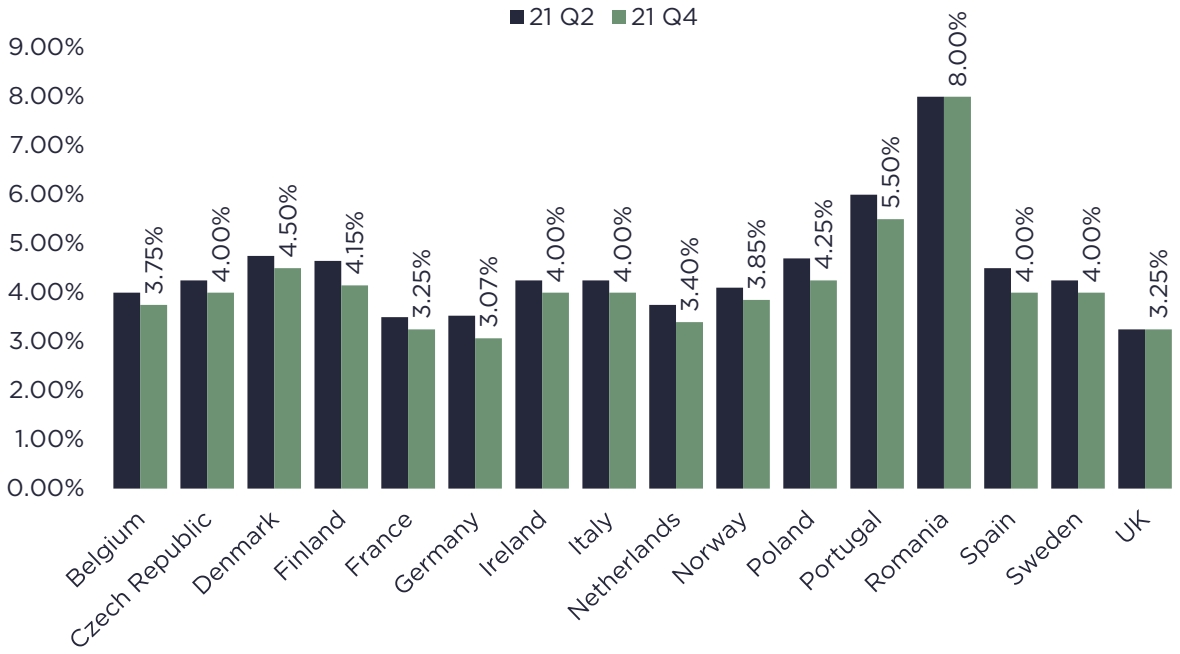

**Source:** Savills

as investors move up the risk curve in search of higher returns. PERE's 2022 capital raising survey indicates that logistics remains one of the sectors with the highest capital allocations, although this marked a proportional fall on 2021, as some investors become cautious of ultra-core logistics locations trading around the 3% mark.

Some landlords may seek to crystallise their annualised double-digit capital growth over the past three years, with some stock returning to the market in 2022/23. Given the vast new levels of warehouse delivery, obsolescence remains a concern for landlords, particularly for build to suit units.

Landlords are now increasingly in search of future-proofed assets, with solar panels to generate new energy, although this may raise challenges for older units with lower weight-bearing capacities. This being said, we anticipate there is still further room for yields to move in for the best stock, particularly in non-core locations this year.

**Chart 5: European prime logistics yields (%)**




**Source:** Savills

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## Investment and Agency

**Marcus De Minckwitz**
Head of EMEA Industrial and Logistics
+44 (0) 207 409 8755
MdeMinckwitz@savills.com

## Research

**Kevin Mofid**
Head of European Logistics Research
+44 (0) 207 499 8644
kmofid@savills.com

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