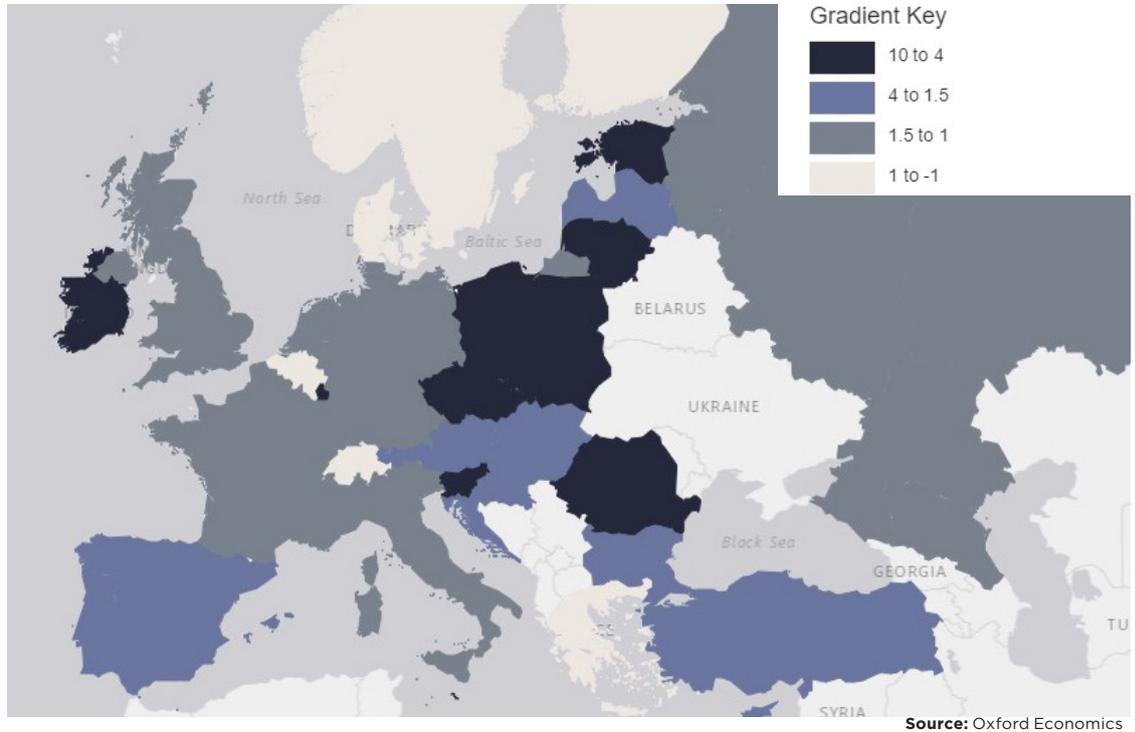


European Logistics



🗨️ The Euro Area household savings ratio has exceeded 12%, the highest level since 2014. European consumers are still putting enough aside in case of an economic slowdown, nearly three times the proportion saved in the UK. 🗨️

Map 1: Transportation and Storage- GVA Growth % pa- next five years



Resilient economic backdrop drives logistics output growth

Economic Overview

Retail sales increased by 2.8% for the year to June 2019 as consumer spending remains resilient across the European Union. The Euro Area household savings ratio has exceeded 12%, the highest level since 2014, which suggests European consumers are still putting enough aside in case of an economic slowdown, nearly three times the proportion saved in the UK.

Despite fears over the slowing manufacturing sector dragging on growth, Focus Economics forecast Euro Area GDP to increase by a modest 1.1% during 2019, set to increase to 1.3% in 2020. Growth of 0.2% was recorded in the second quarter, after a healthy expansion at the start of the year. The latest data continues to point to a two-speed economy, with lingering weakness in the manufacturing sector contrasting

relatively robust services sector activity, though a continued fall in unemployment should provide some relief.

The latest business surveys such as the Manufacturing PMI indicate that the industrial recession in the Eurozone will continue for some time to come—the index recorded its worst quarter since Q1 2013, and a downturn in industry confidence caused economic sentiment to fall to a near three-year low in June. Eurozone industrial output fell by 1.6% mom in June, lower than market expectations, which was driven by decline in output of capital goods, which fell by 4% mom. Overall, analysts see industrial production expanding 0.1% in 2019, which is down 0.2 percentage points from last month's forecast.

Taking a longer term view,

Central and Eastern Europe is forecast to see the strongest economic growth in the transportation and storage sector over the next five years, with Romania (+9.7% pa), Slovenia (+5.6% pa) and Poland (+5.5% pa) leading the charge, according to Oxford Economics. Likewise, strong private consumption growth in Ireland will support economic growth over this period. Strong online retail sales growth from a relatively low base will see Portugal and Spain outperform, though Western Europe's stuttering economy, with sector growth generally between 1-1.5% per annum over the next five years. Indeed, the Nordics are on course for more modest growth from this sector over the forecast period, but with ecommerce currently hovering around 10% of total retail sales, we expect this could create higher levels of demand for logistics space.

Logistics Viability



- Labour
- Incentives
- Freight
- Energy
- Real Estate



Only 0.75% of total costs are logistics real estate occupancy costs.



Euro area consumers save 12.6% of their income, almost three times the UK average.



EU unemployment rate currently stands at 6.3%.

Logistics viability and the importance of Real Estate within the Supply Chain

Approximately only 10% of total operational costs are accounted for by supply chain costs, and only 0.75% of total operational costs are logistics real estate occupancy, industry standard metrics indicate. In general therefore, occupancy costs have less of an impact on margin compared to say, rising labour costs. The viability of a location for logistics purposes therefore is greatly dependant on several key factors other than direct occupancy costs. As an example, a 20% logistics rental growth increase would translate into only a 0.15% increase in total supply chain costs.

Savills adopt the LIFER acronym as an insight into these other key factors for logistics operators. **Labour** generally acts as the main warehousing overhead and choosing regions with a wide labour pool at affordable rates with accommodating national labour laws is essential for occupiers, particularly e-tailers such as Amazon. **Incentives** that are often awarded to encourage these large employers, either by government

or developers, enterprise zones and economic zones can all help determine a business's decision to choose a location. **Transport / Freight** is the single largest supply chain cost and is therefore critical to any logistics business decision on their real estate strategy.

Increasing in its importance to overall viability is the availability, proximity and the cost of **energy** and this will be an increasing factor in real estate decision making. Finally the **real estate** and speed at which it can be made available to occupiers are also key considerations. Land supply, planning laws, construction lead-in times amongst other points all come into this.

Employment and labour flows

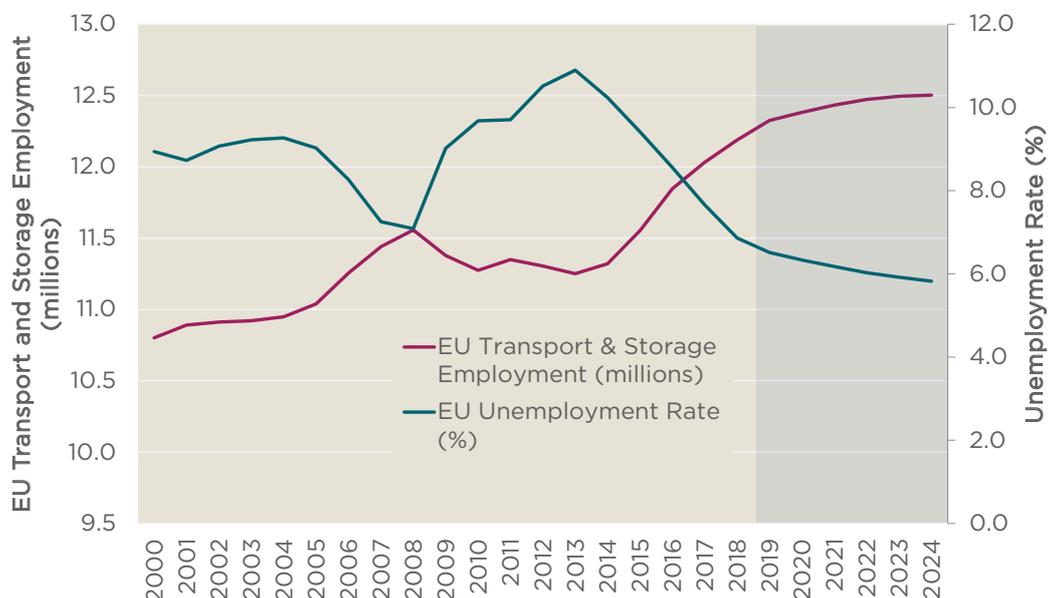
The growth of online retail has helped to generate European transport and storage employment growth of 9% over the past five years, creating over one million jobs, which is 1.5 times the all sector average. The EU unemployment rate currently stands at 6.3%, the lowest level since the survey started in 2000 and this is expected to fall further to below 6% by 2023, as the

European economy reaches full capacity, according to forecasts from Oxford Economics (Chart 1).

Two of the issues arising for logistics occupiers are the falling availability of labour and rising minimum wages across Europe. With European minimum wages rising faster than average earnings, this will add pressure to warehouse operators across Europe. However, this is being supplemented to some extent by westward migration from Eastern Europe. Around 1.3 million Ukrainians received temporary work registrations in Poland during 2016, following the economic slump in Ukraine during 2014-15. Westwards migration has been largely driven by slower growth in Ukraine and higher monthly minimum wages in Poland (€523 pcm vs €142 pcm in Ukraine).

Uncertainty over labour mobility will continue as the Brexit process is prolonged by a further six months, which may delay delivery times for new-build logistics stock. However, we do not expect rising wages and labour shortages to have any major impact on the structural growth of the ecommerce supply chain.

Chart 1: EU Transport & Storage Employment



Source Oxford Economics, Savills Research

Ecommerce Growth across Europe

Online retail accounted for 18% of total retail sales in the UK last year according to the ONS, the highest year on record, and more than any other European country. Forrester's forecasts indicate that ecommerce will account for 25% of total retail sales in the UK by 2023 (Chart 2) although some analysts forecast that even stronger growth is on its way. In Western Europe, 10.2% of retail sales are online, whilst 5.0% is bought online in Eastern Europe.

In the UK, Savills have identified a tipping point of 10.7% of total online retail sales which creates a rapid growth in occupational demand for warehouse space. Last year, UK industrial take up related in some way to retail accounted for 53% of total demand, as the lines between physical and digital retail become increasingly blurred. We expect several countries including Netherlands, Germany and France to follow a similar trajectory in take up volumes, as their online penetration rate hovers around this vital tipping point.

With only around 5% of total retail sales currently made online in Spain and Italy, these two markets are forecast to see the strongest online retail sales growth of all Western European markets over the next five years at 17% per annum and 21% per annum respectively. Likewise, Central and Eastern Europe will witness average growth of 17.5% per annum, with Romania, Russia and Hungary performing the strongest.

Europe approaches ecommerce tipping point

Logistics Market Attractiveness Index

To establish where in Europe the ecommerce revolution is likely to have the biggest shift in logistics, Savills has formed a Logistics Market Attractiveness Index. The index measures 32 European countries against 23 metrics, which assess the strengths of ecommerce and identifies the best opportunities for expanding logistics activities.

This research covers 32 European countries including Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Norway, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey and the UK.

The analysis used to develop the Logistics Attractiveness Index draws on 23 different indicators gathered into two matrices: Ecommerce fundamentals and Logistics viability. We also added a Neighbouring countries element in our final ranking, with each country impacted by the score of its neighbouring countries, to reflect the importance of cross border online sales. The data used for the index was collected at a national level. Where possible these indicators use the latest annual data available and five-year forecasts, to ensure the index incorporates a forward-looking view.

The various indicators have been ranked and weighted across the 32 countries included in this

report allowing us to develop the index. The results of the index does not determine the exclusive attractiveness of a given country to prospective logistics market players, it purely provides a macro guide for retailers and logistics market players to incorporate as part of their specific omnichannel strategy.

The final results show that Germany, France, the UK, the Netherlands and Ireland top the index, all combining strong ecommerce fundamentals, solid logistics viability and high-scoring neighbouring countries (Maps 2 and 3). *Lydia Brissy*

The rise of omnichannel retail

An increase in online spending creates more demand for warehouse space. Given the rise of ecommerce and forecasted growth rates across Europe it is therefore no surprise that we are experiencing unprecedented levels of demand from investors for the sector. It has to be said though that, for the most part, this is in anticipation of what is to come. Of course we have the case studies of the UK and the US where we have seen over five years of rental growth and outperformance, even last year Industrial returns outperformed total property returns in the US by 660bps, and so the outlook is overwhelmingly positive.

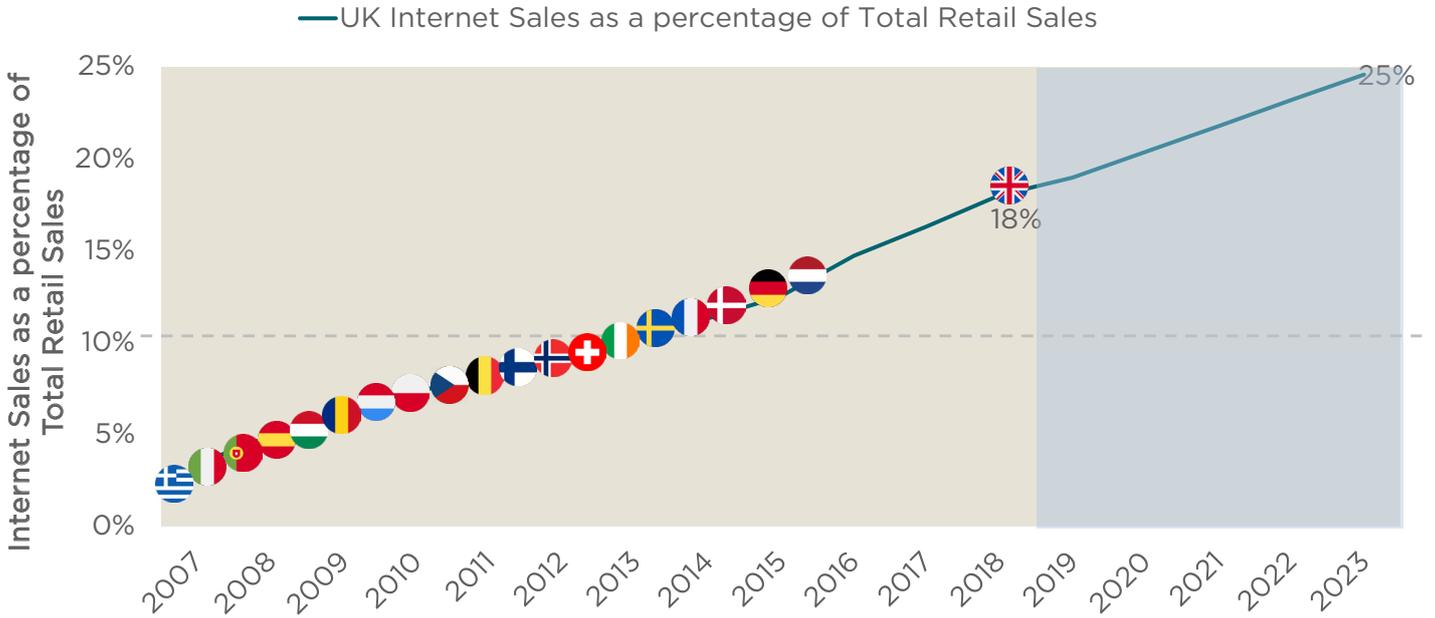
However, there is a level of unpredictability as to how this growth will manifest itself across Europe. What will be the rate of growth, which sub-markets will benefit the most, which may not see any benefit? With the average yield for European

Logistics coming in another 70bps through last year, a lot of this growth is being priced in already so investors need to be very confident that it will come in order to get comfortable with the entry pricing.

There will therefore be continued focus on urban locations, on areas with good transport links, where there is cheap and available labour and, increasingly, reliable and high levels of energy supply. At a country level, there will be a focus on high GDP growth, consumer spending habits, technological advancement. At a real estate level then, the key metric to monitor is vacancy rates. These are very low across Europe when you consider the levels of demand we anticipate from the growth of ecommerce to come. This will drive rents but we also need more development.

Rental growth in the UK in the logistics sector over the period 2008-2013 when online sales were below 10% was between 20% and 100% across the country. E-commerce picked up significantly after 2013 and last year reached 18% of total retail sales. Strong demand for logistics space over this period, especially the small-medium segment of the market, drove rental growth across the country and we now expect a similar rental growth story across the more advanced European markets. *Marcus De Minckwitz*

Chart 2: Online Retail Sales as a % of total

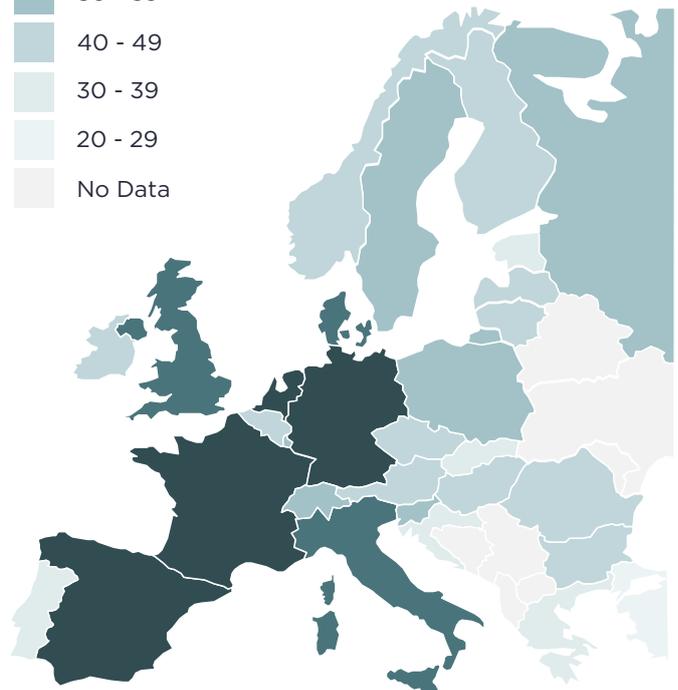
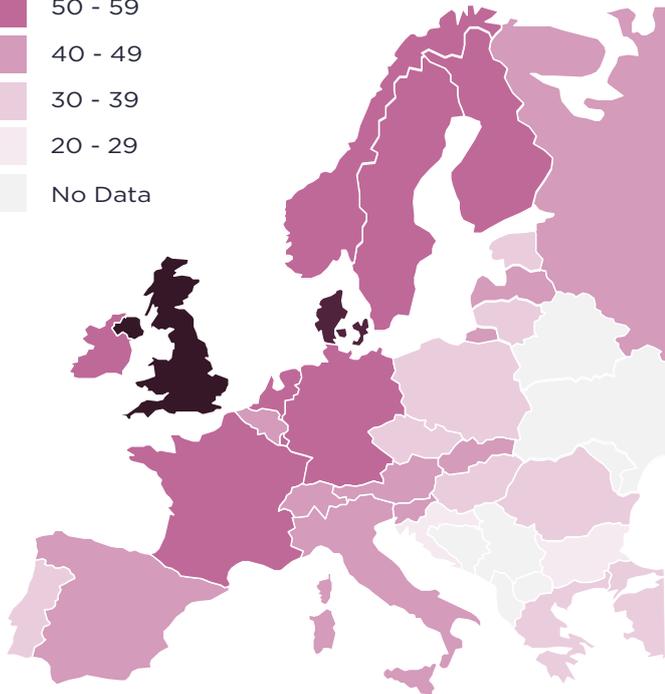
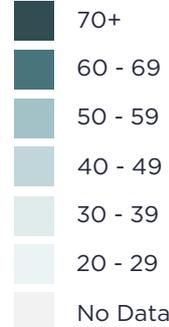


Maps 2 and 3: Savills Logistics Market Attractiveness Index

Ecommerce Fundamentals

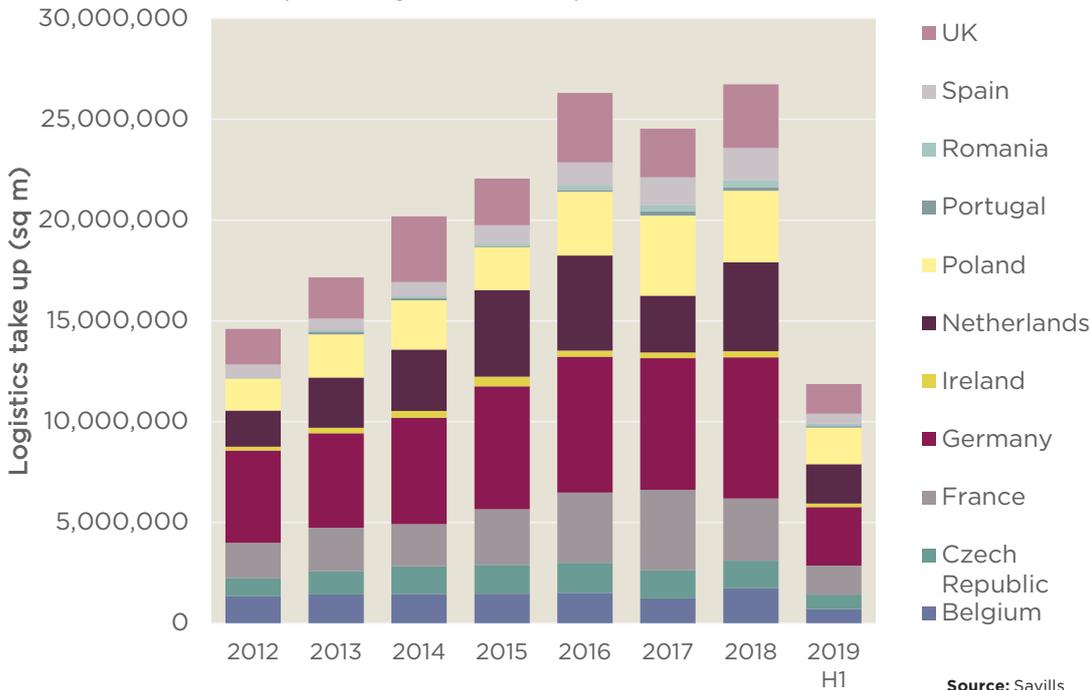


Logistics Viability



Source Oxford Economics, Savills Research

Chart 3: European Logistics Take Up



Source: Savills

Record 2018 logistics take up and resilient H1 2019 deals

Occupational Overview

Logistics take up reached a record 11.9m sq m across the European markets Savills track in H1 2019, in line with the five year H1 average (Chart 3). Germany (2.9m sq m, 25%) contributed the highest proportion of European logistics take up during H1 2019, followed by the Netherlands (2.0m sq m, 16%), Poland (1.8m sq m, 15%), UK (1.5m sq m, 12%) and France (1.4m sq m, 12%).

The key sectors driving demand have generally been from the logistics operators, ecommerce and the manufacturing sector. We expect European logistics take up demand to continue to gather pace, as both third party retailers and ecommerce operators expand their offer.

Vacancy rates continue to fall across Europe, particularly in the core markets. We expect this to add further to rental growth prospects in the short to medium term, as limited new speculative developments are unable to keep up with the growth in demand across the majority of markets.

Czech Republic take up reached 722,000 sq m in the first half of the year, 13% above the H1 five year average. Rents currently remain unchanged at €58 per sq m in Prague and with national vacancy at only 4%, this could apply upward pressure to rents.

In **Romania**, markets remain constrained with the logistics vacancy rate at 5.5% as at H1 2019. Take up mid-year reached 124,000 sq m during H1 2019, around 18% above the five year half year average. Bucharest accounted for around 70% of take up, with prime rents remaining unchanged at €48 per sq m.

In **Poland**, total new logistics developments is forecast to reach 2.5m sq m by the end of 2019. A slowdown in German manufacturing in 2019 is forecast to impact industrial production in Poland, though ecommerce growth and stable private consumption will keep this to only a mild demand for logistics space, with rents remaining steady.

A shortage of available options in **Germany's** top five markets

could see prime rental growth reach around 5% over the next 12 months, due to rising construction prices as developers operate at full capacity. 2018's leasing volumes exceeded 7m sq m, with 2.9m sq m leased during H1 2019.

Logistics take up in the first half of 2019 in the **Netherlands** was limited by the level of available space. The national vacancy rate now stands at only 7.1%, the lowest level since 2010. The growth of 'Agglo-logistics', secondary industrial locations within reach of several large cities, will satisfy increasing demand for shorter delivery times.

Semi industrial and logistics take up in **Belgium** reached a combined 699,000 sq m in H1 2019, largely in line with the long term average. We expect full year logistics volumes to be in line with last year at c.700,000 sq m, but semi-industrial volumes to drop below last year's level of 1m sq m. This is largely due to resilient demand for larger units, but a limited demand for smaller units and a shortage of stock.

France logistics take up reached 445,000 sq m during the first half of

2019, around the five year average level for H1. Ile-de-France accounted for 32% of leasing activity, as rents remain at €52 per sq m, in line with end year 2018.

Spain's strong economic performance continues to boost demand for logistics space. Rents in Madrid (€66 per sq m) and Barcelona (€84 per sq m) have risen by 2% and 4% respectively during the first half of 2019. New speculative development in Madrid has increased vacancy rate to 9.3% in the first half of the year, however, the strongest level of take up in Q1 on record in Barcelona, has pushed vacancy rate below 4%.

Despite ecommerce only accounting for around 5% of total retail sales in **Portugal**, logistics take up reached 69,000 sq m in the first half of the year, 7% above the five year H1 average, with rents rising 11% in this period.

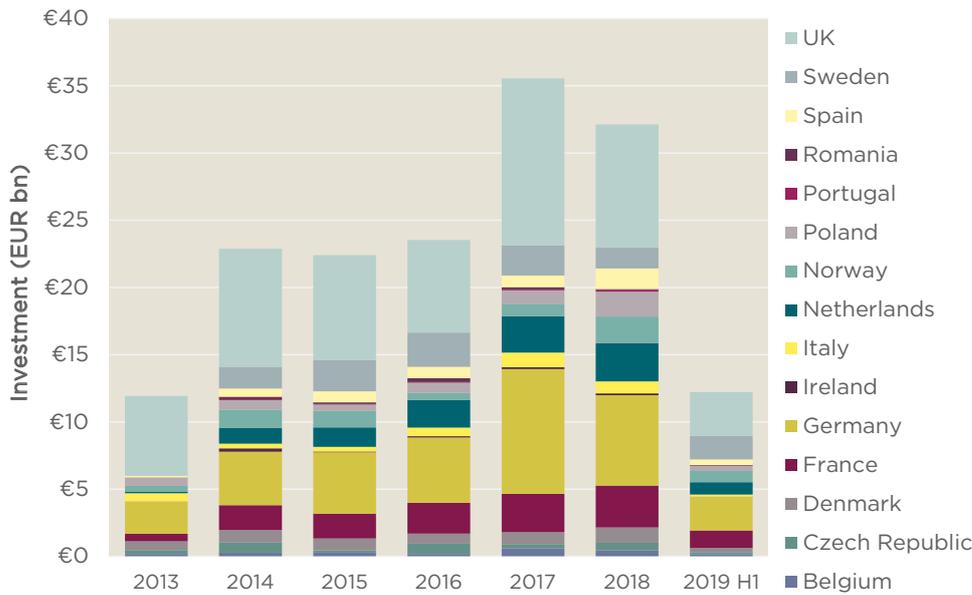
In the **UK**, 2019 has been dominated by talk of Brexit, stockpiling and media attention covering a shortage of warehouse space to assist with these outcomes. However, the growth of the online retail sector drove H1 take up to 1.5m sq m, 28% above the long term average for the first half. Nationwide, vacancy has fallen to only 6.6% and which has increased prime rents by 12% in the first half of 2019 in the London Heathrow market.

Dublin's H1 2019 take up reached 181,000 sq m, 32% above the five year H1 average following **Ireland's** rising ecommerce sales. Limited development activity in Dublin has resulted in falling vacancy, which now only stands at 3.6% and continues to add upward pressure on rents. Indeed, prime logistics rents have risen 5% to €105 per sq m in Dublin during H1 2019.

New developments in **Sweden** continue at healthy levels, with 600,000 sq m being completed in 2019 slightly short of the record volumes produced in 2018. It is very likely the logistics and industrial sector will experience a record year of investment transactions after an impressive start, which is being fuelled by increasing supply.

Strong investment volumes applies downward pressure on yields

Chart 4: European Logistics Investment (EUR, bn)



Source Savills Research

European logistics investment reached €12.2 billion during H1 2019 (Graph 4), 5% below the previous five year H1 average. The UK (€3.3bn) accounted for 27% of volumes, followed closely by Germany (€2.5bn), Sweden (€1.7bn) and France (€1.3bn) during the first half.

Despite several markets exceeding their five year H1 average investment volumes including Sweden (+91%), Poland (+83%), Czech Republic (+80%) and Norway (+16%), total volumes were held back by weaker performances from the UK (-19%) and Germany (-18%) both saw falls on half year averages.

Strong investment volumes in recent years has resulted in yield compression for the larger markets. Average European prime logistics yields compressed 20bps

from 4.9% to 4.7% during H1 2019, though generally remained steady for the core markets (Graph 5). Further inward yield movement has been witnessed for Prague (-150bps), Stockholm (-30bps) and Madrid (-25 bps) during the first half of the year.

Outlook

Long term borrowing costs remain low, or negative across Europe, with the Germany 10Y bond yield at -0.65% and France 10Y bonds yielding at -0.35%, which will maintain an attractive yield spread for logistics real estate going forward. Investors will be paying close attention to each city's development pipeline which will reflect the relative risk premium between countries. Likewise, the likely prospect of strong rental growth across Europe's most urbanised cities and low Eurozone inflation will be factored into

logistics yields.

Indeed, investors will be eagerly analysing pricing relative to other commercial property sectors. In the UK, for example, prime industrial yields (4.00%) are currently 90bps below the all sector average, whereas 24 months ago, prime yields were 4bps above the all sector average. This is a shift we could see transpiring in the most constrained European markets over the next 18-24 months. Looking forward over the next 12 months, further industrial yield compression is expected across Germany, France, Portugal, Greece, Sweden, Czech Republic and Romania.



€12.2bn of European logistics investment during H1 2019.



By 2023, 25% of total UK retail sales will be made online, with 15% online in Western Europe.



10.7% is the tipping point for online retail sales which creates a rapid growth in demand for logistics space.

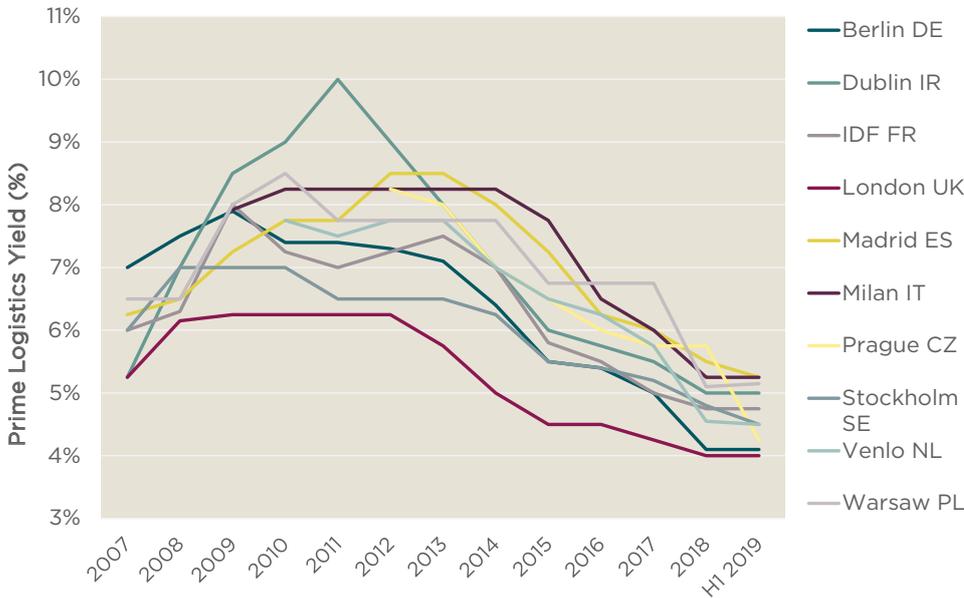


11.9 million sq m of logistics take up in Europe during H1 2019.



Venlo, Netherlands prime logistics yield currently at 4.5%

Chart 5: European Prime Industrial Yields (%)



Source Savills Research

€3.3bn

UK logistics investment in H1 2019



Lessons to be learnt from UK logistics

Whilst the traditional drivers of supply and demand will impact occupier decisions when it comes to acquiring new warehouse space across Europe, “non-property” factors are becoming more and more important. Top of the list is the availability of energy and labour which increasingly go hand in hand.

The key driver for this is that online retailers in particular are becoming more sophisticated in their warehouse fit out by deploying robotics and automation to drive efficiencies. Increased robotics increases the productivity of the humans working in the warehouse and it is not uncommon for warehouses over 100,000 sq m to employ over 4,000 people. With many cities across Europe now benefitting from low levels of unemployment, warehouse occupiers are using advanced demographic analysis when choosing where to locate their new facilities. Indeed it comes as no surprise that in the UK, Amazon has chosen to locate almost 500,000 sq m of new

warehouse space in the North East of the country where the unemployment levels are the highest in the UK.

The next level of non-property analysis would involve examining whether enough energy supply is available to meet the requirement of the building. Highly automated warehouse facilities can require as much energy as 10,000 family homes therefore not all sites will be able to provide this. Typically, brownfield sites which previously housed a manufacturing facility tend to have good energy supplies which can be used by tenants of any new warehouse facilities.

Combined, these requirements also impact the fabric of the building. We have observed that the average building height continues to increase as occupiers look to maximise the cubic space by installing mezzanine floors. Many speculative buildings are now being constructed to 21m clear height which in turn, impacts the floor which must be installed by the developer

which would typically need to be strengthened to accommodate the mezzanine.

Warehouse and industrial park amenity also becomes key in this scenario as the type of worker required is generally more skilled. These robotics engineers and data scientists will require better café facilities, gyms, and other features more traditionally experienced on an office business park.

The locations of the future will be sites where these three factors can be overlaid against traditional real estate indicators such as low vacancy rates and areas of high demand. Where all of these factors combine will be the areas where rents increase fastest and void periods are lowest, meaning that new markets will continue to emerge across the continent.
Kevin Mofid

20bps

Average yield compression for European logistics during H1 2019.





Savills Commercial Research

We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

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