MARKET IN MINUTES
*Savills Research*

# Big Shed Briefing - vacancy projections

savills

## What is driving a rise in warehouse supply, and where are vacancy rates heading?

2022 saw UK industrial and logistics take-up reach 48m sq ft, and whilst not exceeding 50m sq ft for the first time since 2020, it was still the third-best year for occupier demand ever recorded. However, the onset of economic volatility driven by significantly higher inflation, a less than successful mini-budget in September 2022, and the continued knock-on consequences of the war in Ukraine have seen the ripple effect impact both logistics occupier and capital markets.

Throughout 2022, occupier requirement levels for new warehouse space steadily decreased as businesses paused for thought, given the uncertain consumer environment. Nevertheless, issues around inventory security, supply chain resilience, energy supply and the continued need to operate from warehouses with strong ESG credentials have not gone away, meaning that we are seeing demand come from a variety of sectors in 2023. One example is manufacturing-related occupiers, who took the most amount of warehouse space ever recorded last year at just over 11m sq ft and have accounted for 29% of take-up so far in 2023.

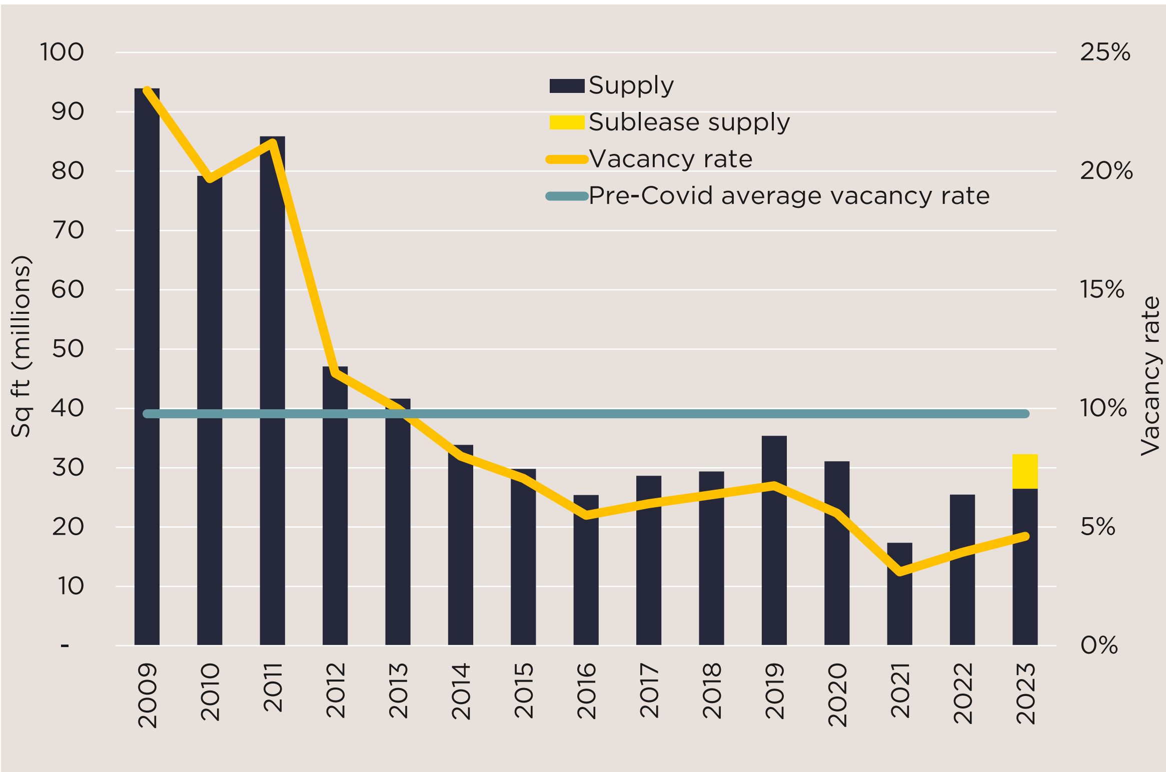
At the end of Q1 2023, the level of supply for units over 100,000 sq ft stood at 32.21m sq ft, equating to a 4.69% vacancy rate, a rise of almost 100 bps since the end of 2022. Of this supply, around 10% is already under offer to occupiers. Whilst this seems like a large rise, when compared with the supply low points of 2021, it should be noted that it matches with the early part of 2019 when supply was also c.32m sq ft.

Moreover, if we examine supply by unit count, we find that the current supply level is made up of 164 individual units, and whilst a rise from the 92 units available in Q2 2022, again, if we look at the long-term average over five years, there are, on average, 150 individual units on the market at any one time.

There are three main reasons that supply is rising at its fastest pace since 2010. Firstly, there has been a significant increase in the amount of "occupier controlled" space being formally brought to the market, where the existing tenant is looking to dispose of part or all of their current obligations through sub-letting or assignment. Occupiers, and 3PLs in particular, have always brought space to the market, but the total amounts were negligible and had little impact overall in the data. However, as 2022 progressed, it became clear that this space needed to be formally recognised as a subcategory within our overall data due to its impact on the overall supply picture. The availability of occupier-controlled space now stands at 5.87m sq ft over 31 units, making up 18% of the total supply.

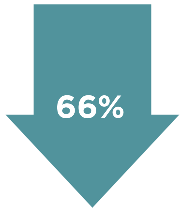
Secondly, there is a significant amount of speculatively constructed space due to reach completion in 2023. Indeed, Q1 2023 saw 3.25m sq ft of speculative completions, and there is a further 18.11m sq ft across 76 units set to reach practical completion in the remainder of 2023 and into 2024. Lastly, as Q1 2023 demonstrated, take-up is normalising following its post-Covid high. We examine these points in detail in the next sections of the report before detailing our vacancy projections from our in-house model to ascertain where vacancy will head over the next two years.

**UK warehouse supply** has returned to 2019 levels




**Source** Savills

### Key Stats

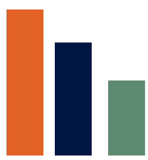



fall in speculative development announcements in 2023

**18.11m sq ft**
of speculative development expected in 2023 and into 2024. Limited new announcements forecast.

**52m sq ft**

Supply is modelled to peak at 52m sq ft by Q4 2023 before falling back down to c.45m in 2025



**38-41m sq ft**
take-up expected in 2024 and 2025

**"Economic and political uncertainty has caused a decline in activity in both occupational and capital markets. As inflation wanes and economic certainty returns, we have seen a rise in occupier requirements in the first part of 2023"**

# Requirements trend upwards as new supply rises

## With a significant amount of speculative space set to reach completion in Q2, occupier requirement levels trend upwards at the right time

A key contributing factor to the rise in supply that we are witnessing at the moment is elevated level of speculative completions due in 2023. As things stand we expect 18.11m sq ft across 79 units to complete in 2023, with 43% of this concentrated in the East Midlands and Yorkshire. In many ways, this was a natural response to the prevailing market conditions of 18 months ago when the vacancy rates in those markets fell as low as 0.59% and 0.61% respectively. In Q2 alone, we expect just over 9m sq ft of speculative completions which will naturally increase the vacancy rate across the country.

However, the picture moving into 2024 is one of a heavily constrained speculative pipeline. Indeed, pre-Covid there were, on average, 1.6m sq ft of speculative announcements per quarter. Post-Covid, this rose to 4m sq ft per quarter. So far in 2023 we have seen 2.7m sq ft of announcements - for context the same period last year was 7.9m sq ft.

Moreover, the picture across size bands and geographies is not uniform, meaning pockets of under-supply will remain in certain markets and size bands. For example, in the West Midlands and the South East, there are no units under construction over 400,000 sq ft, the same being true for the East Midlands, North West and South West with units between 200,000 sq ft and 300,000 sq ft.

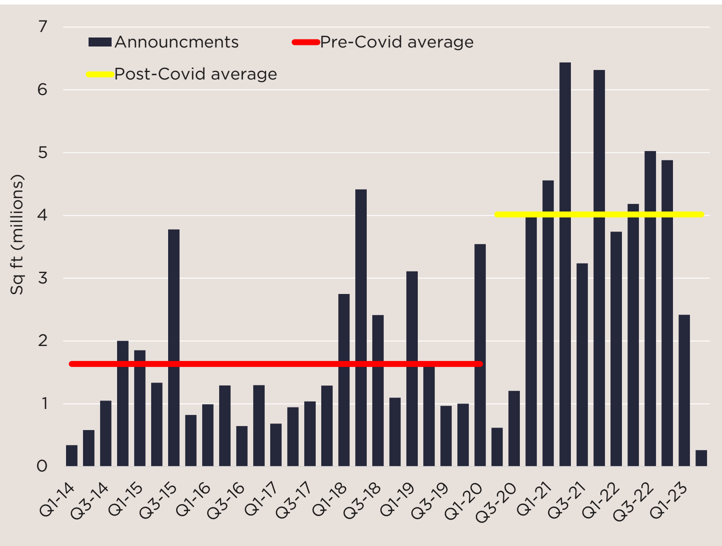
Moving on to requirements also paints an interesting picture. Savills tracks every circulated requirement in the market and has used this data to create a weighted index of demand. Our index splits requirements into five categories: 100,000-200,000 sq ft, 200,000-300,000 sq ft, 300,000-400,000 sq ft, 400,000-500,000 sq ft and 500,000+ sq ft, whereby a requirement for 550,000 sq ft would have a stronger impact on the overall index compared to a requirement of 140,000 sq ft to reflect the size of the requirement and the higher level of take-up if a deal subsequently takes place.

If we compare the index to take-up on a nine-month lag, thereby giving time for a deal to take place, there is a strong statistical correlation meaning that the index is well-placed to be a leading indicator for future demand.

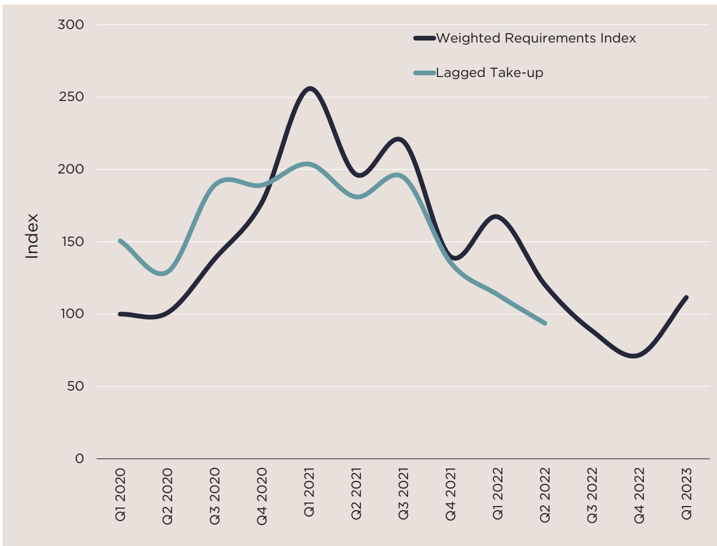
As the chart below demonstrates, the index has rebounded by 57% in the first quarter of 2023, meaning that it is likely take-up will start to rise in the second half of the year and, based on previous quarters of the index, take-up for 2023 should reach between 30 and 35m sq ft for the full year.

57% rise in the requirement index between Q4 2022 and Q1 2023

**Speculative development** announcements have fallen dramatically in 2023, meaning new completions into 2024 will also fall

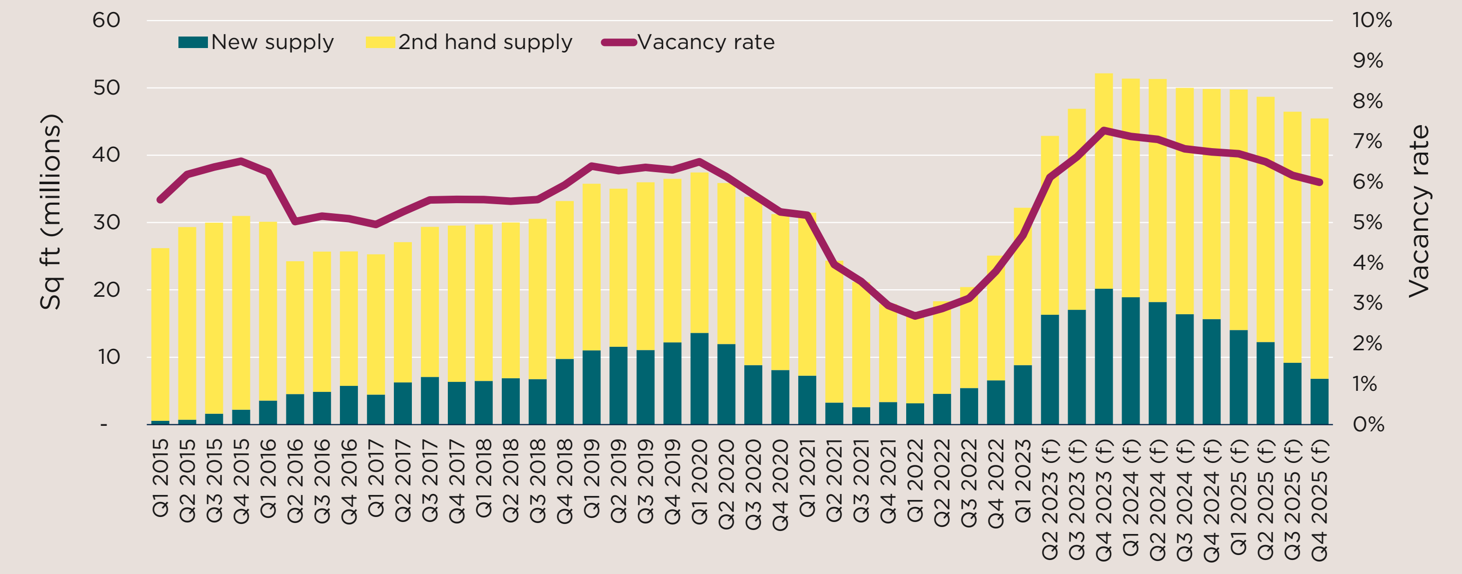



**Savills requirements index** rebounds by 57% in the first quarter of 2023, signalling an increase in take up in the second half of the year




**Source** Savills Research

**Savills baseline vacancy scenario**
A peak of 7.3% before falling steadily back to 6.0% by 2025




**Source** Savills Research

# What is the vacancy trajectory?

## Data-rich model paints varied picture across the country

During the second quarter of 2020, at the height of the first Covid-19 lockdown, Savills Research noted concern in the market that many occupiers were considering returning space to the market and rent was remaining unpaid. Reacting to this, we set about to use all of the data at our disposal to try and model supply and vacancy into the future in order to better understand where areas of concern may arise.

Even our most optimistic modelling, which was of course influenced by the economic indicators during the first lockdown, didn't foresee how strong the market would be over the two years that followed.

Now, as market and economic conditions are equally as volatile, it seems wise to update the model with the latest data to examine the supply position in the market over the next few years.

The model takes data from a number of sources and then makes assumptions regarding future take-up rates across the country to inform its outputs.

Firstly, Savills tracks all lease events for warehouses over 100,000 sq ft in the country. Based on our research at a nationwide level, we have identified 54.38m sq ft of lease events by the end of 2025. The regions most exposed to future lease events are the East Midlands and the North West which account for 32% and 20% of the lease events respectively.

Next, we examine the speculative pipeline both in terms of what is confirmed for delivery and what could then be announced for later in the modelling period.

The model also looks at second-hand supply, tracking how much space comes to the market in an average quarter and then makes scenario-based assumptions based on the potential for company failure or additional occupier-controlled space being returned to the market.

Lastly, the model then looks at various scenarios for take-up, both of existing units and build-to-suit units, in order to establish what the absorption of existing units will be, but also to understand how total inventory levels will rise and therefore impact the vacancy rate.

Our baseline scenario for vacancy suggests that, at a nationwide level, vacancy will rise and peak around 7.28% in Q4 2023 before steadily falling to 6.0% by the end of 2025.

At a regional level, and detailed in the table on the next page, the picture is more nuanced with markets with smaller inventory levels, such as the North East, Wales or Scotland being more exposed to larger rises in vacancy due to the amplifying nature of having large units vacant. In the East Midlands, however, the model suggests that vacancy could actually fall below its current level as this market has had the highest levels of take-up over the last 10 years, which the model accounts for moving forward.

**Whilst we have used the model to project vacancy forward at a nationwide and regional basis, it can also be used to examine market conditions in sub-markets and sub-size ranges. We believe the model is a useful tool to assist the market with future development and investment decisions, and in time it can identify areas where under-supply exists, which could, in turn be a leading indicator for rental growth.**

### Assumptions

Take-up falls to c.30m sq ft in 2023 before rebounding to c.38-41m sq ft in 2024 and 2025

80% renewal at lease event

Elevated levels of new second-hand supply in 2023 before reverting to average

Current speculative development pipeline delivered with minimal additions

## Our model shows that not all markets will react uniformly to the prevailing market conditions

## Key Market Data

## Vacancy Rate Projections

| | Five-year average annual take-up | Current supply | Confirmed speculative pipeline | Current vacancy rate | Peak vacancy rate | 2025 year-end vacancy rate |
|---|---|---|---|---|---|---|
| **United Kingdom** | 44.65m sq ft | 32.21m sq ft | 18.11m sq ft | 4.69% | 7.28% | 6.00% |
| **London** | 1.62m sq ft | 1.96m sq ft | 0.58m sq ft | 4.62% | 6.70% | 5.99% |
| **South East** | 5.30m sq ft | 4.63m sq ft | 2.28m sq ft | 5.00% | 6.96% | 5.31% |
| **East Midlands** | 10.03m sq ft | 5.74m sq ft | 3.51m sq ft | 4.51% | 6.25% | 4.13% |
| **West Midlands** | 6.39m sq ft | 5.19m sq ft | 2.63m sq ft | 5.49% | 8.35% | 5.75% |
| **East of England** | 2.28m sq ft | 2.21m sq ft | 0 sq ft | 6.82% | 8.59% | 8.01% |
| **North West** | 5.64m sq ft | 4.26m sq ft | 2.02m sq ft | 4.78% | 7.14% | 6.69% |
| **Yorkshire & Humber** | 6.76m sq ft | 1.99m sq ft | 4.35m sq ft | 2.70% | 8.57% | 6.30% |
| **North East** | 2.81m sq ft | 0.90m sq ft | 0.45m sq ft | 3.71% | 7.91% | 6.66% |
| **South West** | 2.17m sq ft | 0.88m sq ft | 1.96m sq ft | 2.31% | 9.20% | 8.04% |
| **Wales** | 0.95m sq ft | 3.57m sq ft | 0.22m sq ft | 7.85% | 8.06% | 6.69% |
| **Scotland** | 0.69m sq ft | 0.88m sq ft | 0.13m sq ft | 3.24% | 4.54% | 4.46% |

**Source** Savills Research

# Summary

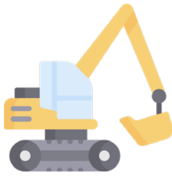
## 5 KEY CONSIDERATIONS

### 1. Sustained demand

Occupier requirement levels for new warehouse space steadily decreased in 2022 due to sustained economic volatility. However, issues around inventory security, supply chain resilience, energy supply and ESG aspirations will mean that demand is still set to come from a variety of sectors in 2023. We can see the resilience of occupier demand within our requirements index, which has increased by 57% in Q1 2023.

### 2. Rising vacancy rate

We have seen an unprecedented rise in the amount of ‘occupier-controlled’ space being formally brought to the market. This space now stands at 5.87 million sq ft, making up 18% of the total supply. Vacancy rates have increased to 4.69%, this is however in line with 2019 pre-Covid levels.

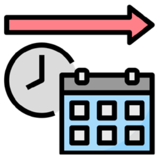


### 3. Speculative development

The rising vacancy rate will be exacerbated by the significant amount of speculative development set to reach completion in 2023. However, as we move into 2024, there is a significantly constrained pipeline with a 66% drop in announcements so far this year.

### 4. Trends are not universal

The picture across size bands and geographies is not uniform, so there will still be pockets of under-supply and differences in the quality of supply. In some regions, supply is poor quality or concentrated in the smaller size bands, and there remain many areas of the market where there is less than one years worth of supply. Whilst we have seen a strong rise in requirements at a national level this hides regional variations, suggesting take-up in some regions will rebound quicker than others.



### 5. The future...

With all this in mind, what is the vacancy trajectory? Using our model, the baseline scenario for vacancy suggests that it will peak at 7.28% in Q4 2023, before falling back to 6% by the end of 2025. We have based this projection on data and assumptions at the end of Q1 2023.

**Savills Research**
Our commercial research team provides bespoke consultancy solutions to clients across all sectors, reaching from central London to the whole of the UK and also into key European markets.

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