DTRE

Q1 2022

RESEARCH

Big Box Logistics

OCCUPIER & INVESTMENT

MARKET REVIEW

DTRE

Q1 2022
RESEARCH

5 Things You Need to Know

ABOUT **BIG BOX LOGISTICS** IN Q1'22

1. **10 million sq ft** of take-up in Q1'22, **40% ahead of the quarterly average**

2. The DTRE Big Box National **Vacancy Rate** now stands at **2.3%, a record low**

3. Q1'22 has seen over **£1.7bn traded** with a further **£1.2bn under offer**

4. NIY for Distribution Warehouses now stands at **3.6%, down c.100bps** year on year

5. DTRE doesn't expect the prospect of continuing rate rises to **signify a softening of yields**

DTRE

Q1 2022 RESEARCH

Occupational

The first three months of 2022 has seen just over 10 million sq ft of take-up, 40% ahead of the quarterly average since 2010, as occupier demand for new logistics space shows little sign of slowing down at present.

WRITTEN BY

Robert Taylor

Research Partner

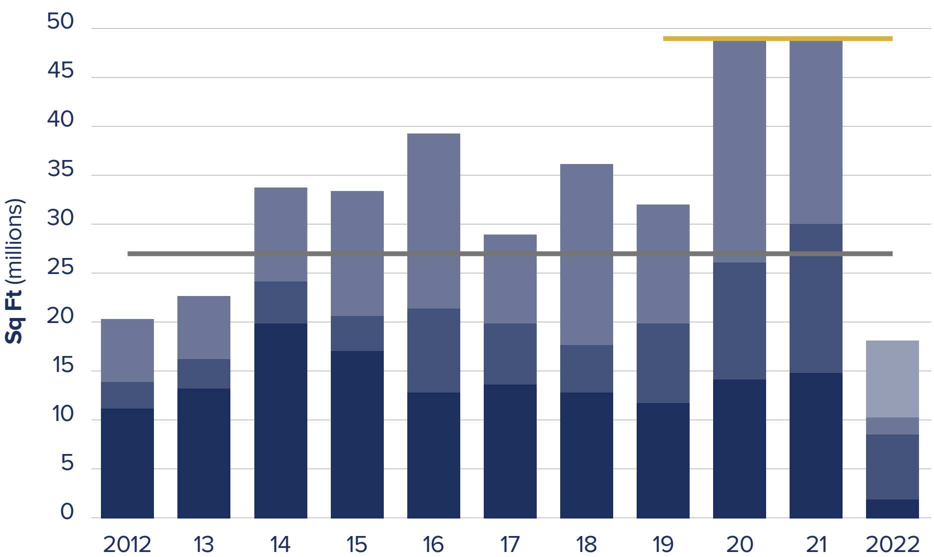

Fig 1

Take-up Reaches Just Over 10m sq ft

- Under offer
- New / Spec Built
- Design & Build / Pre-let
- 2nd Hand
- Average Take-up (2007-19)
- Average Take-up (2020-21)

Source | DTRE Research

It was the logistics providers that were the dominant players and accounted for just over 40% of the number of deals done, with Iron Mountain committing to two buildings on Magna Park, whilst Unipart took 355,000 sq ft at MPS8, Magna Park, iForce acquired Thrapston 151 and Wincanton took Unit E at Icon Harlow.

DTRE's Big Box Logistics Vacancy Rate has moved down through the quarter, from 2.6% at the start of January to stand at just 2.3% by the end of March. With up and built supply still at historically low levels the question moving through the remainder of 2022 will be can occupier demand be satisfied?

> **DTRE's Big Box Logistics Vacancy Rate has moved down through the quarter, from 2.6% at the start of January to stand at just 2.3% by the end of March**

There is now two clear pathways for the remainder of the year. Firstly, the downside risk to the market is that there's a plethora of issues facing occupiers outside of the running and leasing of their real estate, such as labour supply and supporting staff through the current 'Cost of Living Crisis'. There has already been a swathe of pay announcements, and retailers ranging from Sainsbury's to Aldi and Marks & Spencer now pay store staff £10 an hour or more and John Lewis Partnership will increase its pay budget by £54m this year.

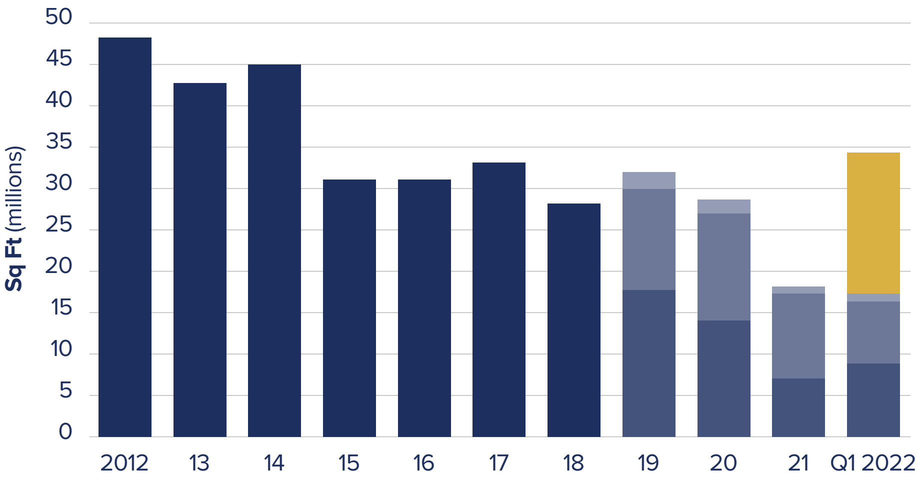

Fig 2

A Further Drop in Supply – Although 17 million sq ft is under construction

- Total
- Grade A
- Grade B
- Grade C
- Under Construction

Source | DTRE Research

Put on top of this construction costs rising and occupiers having to face the prospect of day one rent reviews, occupiers, and particularly retailers, in the face of falling retail sales and plummeting consumer confidence, could scale back on their growth plans which will negatively impact take-up of Big Box logistics space.

The alternative view is that if retailers don't commit to acquiring space this year they could well be left behind in the arms race for next-day delivery and supply chain perfection. This alternative view is very much the view held at Next and Very Group, two retailers that are investing in their warehousing, distribution and automation in part to help alleviate wage inflation and reduce the reliance on people.

According to Next's results, last year they spent £124m on a new, "highly automated" warehousing which will deliver a 45% increase in boxed capacity whilst reducing marginal labour cost per unit by 40% and they will invest a similar sum this year. The Very Group in their recent trading statement announced that high levels of automation at the facility means labour costs per unit are 60% below its previous operations.

All in all, w**e expect demand to hold up in the face of wider economic issues**, well ahead of the long run-average of 28 million sq ft we saw annually from 2007 to 2019. However, whether take-up will top the 50 million sq ft plus seen in each of the last two years is doubtful.

> **…we expect demand to hold up in the face of wider economic issues…**

Investment

In a continuation of what we saw in 2021, the investment market for Big Box Logistics has carried on where it left off, albeit with a slowdown in the quarterly volume traded. Q1'22 has seen over £1.7bn traded with a further £1.2bn under offer, down 45% from the £3.13bn traded in Q4 2021.

The biggest deal of the year so far was Cain International's £550mn purchase of a portfolio of seven speculative units from Firethorn Trust. The second-largest deal was AXA's £392mn purchase of the Hercules Portfolio of 10 single-let assets from Goldman Sachs at 3.08%. Finally, the largest single-let stand alone deal was M&G's purchase from Fiera Real Estate of the former Debenhams unit in Peterborough, which was let to Amazon for 15 years in December for £120mn/3.25%.

Whilst volumes may have tailed off in Q1, with £1.2bn under offer and **DTRE currently tracking close to £2bn of on and off-market opportunities** then Q2 and Q3 again look like producing robust volumes and by historic standards 2022 looks set to be another standout year.

> **DTRE currently tracking close to £2bn of on and off-market opportunities**

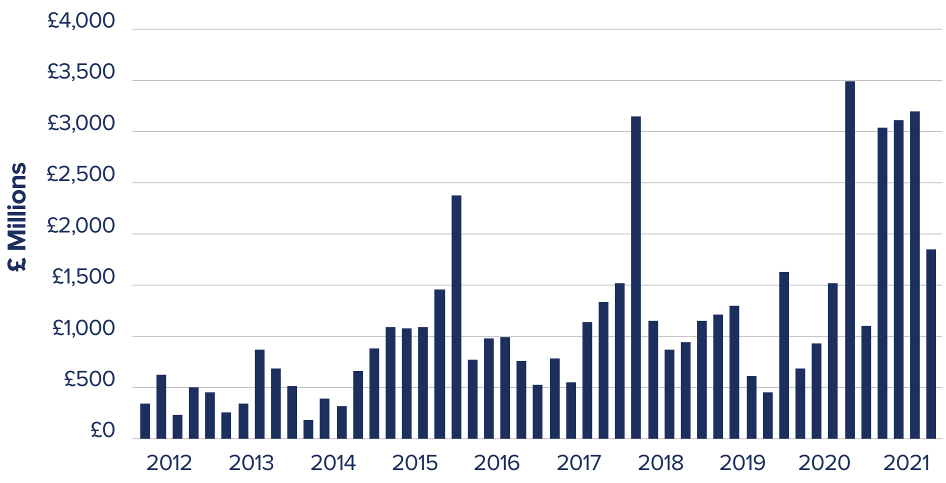

Fig 3
Investment Volumes by Quarter
Source | DTRE Research

Pricing has remained very firm, in spite of rising interest rates, inflationary pressures and a narrowing spread between gilts and yields. **According to MSCI's Monthly Index, the net initial yield for Distribution Warehouses now stands at 3.6%, down c.100bps from March 2021**, and even 20bps from the start of the year.

The rental growth story continues to convince investors to 'sharpen their pencils' when bidding and, again, according to MSCI, average annual rental growth reached 11.8% in the 12 months to end March 2022, with London Industrials ahead even further at 15.7%.

We said in our last report in January that we didn't expect the prospect of rising interest rates to result in yields moving out and we remain steadfast in that argument, with little to no evidence yet of yields softening, despite the UK 10-year gilt rising to 1.9% from sub 1% at the start of 2022.

This is because investors continue to buy into the occupier story and the forecasted rental growth projections, with a wall of money that will continue to target the sector and finally because the inflationary environment and resulting interest rate rises will run out of steam faster than the market anticipates.

> **According to MSCI's Monthly Index, the net initial yield for Distribution Warehouses now stands at 3.6%, down c.100bps from March 2021.**

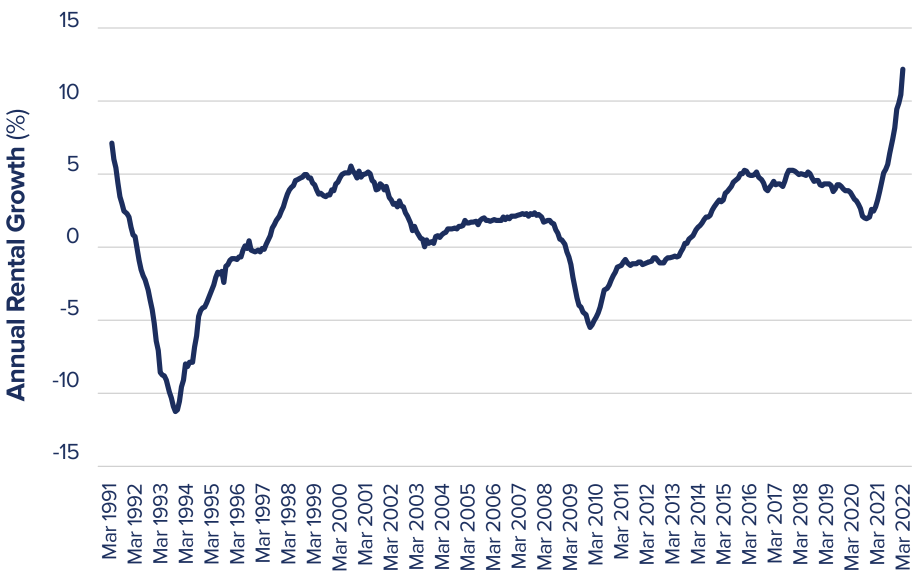

Fig 4
Annual Rental Growth - Distribution Warehouses
Source | MSCI

Finally, assets with the highest ESG credentials or assets with sub-5 year income could still see sharpening yields as there remains a wall of money currently sat on the sidelines chasing these particular assets and investors desperate to increase their weightings in the sector.

DTRE Big Box Logistics

OCCUPIER & INVESTMENT
MARKET REVIEW

RESEARCH
Robert Taylor
Research Partner
robert.taylor@dtre.com
07732 804 410

RESEARCH
Jamie Poole
Data Analyst
jamie.poole@dtre.com
07833 230 414