DTRE

Q4 2022
RESEARCH

Big Box Logistics

OCCUPIER & INVESTMENT
MARKET REVIEW

5 Things You Need to Know

ABOUT **BIG BOX LOGISTICS** IN Q4'22

1. Take-up during Q4 2022 reached **10.8 million sq ft**

2. The annual total for 2022 was **40.8 million sq ft,** the third best year on record

3. Vacancy rate has increased through 2022 and now stands at **3.5%**

4. 2022 saw **£7.8bn** traded, the second-best year ever... however **40%** was in Q1

5. Positive **occupier fundamentals** and **rental growth** will encourage **logistics yields to stabilise** sooner than other sectors

Occupational

Three Prime Ministers, four Chancellors, inflation running at 11% and interest rates up by 325 basis points, 2022 was a year like no other. In terms of Big Box logistics the headlines could quite easily read take-up down, vacancy up, rental growth slowing. However, the truth is much more nuanced than that and in spite of a series of headwinds, occupier demand for Big Box logistics witnessed another standout year, with close to 41 million sq ft transacting, the third-best year ever recorded.

WRITTEN BY
Robert Taylor
Research Partner

Despite the gathering storm clouds in the latter third of 2022, in-particular, **Big Box take-up during Q4 2022 reached 10.8 million sq ft bringing the annual total for 2022 to 40.8 million sq ft**. Whilst this was down 25% on the record 54.7 million sq ft recorded in 2021, it was 67% ahead of the average annual level of take-up from 2009 to 2019.

And those stats only really tell half the story. Whilst overall volumes were down, DTRE recorded 176 separate Big Box transactions in 2022, compared to 188 in 2021, a fall of just 6% in terms of number of units being let.

In addition, and as mentioned in our October report, one of the key reasons take-up declined in 2022 versus 2020 and 21 was due to the size of buildings being let. In 2020 and 2021 over two-thirds of take-up was in units of 300,000 sq ft or greater, but with the absence of Amazon and a dearth of up and built product in those upper size ranges, take-up of units over 300,000 sq ft slipped. By the end of 2022 just 19.1 million sq ft had transacted in units of 300,000 sq ft +, down 40% on what we witnessed in 2020/21.

> **Big Box take-up during Q4 2022 reached 10.8 million sq ft bringing the annual total for 2022 to 40.8 million sq ft**

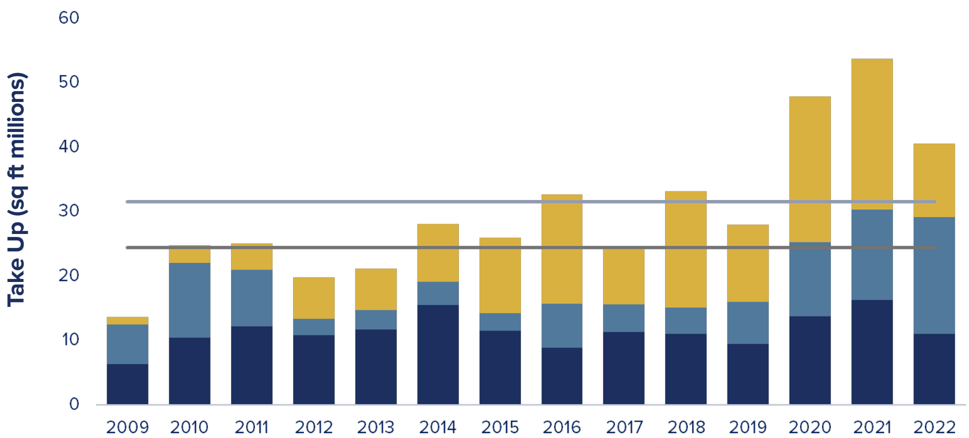

Fig 1
Take-up per annum

- 2nd Hand
- New - Spec Build
- Design & Build
- 10 Year Average (2012-2021)
- Long Run Average (2007-19 'Pre Covid')

Source | DTRE Research

DTRE

Q4 2022 RESEARCH

Two wider economic trends observed in 2022 were the retreat of the retailers from Covid induced highs and supply chain problems, owing to China's rolling lockdowns and Brexit red-tape, and both these wider trends are apparent in the DTRE take-up data.

Retailers, who accounted for 45 million sq ft, combined, in 2020 and 2021 took just 11 million sq ft in 2022, down 55% year-on-year. Whilst 3PL's and logistics providers, prompted by supply chain delays and shipping problems through much of the year responded by taking 14.9 million sq ft – 129% ahead of the annual average taken by 3PL's from 2007 to 2019.

Moving to supply, **DTRE's Big Box vacancy has risen from the lows seen in 2021 but remains low by historic standards at just 3.5%**. The rise in supply is predominantly due to an influx of new speculatively built, Grade A stock, that completed during Q4 2022. This new supply is most apparent in the 300,000+ sq ft size range where the amount of currently available units tripled in the final quarter of 2022 (albeit this stands at just 12 units).

> **DTRE's Big Box vacancy has risen from the lows seen in 2021 but remains low by historic standards at just 3.5%.**

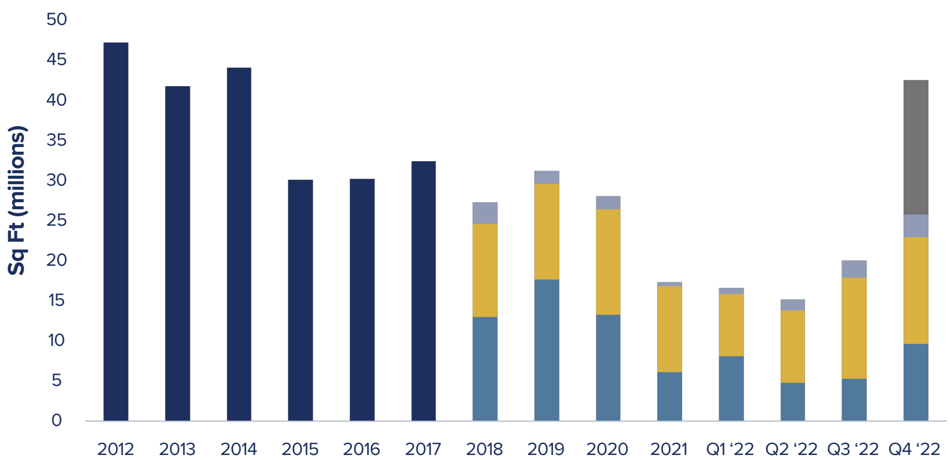

Fig 2
Supply per annum

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

Source | DTRE Research

Overall, the volume of speculative development has also risen in the past year. With 16.5 million sq ft completing during 2022, this was up 23% on 2021 and the largest amount of spec development in a single-year. There is currently another 16 million sq ft of development under construction that will reach practical completion in the next 6 months, however, with the taps for new development near-enough turned off in the final three months of 2022 it's unlikely that last year's 16.5 million sq ft of completions will be significantly surpassed, if at all.

Finally, whilst rental growth has slowed from the highs at the mid point of 2022 – we continue to see record rents being set across the country. For example, in the North West £7.95 per sq ft being achieved at Omega, Warrington, whilst Ergo's 367,000 sq ft unit at Ergo Park Oldham is available at £8.00 per sq ft. According to MSCI, annualised rental growth to end November 2022 reached 12% for distribution warehouses, down from the highs of 13.7% seen in August '22, but still well ahead of the average of 2.6% seen since the inception of the MSCI Index in 1987.

Investment

Twelve months ago it would be fair to say that not many people anticipated the extreme & sudden downturn that was about to be inflicted upon the UK's commercial property market. Inflation was said to be 'transitory' and interest rate expectations topped out at around 1.75%. Consequently, what followed took nearly everybody by surprise, with inflation now running close to 11% (in the last CPI reading from November) and interest rates reaching 3.5% by year-end, with a further 50 bps at least of tightening still expected, as the Bank of England, and central banks around the world, grapple to bring inflation back under control.

The consequence for the industrial and logistics sector being that values were hit hard, in-fact with yields at historic lows it was this sector that was hit the hardest. According to MSCI's Monthly Index, Capital Growth went into reverse to the tune of -23% from June to November 2022 as rising yields significantly impacted capital values. Retail was the next worst performer at -12.9%.

Bearing all of the above in mind, it is almost remarkable to report that **2022 witnessed £7.8bn of single-let warehouses and single-let portfolios traded, the second-best year** ever in terms of overall volumes. But, given the rocky nature of 2022 it will be unsurprising to learn that nearly 40% of the total volume was traded before the end of Q1 – with the remaining 9 months witnessing a significant slowdown. Particularly when compared to 2021.

> **... 2022 witnessed £7.8bn of single-let warehouses and single-let portfolios traded, the second-best year ever**

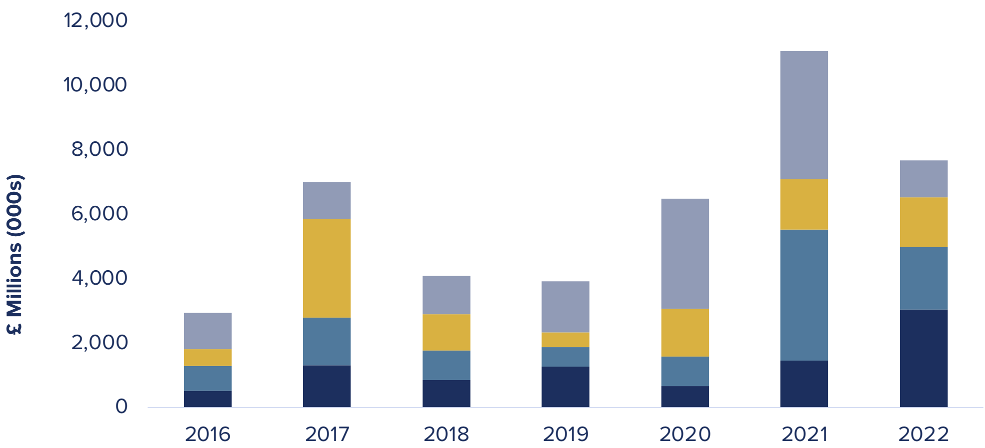

Fig 3
Single-Let Investment Volumes per annum

- Q1
- Q2
- Q3
- Q4

Source | DTRE Research

However, it is important to give the remaining 9 months of 2022 some historical context. **Total volumes for Q2, Q3 and Q4 in 2022 averaged out at c.£1.55bn, that is 10% ahead of the quarterly average seen from 2017 to 2021.**

Total volumes for Q2, Q3 and Q4 in 2022 averaged out at c.£1.55bn, that is 10% ahead of the quarterly average seen from 2017 to 2021.

Besides Q4'22 still witnessed some significant trading, with ICG buying up a portfolio of 7 Morrisons distribution warehouses for £220m, Aviva paying £90m/4.43% for 505,000 sq ft unit on Omega in Warrington let to Iceland for 20 years and The Range funding their own unit at Gateway 14 in Suffolk, a 1.2million sq ft development which cost c.£200m.

Blackstone, through their various vehicles St Modwen and Mileway, were the most active investor, undertaking five different purchases in Q4. Their largest single asset acquisition of a 172,380 sq ft Yodel distribution centre in Hatfield for £49m. Advised by DTRE on behalf of St Modwen.

Whilst Q4'22 saw £1.15 bn traded and was the lowest quarterly volume seen in 8 quarters since Q3 2020 and Q1'23 feels like it has got off to a cautious start, there are reasons to be optimistic, with much of the fog around inflation and interest rates beginning to clear, many investors feel a bottom may now have been reached.

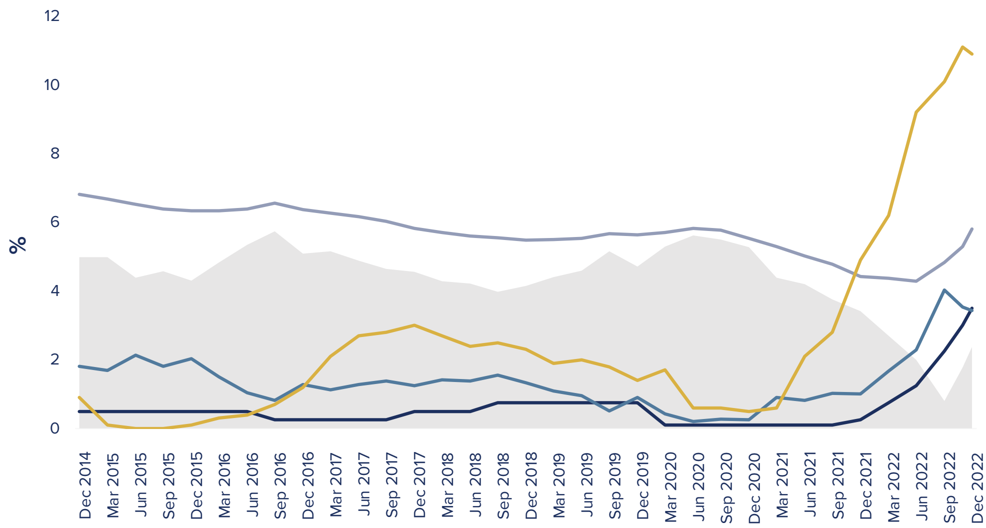

Fig 4
Spread between Distribution Warehouse Yields and UK 10 Year Gilts

- Spread
- Bank of England Base Rate (%)
- Distribution Warehouse Equivalent Yield (%)
- 10-year UK Gilts
- CPI Inflation (%)

Source | MSCI & The Bank of England

Some of this is already playing out in the publicly traded REITs, with Tritax Big Box and SEGRO seeing their share prices increase by 11.1% and 10.8%, respectively, versus a 4.7% increase YTD in the FTSE All-Share and a 8.2% increase across the FTSE 350 Real Estate Index.

Logistics with its rental growth expectations driven by the strong underlying fundamentals, namely a lack of supply (3.5% vacancy rate) and strong occupier demand (2022 being the third best year ever of take-up), **will continue to be the best bet for investors over the medium term** and it's realistic to expect yields in logistics to stabilise sooner than other sectors.

Logistics with its rental growth expectations driven by the strong underlying fundamentals... will continue to be the best bet for investors over the medium term

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