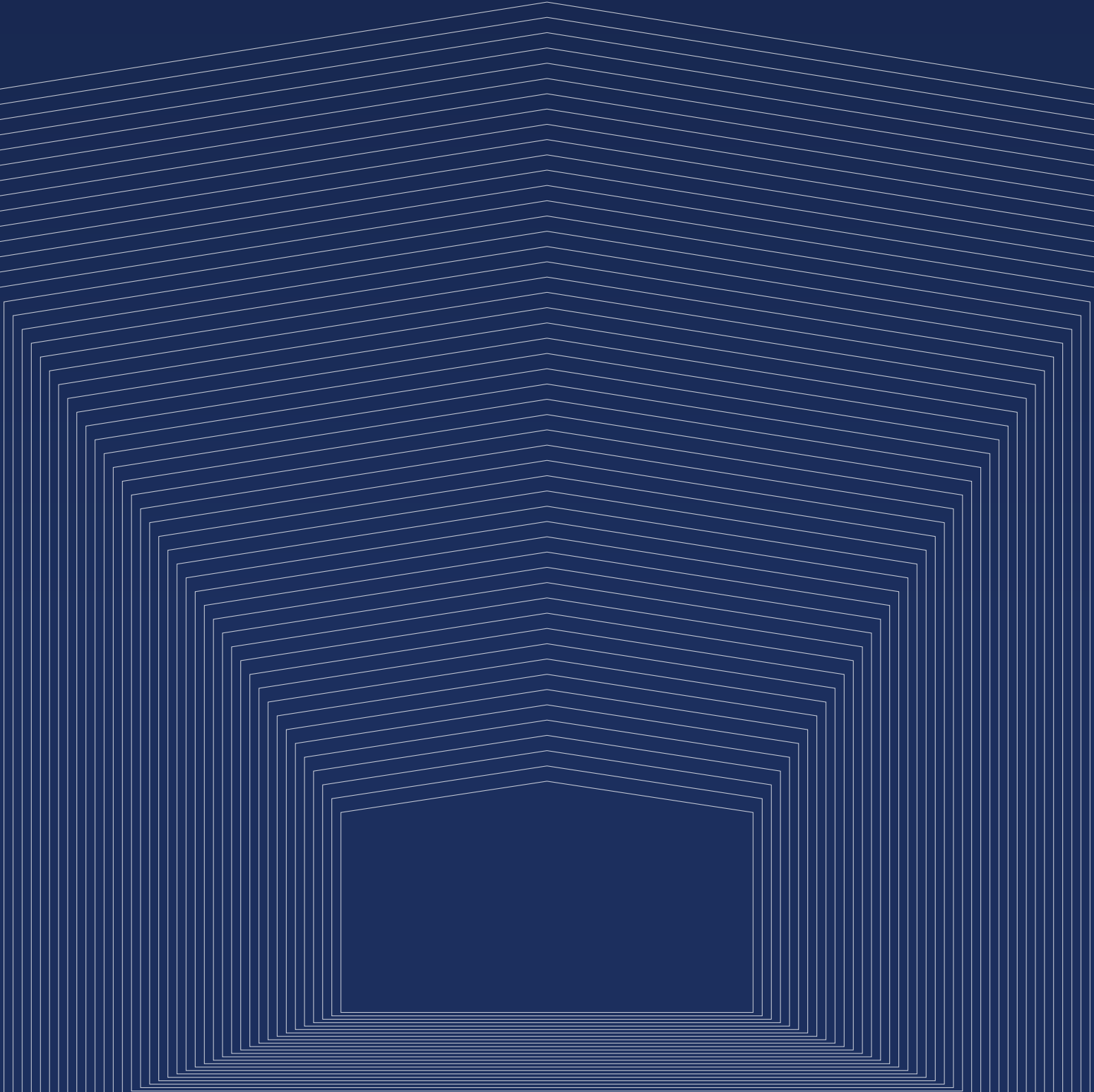


BIG BOX LOGISTICS

OCCUPIER & INVESTMENT
MARKET REVIEW

DTRE

Q2 2023
RESEARCH



5 Things You Need to Know

ABOUT **BIG BOX LOGISTICS** IN Q2'23



Big Box take-up has reached **11.6 million sq ft by end Q2'23** – with a further 9.4m sq ft under offer



The **DTRE Big Box Vacancy rate** (all units over 100,000 sq ft) stands at 4.9% up from 3.5% at end of 2022



Trading volumes have reached **£3.2bn - £1.4bn** in single-let and **£1.8bn** in multi-let



Despite slowdown, investment volumes are **20% ahead of the half-year average from 2011-19**



Given the occupier fundamentals and rental growth expectations **we expect prime yields to strengthen by end 2023 once inflation comes under control and rate hikes are paused**

Occupational

Six months into 2023 and whilst take-up volumes have remained robust, it is clear that we are now entering the new 'Post-Covid' phase. At the end of H1 2023 take-up stands at 11.6 million sq ft, down 44% year-on-year and closer to the pre-Covid (2007-19) average of 14 million sq ft (see Fig 1).

Decision-making by corporates has slowed substantially now the Covid 'race-for-space' has ended and as a result deals are taking longer to complete. Therefore, and in a similar vein to our Q1 report, there remains a substantial amount of space under offer. DTRE are currently aware of 9.44 million sq ft under offer across 37 separate transactions.

Transactions over 300,000 sq ft have been a contributing factor to the suppressed level of take-up for over a year now. In the eight quarters from Q2'2020 until end Q1'2022 we witnessed 100 separate transactions over 300,000 sq ft at an average of 12.5 per quarter. In the last five quarters that has slowed to just 36, a fall of 42% in the number of deals over 300,000 sq ft signing each quarter.



WRITTEN BY
Robert Taylor
Research Partner

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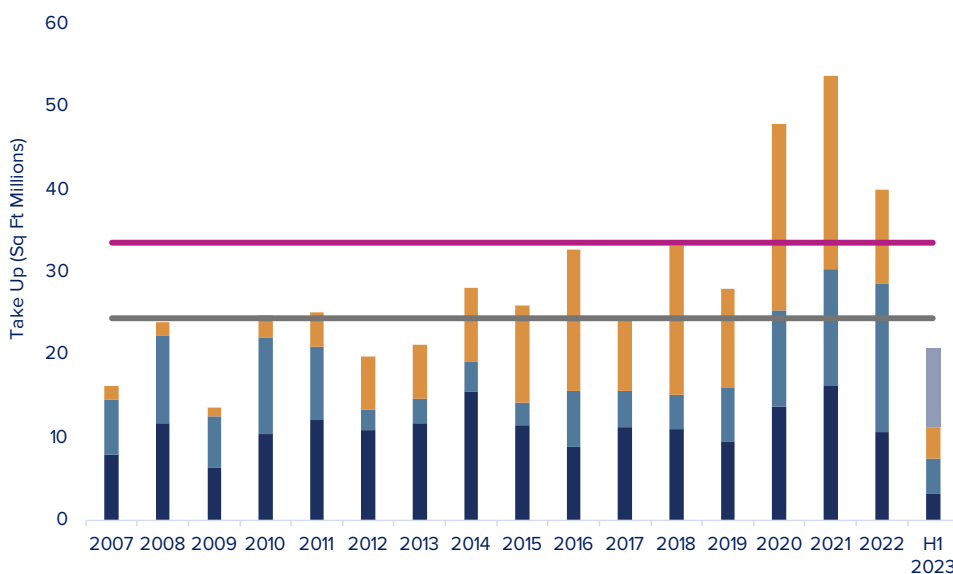


Fig 1
Take-up per annum

- ◆ 2nd hand
- ◆ New
- ◆ D&B
- ◆ Under offer
- Long Run Average (2007-19 'Pre Covid')
- 10 Year Average (2013-22)

Source | DTRE Research

This may cause some concern given the amount of units that are either under construction or have returned to the market in that size bracket over 300,000 sq ft. There are currently 42 separate units of 300,000 sq ft or greater, totalling 17.8 million sq ft that are either available or will reach practical completion within the next 6 months, 31% ahead of the number of available units we were tracking at the start of 2020.

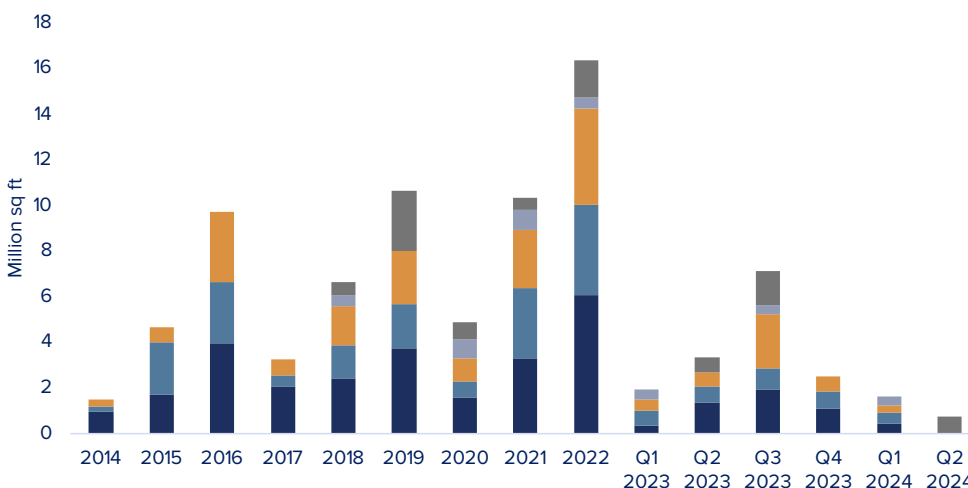
Given in the last two years we have witnessed 18.4 million sq ft of take-up, this would imply there's currently almost two years of supply on the market in the 300,000 sq ft + size range.

Nonetheless, **the market has largely avoided an oversupply. Brexit, Covid and then last year's pricing correction in land values (see Fig.2) has held back over development.** For that reason, from late summer this year the speculative development pipeline drops off significantly, with just 4.8 million sq ft of new units due to complete from Q4'23 onwards and this will continue to support rental growth in the sector.

Whilst rental growth has slowed in recent months, it remains firmly in positive territory and according to MSCI, distribution warehouse rents have grown at annualised rate of 8.31%, closely tracking the rate of CPI inflation in the UK, which stands at 8.7% for May 2023.

Rental growth and inflation have a strong correlation and given the stubborn nature of inflation in the UK currently, this will continue to translate through to given the continued tight vacancy rate (4.9%) and the nature of the occupiers in the logistics sector. However, as with inflation generally, we expect rental growth to fall to close to 4.5% by the end of 2023 and to 2.5% by end 2024.

Moving forward the logistics sector continues to offer strong growth prospects, particularly when compared to the traditional real estate sectors of offices and retail. The amount of occupier space currently under offer, coupled with the number of active requirements DTRE are tracking, totals close to 15 million sq ft and it is still expected that year-end take-up volumes will reach close to 32 million sq ft. That would be 19% ahead of the pre-Covid average (2007-19) as we move into the new 'Post-Covid' era for Big Box logistics.



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”



Fig 2
Development Slowdown from Q3 2023

- ◆ 500,000 sq ft +
- ◆ 400-500,000 sq ft
- ◆ 300-400,000 sq ft
- ◆ 200-300,000 sq ft
- ◆ 100-200,000 sq ft

Source | DTRE Research

Investment

Interest rate rises have now firmly impacted the capital markets with interest rate rises ensuring that transaction volumes are down significantly when compared to 2021 and 2022. The sense of optimism that had begun to creep into the market by end Q1' 23 has been eroded by further rate rises up to 5% by the Bank of England. Inflation remains stubbornly high and now further interest rate rises, possibly up to as high as 6%, are now expected.

Yet volumes have reached **£3.2bn** across the entire sector, suggesting that the **sector fundamentals remain attractive**, with £1.4bn in single-let and £1.8bn in multi-let. Whilst this is down significantly on the £7.5bn witnessed in H1'21 and the £7.2bn seen in the first half of 2022, it is very much ahead of the volumes seen prior to Covid.

Indeed prior to the Covid-boom, the average volume of deals transacted in the first half of the year from 2011 to 2019 was £2.67bn, so with H1 2023 seeing £3.2bn, the sector stands at 20% ahead of the pre-Covid average.

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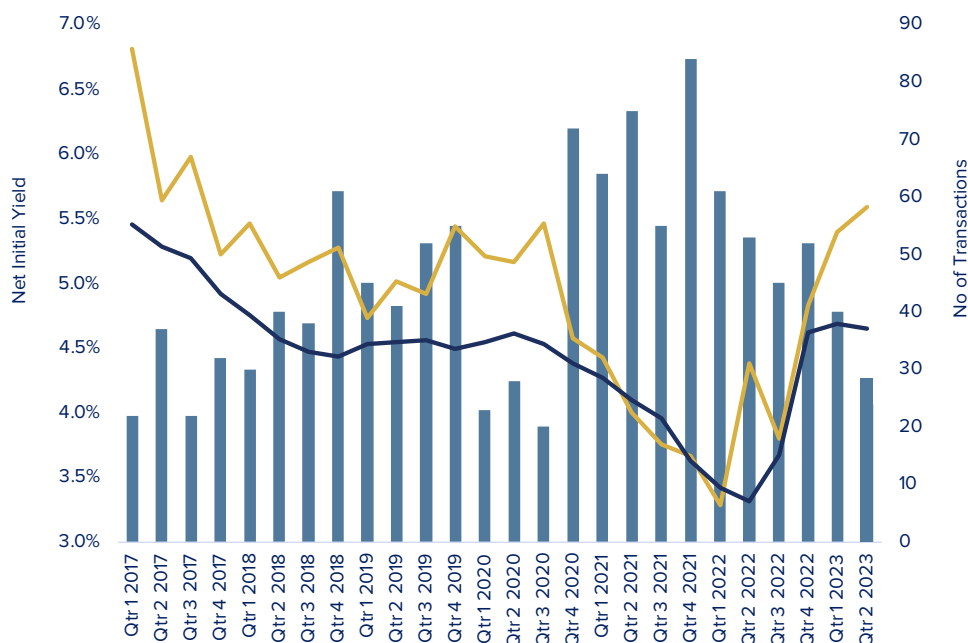


Fig 3
Single-Let Investment Volumes by Quarter

- ◆ No. of Transactions
- Average Transactional NIY
- MSCI NIY

Source | DTRE / MSCI / RCA

However, that is not to say the current market is without difficulties and a degree of inertia has set in over recent weeks. There had been a limited but increasing number of motivated vendors in the market through the year. However, in the face of ever-increasing debt costs, yields have had to move out and as a result there's now a mismatch between vendor and purchaser aspirations and as a result we expect trading volumes for Q3 to be suppressed.

Prior to the recent shift in interest rate expectations the market had seen signs of life and in total £1.9bn has been transacted in Q2'23 across both multi-let industrial and single-let logistics, with DTRE advising upon a significant element in the quarter.

The single largest deal of the quarter was the purchase of Trafford Park and Heywood Distribution Park from Harbert (advised by DTRE) by Blackstone for £480m, whilst Blackstone also bought the Spears Portfolio from BlackRock for £152m/5.42% NIY, for which there was a significant list of seven underbidders, demonstrating the weight of capital still sat on the sidelines trying to improve their weighting in the sector.

When focusing on the single-let market, this year has so far seen just over £500m of deals transact, with the key deal of Q2 occurring just last week with Clarion's purchase of Phase 1 & 2 Gorse Point in Widnes from Mirastar, advised by DTRE, for £89m.

The headlines were grabbed by Abrdn, who sold the Amazon occupied Wembley 180 to clients of Deutsche Bank for £74m/3.49% net initial yield. DTRE acted for Abrdn.

Moving through the remainder of 2023, the occupational market is demonstrating a robustness that when coupled with rental growth should prove enticing to purchasers trying to access the sector.

Nonetheless, inflation and interest rates on both sides of the Atlantic, remain a significant threat to volumes. The US with CPI at 4% is significantly ahead of the UK (8.7%) in its fight against inflation. If inflation can be further tamed by the recent rate rises, then particularly **in the US we could see interest rate cuts by the end of 2023 (see Fig 4). Perhaps the UK will be seen to be more competitively priced at that point.**

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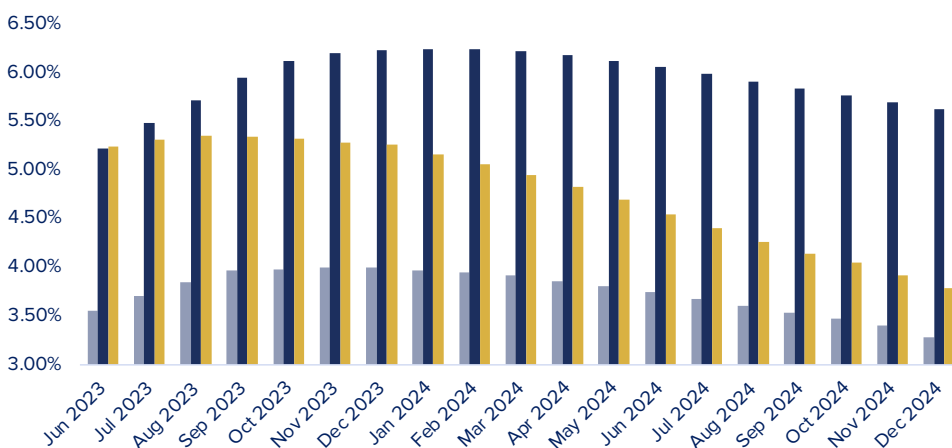


Fig 4
SONIA Forward Curve Indicates Higher for Longer Interest Rates in the UK

- ◆ Euro
- ◆ UK
- ◆ US

Source | Chatham Financial

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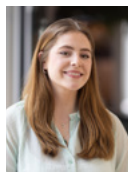
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