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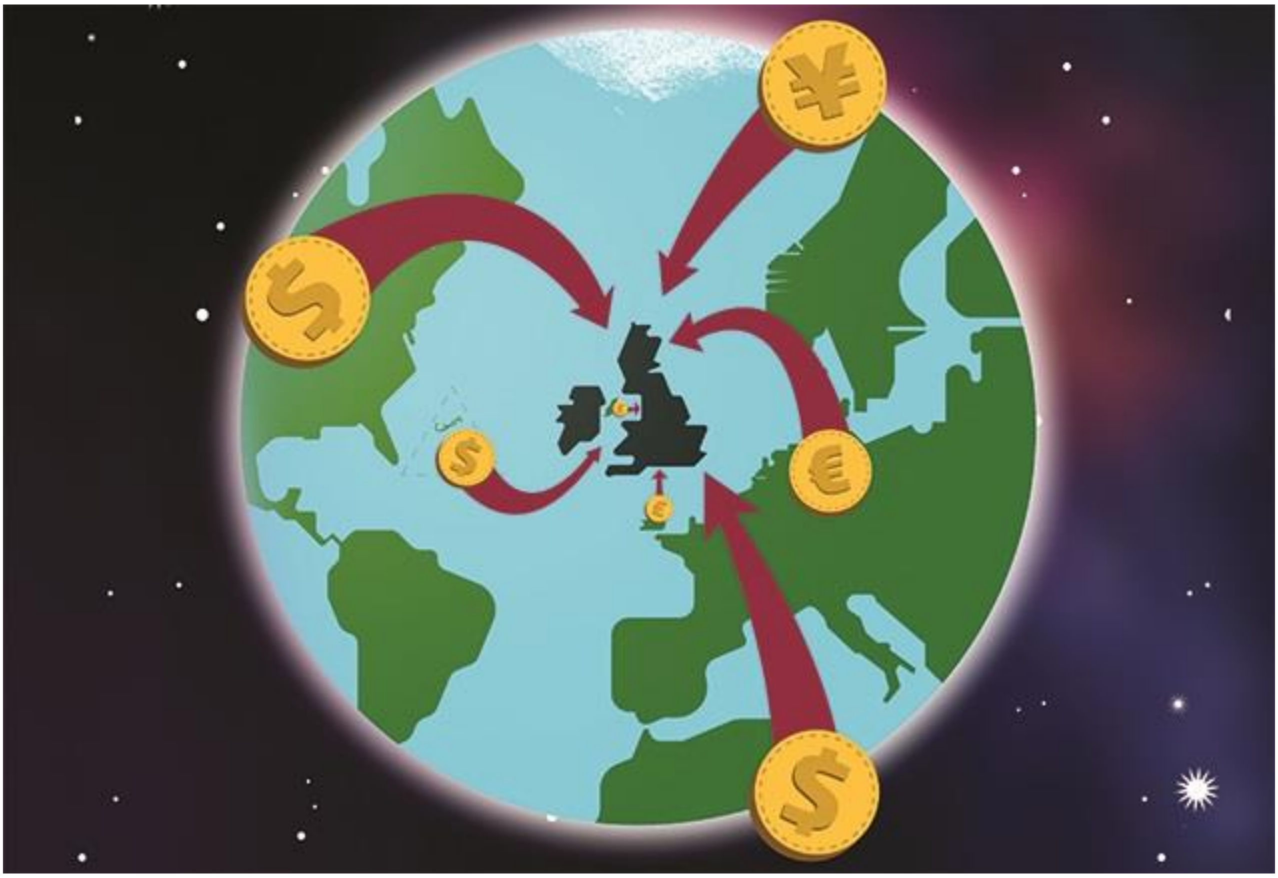
The year sheds became chic - how overseas capital is boosting industrial investment

24 May 2016 | By David Parsley

It was a record breaker and sparked a level of interest in the industrial market not witnessed for many years.



An influx of international capital is driving investor appetite for sheds - Source: Alan Dalby

While the logistics and industrial property sector has never been considered the most glamorous in the world of real estate investment, it has become more interesting in recent months.

Sure, the words ‘fashionable’ and ‘logistics’ do not appear in the same sentence too often, but it does look as if a sort of industrial chic is in vogue.

The record breaker was the £126m deal to buy the Amazon-let fulfilment centre in Leicestershire, fronted by BNP Paribas REIM on behalf of a private Korean investor. The 1m sq ft unit in Bardon was sold at a yield of 4.5%, a level even prime London offices are rarely reaching.

The deal, among others, demonstrates how occupier demand is driving investor appetite in the sector.

Hugh White, head of national investment at BNP Paribas Real Estate, acted for the buyer at Bardon, and believes that the industrial sector is set for a strong few years ahead.

"There are a number of factors driving the investor interest in the industrial and logistics sector right now," he says.

"Everyone bangs on about ecommerce, but the simple fact is the high street's loss has been the big shed market's gain.

"More and more products are sold online, so retailers need fewer and fewer shops on the high street, but they do need big, efficient distribution centres that can deliver to customers in very specific timeframes. Whether it's a 1m sq ft mega-box or the 50,000 sq ft edge-of-town centre, there's incredible demand for space."

An Amazon fulfilment centre in action - Source: Flickr/Scott Lewis/Creative Commons

The strong rental growth in the sector, with sheds in London now topping £20/sq ft, has led overseas investors to look at UK industrial, which is increasingly seen as a safe haven as other areas of the property world brace themselves for a slowdown, White adds.

"We've seen proper rental growth in the sector, and the occupiers generally offer good covenants," he says. "Just a few years ago, yields in the sector were at around 8% or 9%, but there has been an influx of overseas money, particularly from the Far East and, to a lesser extent, the Middle East, and especially in the last six months.

"It is, I believe, fundamentally a defensive play. In the way that retail used to, the sector offers low obsolescence, strong tenants and steady income. I believe the sector will be as buoyant as it is now for the next few years at least."

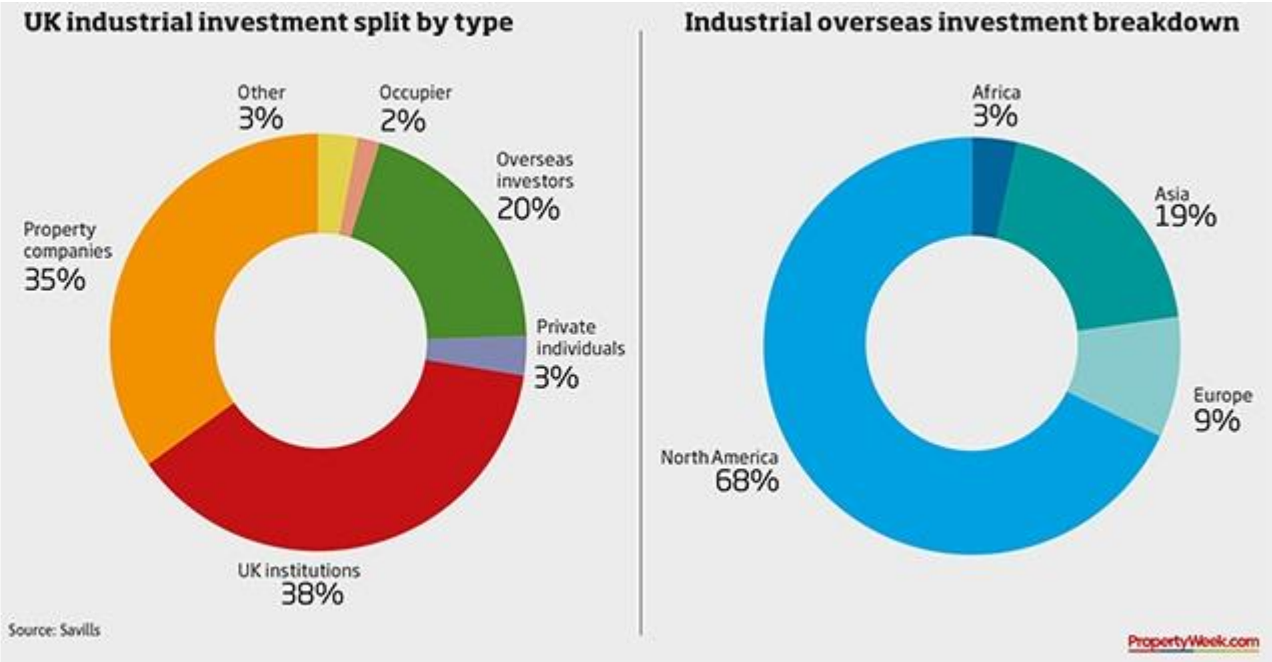
Overseas investment

Another demonstration of the influx of overseas money was revealed at the beginning of April, when the Malaysian Employees Provident Fund (EPF) bought a £200m portfolio of industrial assets from IM Properties, in one of the biggest portfolio sales to land this year.

The Project Phoenix portfolio is made up of 18 properties located on business parks and industrial estates stretching from Heathrow to Birmingham, totalling 2m sq ft. It has been sold to CBRE Global Investors, acting on behalf of Malaysia's state pension scheme, which had been keen to acquire prime UK assets in the distribution and logistics sector for some time.

The £200m price tag represents a significant chunk of IM Properties' group-wide holdings of £900m, but managing director Tim Wooldridge says now is the perfect time to further strengthen its buying power in the market.

The catalyst for the decision to sell, Wooldridge says, was the dramatic collapse in China's stock market last August and a slide in the commodities market.



"Most observers thought the tumble in share prices was just a blip, given its remarkable growth trajectory in recent years. We saw it as an indication of volatile times ahead," he recalls.

"We have always been opportunistic in our approach to deal-making, so thought it the ideal time to test the market for our industrial portfolio ahead of economic headwinds manifesting themselves in pricing. If solid interest was there, and at a strong price for us, we could generate a significant cash pile for acquisitions and expansion during a more uncertain 2016.

When economies start to slow, a lot of people just sit on their hands and wait to see what happens, but IM Properties prides itself on being fleet of foot, and thought there would be value opportunities for cash buyers, Wooldridge adds.

The hunger for the sector is also apparent in the number of new funds that have been launched in recent months. In January, Jamie Ritblat's Delancey bought a 60% share in Barwood Developments to form a new property development company called DB Symmetry, for instance.

The joint venture will focus on building out Barwood's land bank, which has an expected development value of more than £1.4bn, and may develop some sites speculatively. Barwood and Delancey expect to receive planning permission for more than 20m sq ft of logistics space over the next four years.

Meanwhile, Pacific Industrial & Logistics REIT, the new venture backed by property veteran Sir John Beckwith, floated on the London Stock Exchange's AIM market last month and acquired a £27.6m portfolio. The group is focused on UK industrial and logistics properties, typically single let, with average lot sizes of less than £10m. Its ambition is to build a portfolio worth more than £250m within two years.

Then there's Griffen Capital, a UK-based investment manager and adviser. Its main vehicle is the Griffen UK Logistics Fund (GULF), a Jersey-based investment fund focusing on the industrial and logistics sector in key locations in the UK. The fund is understood to be targeting investment of around £700m.

If further evidence were required to prove the industrial sector was in good health, Gerald Eve has provided it with its hot-off-the-press Prime Logistics report, which covers activity in the sector over the first quarter of 2016. It shows that while take-up during the first quarter fell 4% to 10.8m sq ft, it is still comfortably above the five-year quarterly average of 9.6m sq ft.

Pre-letting boost

It was the pre-letting activity of mega-sheds that helped drive take-up, with three deals of more than 1m sq ft completing during the period. The largest of the quarter was the purchase of 55 acres of land for a 1.2m sq ft facility by The Range at Western Approach in Bristol.

DHL also took a pre-let of 1.085m sq ft at Magna Park, Lutterworth, and Amazon pre-let 1.053m sq ft at Mountpark, Coalville, both in Leicestershire. Over the past five years, very large sheds have accounted for an average 6% of take-up per quarter. However, during the last quarter, they accounted for 36%. This pushed the average deal size up to 168,272 sq ft, from 103,478 sq ft in the fourth quarter of 2015.

Volumes traded in the first quarter were down 51% on the final quarter of last year, but such a drop is to be expected in the quarter after the year-end and should be compared with the first quarter of 2015, which showed an even larger quarterly fall of 68%.

DHL took a 1.085m sq ft pre-let at Magna Park in Lutterworth

George Underwood, a partner in Gerald Eve's national investment team, explains that some of this subdued activity could in part be explained by a combination of EU referendum uncertainty and a reduction in industrial allocations by institutions. This has not affected pricing, however, and prime yields remained flat across all its locations during the first quarter.

"Even though domestic institutions are not under the same pressure to invest," he says, "there continues to be significant investor interest due to the increase in overseas buyers in the first quarter who have kept pricing stable.

The hiatus in activity by institutions, particularly in the speculative development market, does perhaps leave an opportunity for other investors to enter the forward-funding market, given the still-attractive market fundamentals.

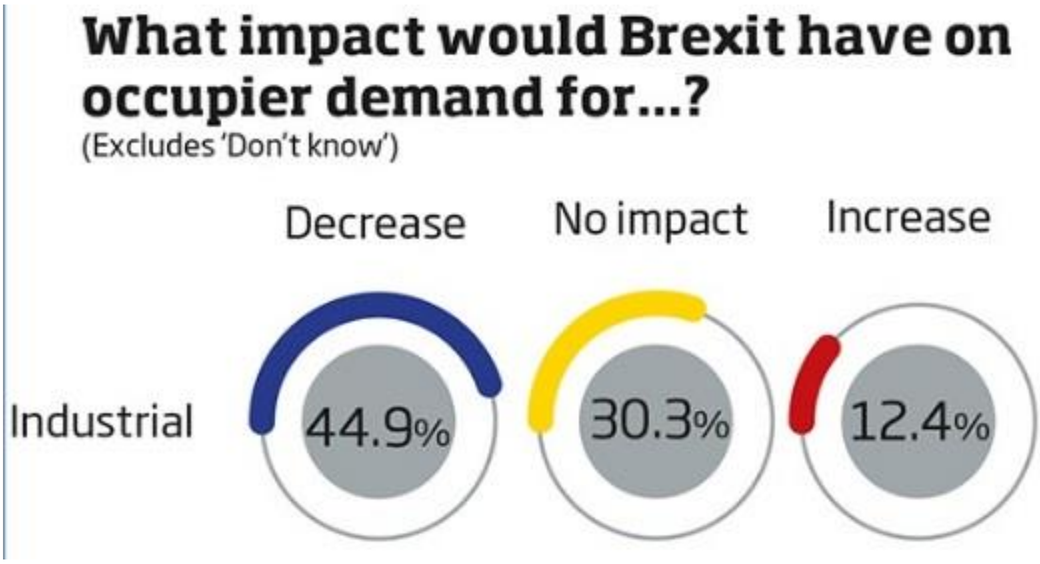
While Gerald Eve expects prime rental growth to remain positive, it also expects it to tail off somewhat. Looking forward, and inferring 'non-prime' rental growth from the relationship between IPD and prime rents, suggests that the non-prime segment, on the other hand, is set to experience superior rental growth over the next few years. Prime rents have already enjoyed strong growth and the supply of secondhand stock is limited, so Underwood expects there could be improved levels of rental growth on non-prime stock.

Brexit impact

Then there is the EU referendum to take into consideration. While the report states that the odds are currently in favour of the UK staying in the EU, a swathe of the electorate remains undecided. A vote in favour of Brexit would have serious long-term ramifications, he argues.

"Such uncertainty will have an undoubted effect on property and financial markets, and while there is likely to be a slowdown in activity, we could also see investors hedge against the impact and make the most of a temporary drop in pricing," Underwood elaborates.

“Life outside the EU will require the renegotiation of trade agreements, which could have an impact on the already struggling manufacturing sector, and if the domestic economy stalls and interest rates rise, then this too could have consequences for consumer spending and the demand by retailers in particular for logistics space.”



Whatever the outcome, Underwood believes the second half of 2016 looks set to be characterised by strong levels of occupier activity and more speculative development completions.

After all, he says, the fundamental attractions of logistics have much more to do with the assets themselves than with membership of the EU and heightened levels of investment transactions on prime stock.

“We forecast that distribution warehouses will deliver one of the highest total returns of all asset classes to 2018, at an average 7.8% a year. The fundamentals of the sector remain conducive to further investment and we still see further growth in both prime and non-prime rents to be had.”

The industrial and logistics sector has seldom been described as fashionable, but with industry commentators singing its praises and both domestic and foreign investors showing an interest, it might just be the next big trend.