Press Cutting

Client: Griffen UK

Publication: Estates Gazette

Date: 24 November 2016

Rise of the mach

MACHINES

The £200m invested in automation by Marks & Spencer at its 900,000 sq ft Castle Donnington warehouse could begin to look like small change when the next generation of machinery goes into action.

Automated picking and sorting systems are already big news: they could soon be a huge disruptor for a logistics sector still heavily reliant on people power (and the kind of floorspace and facilities people need). The Bank of England's chief economist, Andy Haldane, has predicted that robots will remove about 15m jobs, many of which will be in the supply chain.

Amazon's Kiva machines are now scuttling around warehouses carrying parcels and are said to have cut US supply chain costs by about 20%. Manufacturing is also listening out for the march of the machines. The 150,000 sq ft Rolls-Royce factory in Rotherham has been heavily automated, with the result that production times are down to a quarter of what they were.

Distribution giant Wincanton already has a number of semi- and fully automated warehouses in its portfolio. Managing director Liam McElroy says: "We have seen the difference that automated technology can make to a business."

Wincanton is supporting a major food manufacturer with a new Qubiqa layer picker. This machine is designed to create pallets of mixed products to customer specifications, sorting up to 180 layers per hour, 24/7. The result is that more than 90% of its despatched volume is untouched by a human hand.

Another recent customer project achieved pick productivity improvements of more than 50% as material flows were optimised by new automated technology.

This is just the start says McElroy, who talks enthusiastically of driving huge efficiency gains and improved levels of responsiveness during busy periods, using automated solutions, including robotics, conveyors and smart software.

"Take picking, perhaps the most basic but labour-intensive function within a warehouse. New automotive solutions mean that workers no longer need to waste time and effort physically locating and retrieving goods. Instead, goods can now be transported to the worker – increasing safety, minimising physical labour and reducing warehouse footprint," he says.

"It's not just the warehouse floor that is reaping the benefits of new innovations – stock auditing and tracking practices can now be a painless exercise. Everything can be monitored in real-time and recorded automatically – there is no need to manually scan a barcode to register a case; smart sensors do this for you. Improvements to operational efficiency and financial management can therefore extend across a business."

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Parcel companies and online platforms have reconfigured the UK warehouse sector, but under pressure from three big disruptors – people, machines and money – it could be about to undergo yet another phase of reinvention. *David Thame* reports

PEOPLE

Never underestimate the disruptive power of individuals – especially if they have a clearly thought-out strategy, and don't think that "It has always been done like this" is a convincing argument.

South African investor and developer Rui Nobre has been buying property in the UK since 2008. Since 2014, his business, Griffen UK Logistics Fund, a Jersey-based investment fund, has been focusing on the industrial and logistics sector in key locations across the UK, primarily the East and West Midlands.

Rui Nobre

Today, with around £200m invested and an 800,000 sq ft development programme under way, Nobre says the industrial sector is ripe for healthy and very necessary disruption. "It is needed because the market is rooted in inefficiencies," he says. "We have an opportunity to create a less lease-centric industrial property scene.

"This is not about disruption for its own sake. The e-commerce boom has destabilised the market, and we have probably got 10 years of opportunity before the market stabilises.

"Partly that is because of the feudal structure of property in the UK, partly because it is so reliant on long leases – unlike the three-, six- or nine-year leases in Europe, or five- and 10-year leases in the US. But in the UK, banks are still focused on long-dated leases, and the market gets skittish when it can't have them. But pulling in the other direction are occupiers who have simple specific requirements. For instance, they want their market and their suppliers and ports within four hours' drive time. They also think in terms of cubic feet, not square feet.

"The opportunity is there to make the market less lease-centric. Landlords will start to balance short-term leases on units in fantastic locations against long-term client satisfaction. And when I am told that is not how it's done here, it infuriates me. That expression doesn't mean anything."

Nobre says international investors like him will lead the change. Talking of long-dated leases, he says: "The market has been wrapped in cotton wool. A pampered local market is being exposed to international money."

FTI CONSULTING

Layer picker, Wincanton

MONEY

Follow the money is always wise advice – and the money in property ought to come from tenants to landlords. But what if it starts to go the other way, and landlords are accidentally subsidising tenants?

The problem is that warehouse operators increasingly think in cubic metres, while their landlords think in square feet.

Amazon's deal on 2.2m sq ft at Roxhill/Port of Tilbury's London Distribution Park is thought to be the first quoted in cubic feet, rather than sq ft. It reflects four layers of mezzanine flooring, each of 600,000 sq ft. The 20-year lease is said to reflect a rent of £3.60 per sq ft – no cubic feet figure is available.

Cubic deals are handy for occupiers, but might be less so for landlords and developers. Back-of-the-envelope estimates suggest that adding an extra 5m height-to-eaves onto a building adds 30-40% to the construction cost and 50% to the capacity, yet the rental increase may only be 5-10% (albeit over several years' income). This looks like a fantastic deal for occupiers.

Working out how to "rentalise" mezzanine flooring is even harder. According to estimates from Savills, for four levels over 160,000 sq ft with standard floor loadings, and assuming the foundations are up to the job, the cost might be £100 per sq m. Yet some landlords price as if it were financing (the cost of putting it up), not property (the value of its use).

Richard Sullivan, director at Savills, says: "The volume of the building is intrinsic to logistics, but at the moment volume does not get converted into rent, and tenants get the benefit of that. For landlords, the question of how to monetise mezzanines is difficult – it depends if they want the risk of taking a standard envelope and turning the building into a more bespoke unit. That is why some will prefer to leave it to the tenant, although in the Tilbury case obviously Legal & General, which funded the Amazon building for £150m, must be happy."

Len Rosso, director at Colliers International, guesses that sq ft pricing means the tenants are getting a better deal than their landlords.

"I think landlords would argue that if pricing by sq ft means they get a great customer, then that's good. There is no need to be greedy. And remember, industrial rents have gone up sharply over the past five years, so landlords have already done quite well," he says.

Sullivan suspects landlords will rationalise any costs entailed by pricing in sq ft by arguing that the building now has a longer potential earning life, because it is more flexible. On the other hand, not everybody wants a huge volume of air to heat – so maybe it is less flexible?

The economics are sufficiently unclear for Sullivan to wonder if the property business may come to regret not moving to cubic pricing a lot sooner. "Occupiers have got used to paying what they pay for sq ft – they will push back if landlords try to change it," he warns.

ALIBABA

If you think Amazon has been disruptive, what could Alibaba do?

The Chinese online retail giant has been gently edging into the UK market for the past two years. In July, it took 240,000 sq ft at Prologis' 4XP site in Dunstable, Bedfordshire – its first big UK logistics acquisition.

Due to be operational by Christmas, it will be Alibaba's UK and European distribution base – and although this is its first UK warehouse, it is unlikely to be its last. In anticipation, a tiny UK head office of 15 is growing to 60-plus.

"I hope it's not the last we see of Alibaba, but it is clearly risk-averse. This deal is through a third party and not on its balance sheet," says Colliers' Len Rosso, quashing hopes that the Chinese business will be appearing soon at a warehouse near you.

However, the extent of Alibaba's power to disrupt is obvious: this summer the firm announced that it expects to record 6tn yuan (£726bn) in gross merchandise volume in 2020, roughly double the 3.1tn yuan this year.

According to NASDAQ figures, in 2015 Alibaba's GMV was $398bn (£326bn) compared to Amazon's $226bn.

But revenue tells a different story and shows how far Alibaba has to go: $14bn for Alibaba, $107bn for Amazon.

If Alibaba can successfully move into higher-value European markets, analysis say it could quickly give Amazon a run for its money. And that means a big shake-up for the warehouse sector, where Amazon is a market-dominant tenant.

(According to Savills, Amazon took 26% of UK warehouse floorspace let in the third quarter of 2015.)

Cainiao, Alibaba's delivery partner, is expected to grow its Chinese logistics network to more than 54m sq ft this year, and if just a fraction of this eventually came to the UK, it would have enormous implications.

Cushman & Wakefield, Savills and Colliers International acted for Prologis in the Dunstable deal. Aspect Property Consultants was the acquiring agent.