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Shorter UK warehouse leases could boost rent growth

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By Benn Dorrington

Industrial tenants in the U.K. are increasingly pushing landlords to offer shorter lease terms, and that trend could fuel rent growth in the sector, a warehouse landlord says.

Rui Nobre, CEO of investment adviser Griffen Capital, which has invested about £200 million into U.K. industrial property through its fund, said lease terms shorter than the common 15-year period are becoming more prevalent for logistics warehouses in Britain as third-party logistics providers (3PLs) and international landlords challenge the status quo. Warehouses are often considered a safe bet for investors in the U.K. because the lease terms are typically longer compared to the office and retail sectors.

Nobre, who has been investing in the sector since 2008, said 3PLs often want lease terms that reflect the terms of their delivery contracts with retailers and other businesses, but are generally offered 10- and 15-year lease terms. Occupiers, in response to longer leases, have traditionally pushed back when landlords wanted to raise rents, he said. However, in the last few years, landlords have been able to raise rents more aggressively due to strong take-up and a shortage of supply.

The CEO believes a shift toward giving tenants more flexibility in their lease terms could promote even further rental growth and provide more opportunities for landlords to improve assets and review rents.

International money is also driving change. Nobre said commercial landlords from other countries were familiar with flexible terms in their home markets and were open to working with shorter terms in the U.K. He pointed to mainland Europe's standard terms of three, six and nine years, as well as five- and 10-year leases in the U.S.

[Prologis Inc.](#) is one industrial landlord that has offered more flexible lease terms, says Savills SE industrial director Bridget Outtrim, who advises tenants, landlords and developers on industrial real estate. She said the U.S. property company prefers longevity in general but is known to offer very flexible terms to occupiers in the U.K. in exchange for higher rent. As a rule of thumb, Outtrim said occupiers always want more flexibility, while landlords prefer certainty.

She added that lease terms are shaped by a range of factors, including the quality of the building, the location and, critically, the availability of supply. According to Savills' April research, while 2.9 million square feet of stock was added to the U.K. market during the first quarter, strong take-up levels of speculative and second-hand stock have kept nationwide supply of logistics real estate low at 26.3 million square feet.

It follows a record year in 2016, which saw a take-up of 34.6 million square feet of logistics space in the U.K. The ascent of online shopping and home delivery has disrupted the market in recent years. Retailers and parcel companies are behind buoyant demand for warehouses as they seek to improve their supply chains and keep pace with the likes of e-commerce giant Amazon, which accounted for 23% of U.K. take-up last year, according to Savills. Supply levels will face further pressure in years to come with only 4.4 million square feet of development projects due for delivery over the next 18 months.

Contrary to Griffen's Nobre's argument, competitive market conditions are prompting some tenants to request even longer terms of up to 25 years, according to Colin Godfrey, partner and fund manager of [Tritax Big Box REIT Plc](#). "Tenants want to sign long-term leases because it gives them long-term certainty of being in that location, which is mission critical to their operations," he said. The fund manager said warehouses are strategically important to retailers, who often invest tens, if not hundreds, of millions of pounds into the fit-out of such buildings.

With the difficulty of finding the right site in the current low-supply market, Godfrey said businesses want to hold on to their positions and avoid disruptions to their supply-chain networks. He added that mega warehouses, also known as big boxes, tended to have longer lease terms, while landlords were more likely to accept shorter terms on smaller or older buildings.

Average lease terms for SNL-covered landlords in the sector vary greatly, according to the latest earnings releases. Mega warehouse-focused [Tritax Big Box REIT Plc](#) recorded a weighted average unexpired lease term of 15.3 years during 2016. [SEGRO Plc](#), a pan-European business holding both big box and smaller urban warehouses, said the average lease terms for 2016 were 8.2 years in the U.K., compared to just 5.2 years in continental Europe. [LondonMetric Property Plc](#)'s mixed warehouse portfolio reported a WAULT of 12.7 years for the six months to September 2016.

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Tritax Big Box REIT Plc (BBOX-LON)	£ 1.42	0.50%
LondonMetric Property Plc (LMP-LON)	£ 1.67	(0.30%)
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