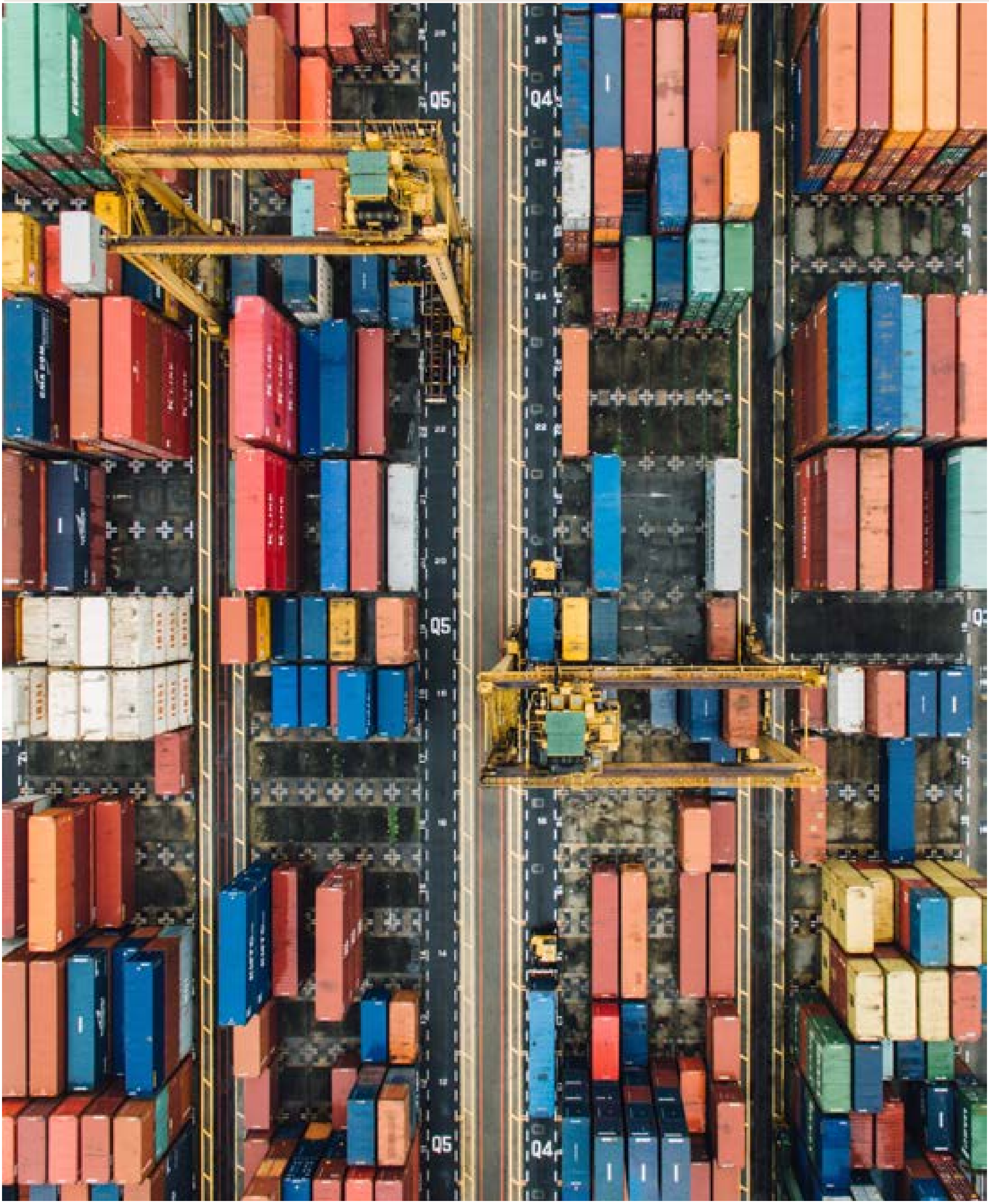
SPOTLIGHT
Savills Research

European Commercial – Autumn 2023

2023 European Real Estate Logistics Census



● Landlords ● Investors ● Developers ● Occupiers

Introduction

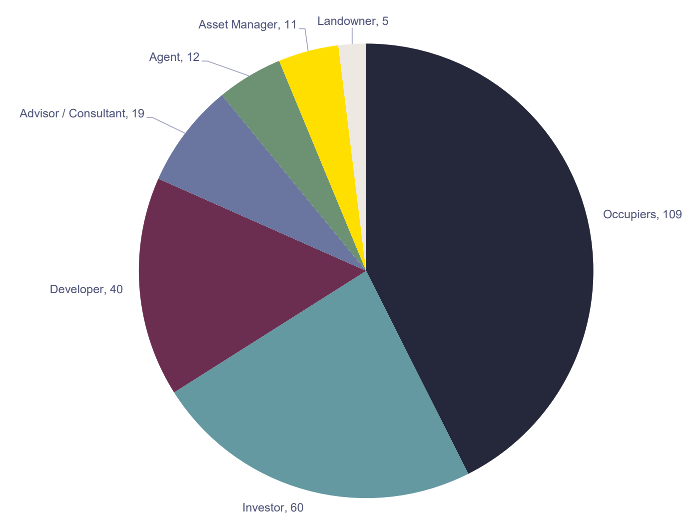
In the first half of 2023, the European logistics market faced significant macroeconomic challenges. Take-up decreased by 37% compared to the record high in H1 of 2022, but we believe this is due to a return to normal demand levels. Historical trends show that the 13.2 million sq m of logistics space signed in H1 2023 still surpasses the 11.7 million sq m recorded in the same period in 2018 and 2019, before the Covid pandemic.

The economic turbulence has had a greater impact on the investment market than on the occupier market. In the first half of 2023, investment volumes reached only €10 billion, which is significantly lower than the H1 averages of €25.3 billion during the pandemic (2020-2022) and €16.7 billion before the pandemic (2017-2019). Despite this decrease in volumes, investor interest is still higher than before the pandemic, with investment into logistics property accounting for 17% of total real estate investment volumes compared to the average of 13% between 2017 and 2019. The Census suggests that both volumes and shares may improve, as 24% of investors and asset managers claim to be under-allocated. However, this may be partly due to the fact that logistics values have decreased at a faster rate than many other asset classes in the four-quarters to Q2 2023.

Despite short-term headwinds, we believe that occupier markets will continue to benefit from the well-documented mega-trends that have underpinned the sector over the last decade and were amplified by the onset of Covid. These drivers remain in place today, even as the near-term macroeconomic outlook remains challenging. There are some promising signs in the investment market. Whilst inflation has persisted, interest rate hikes have begun to take effect, and we have seen price growth start to decelerate as the year has progressed.

Given the market backdrop, understanding occupier and investor intentions and gaining insights into their key challenges and opportunities is crucial. Savills and Tritax EuroBox are delighted to share the results of our third annual European Real Estate Logistics Census. Global supply chain consultancy Analytiqa undertook the Census and data collection over the summer of 2023. In total, 256 key players in the sector took part, comprising occupiers (43%), investors (23%), developers (16%), advisors and consultants (7%), agents (5%), asset managers (4%) and landowners (2%). Occupiers were further split into retailers (37%), logistics (34%) and manufacturers (29%).

Chart 1: Census respondents by type



Source: Savills, Tritax EuroBox

How are business conditions for the survey respondents?

Our survey results suggest an improving outlook among occupiers, with 42% saying current business conditions are more favourable than six months ago. This is an improvement compared to the 35% who felt the same way a year ago, suggesting that occupiers have adapted to the economic situation and are more optimistic about the future. However, respondents in the broader property sector, such as developers, landowners, and agents, have become more pessimistic (27%). The current economic situation is uncertain, as reflected in the variety of responses we received from all categories of respondents – ranging from "much more favourable" to "much more difficult."

Occupiers were less concerned with rising costs than last year (42% in 2023 vs. 60% in 2022), likely due to slowing inflation in recent months. Economic uncertainty remains the second most common factor affecting businesses, with 28% of responses citing it as a concern, consistent with last year's survey. Other issues, such as labour availability (21% vs. 34%), end consumer price issues (19% vs. 28%), and warehouse space availability (16% vs. 18%), have all eased this year.

Logistics occupiers are the most worried about rising costs (54% compared to 31% of manufacturers and 40% of retailers), likely due to the broad based nature of inflation and in particular increases in fuel prices over the past year due to the ongoing conflict in Ukraine. While only 5% of logistics occupiers are concerned about supply chain risks, 22% of manufacturers and 23% of retailers are. Similarly, manufacturers (22%) and retailers (23%) are more worried about end consumer prices than logistics occupiers (16%), reflecting the differences between the sub-sectors.

Chart 2: How do you view business conditions when compared with the last six months?

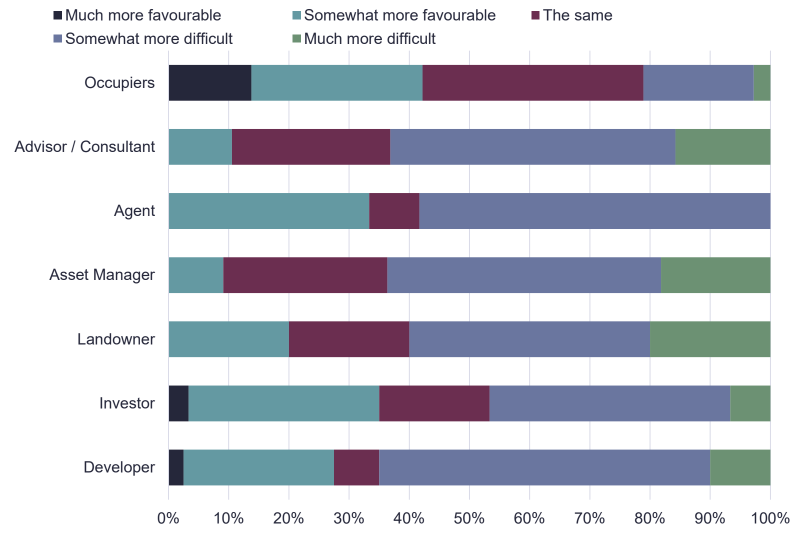
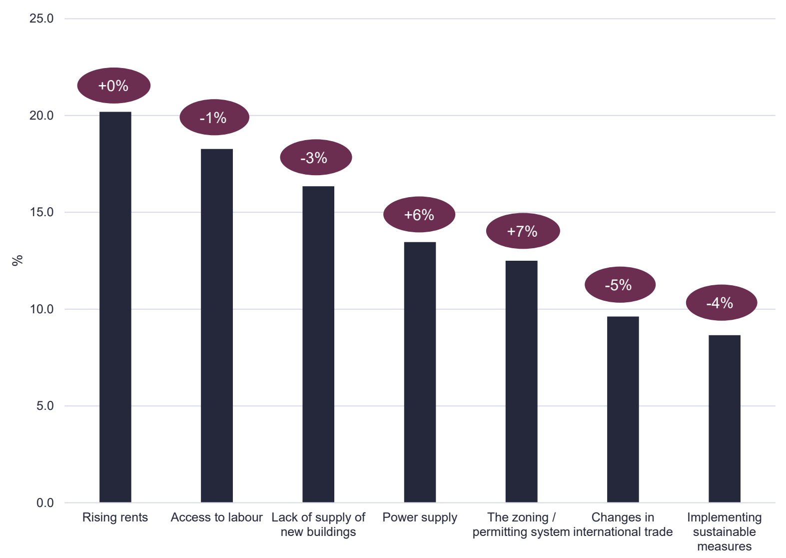


Chart 3: What concerns do occupiers have this year compared to last year?



N.B. The charts presented in this report track respondents, not responses, so totals will not

Source: Savills, Tritax EuroBox

Investors have become more discerning

Uncertainty and challenging credit conditions have led to a sharp fall in investment volumes in the sector in the short term and, as shown by our results, led to investors becoming much more discerning in potential investments. Almost a quarter of investors (23%) that participated in our Census remain underweight in logistics real estate compared to 20% that are overweight. Crucially, 76% of respondents expect to allocate more or a similar amount of capital into the sector this year.

There have been limited changes to investor priorities: power supply and labour availability have risen to 6th and 7th, with long lease lengths falling back to 8th. With the exception of long lease length, every criterion has increased in importance to investors. Building location remains top of the priority list. It also saw the greatest increase, with 92% of investors ranking it as "important" or "very important". Achieving rental growth is a priority for 84% of respondents, highlighting its importance. While ESG is one of the lowest priorities for occupiers when considering space, 77% of investors believe it is "important", likely reflecting concerns about future building obsolescence.

In terms of challenges to deploying capital into the sector, investors ranked market pricing as the greatest hurdle, jointly followed by difficulty in obtaining credit and a lack of suitable logistics stock to invest in. We would draw two conclusions from this. Firstly, the investor market will likely remain slow in the second half of the year until buyer and vendor expectations come more in line with each other. Secondly, upon reaching this inflection point, there will be significant competition for limited stock that satisfies investors' requirements.

Chart 4: Investors: what factors are important or very important when deploying new capital?

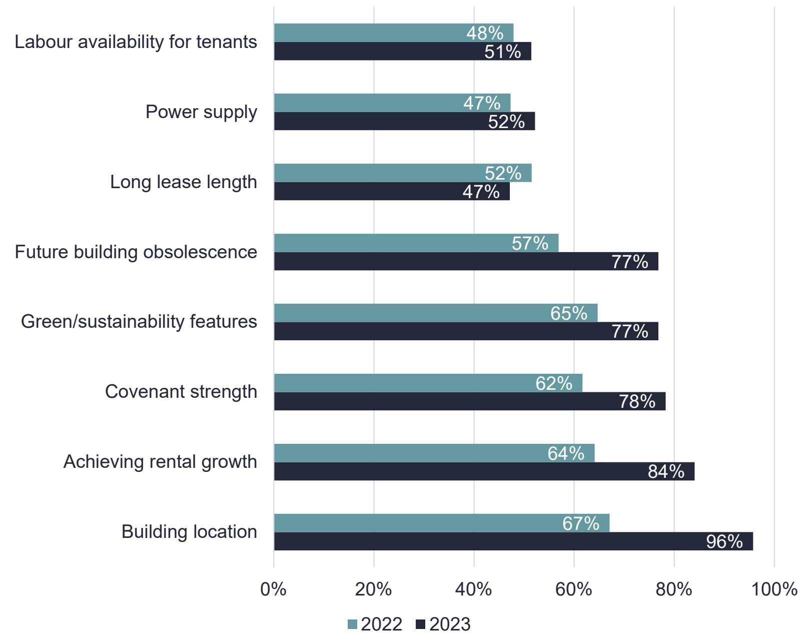
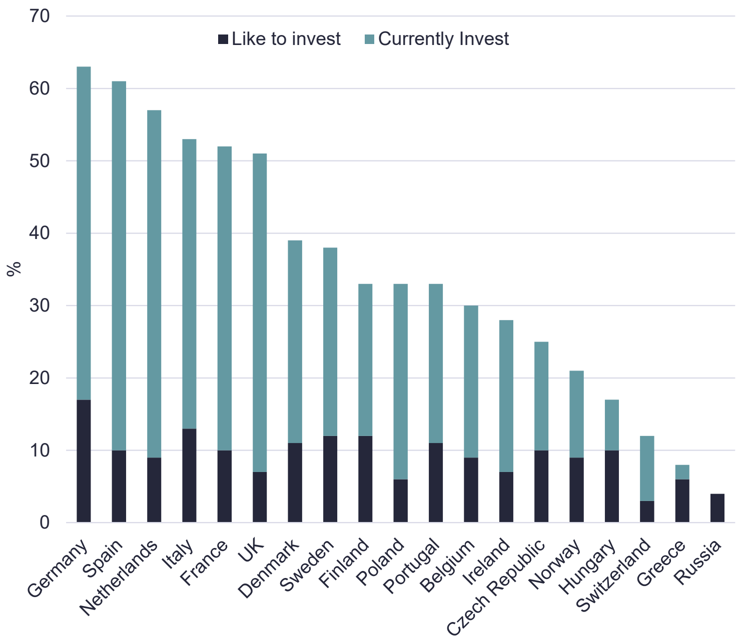


Chart 5: Investors: where do you expect to deploy capital over the next three years?



Source: Savills, Tritax EuroBox

A lack of suitable sites continues to affect developers

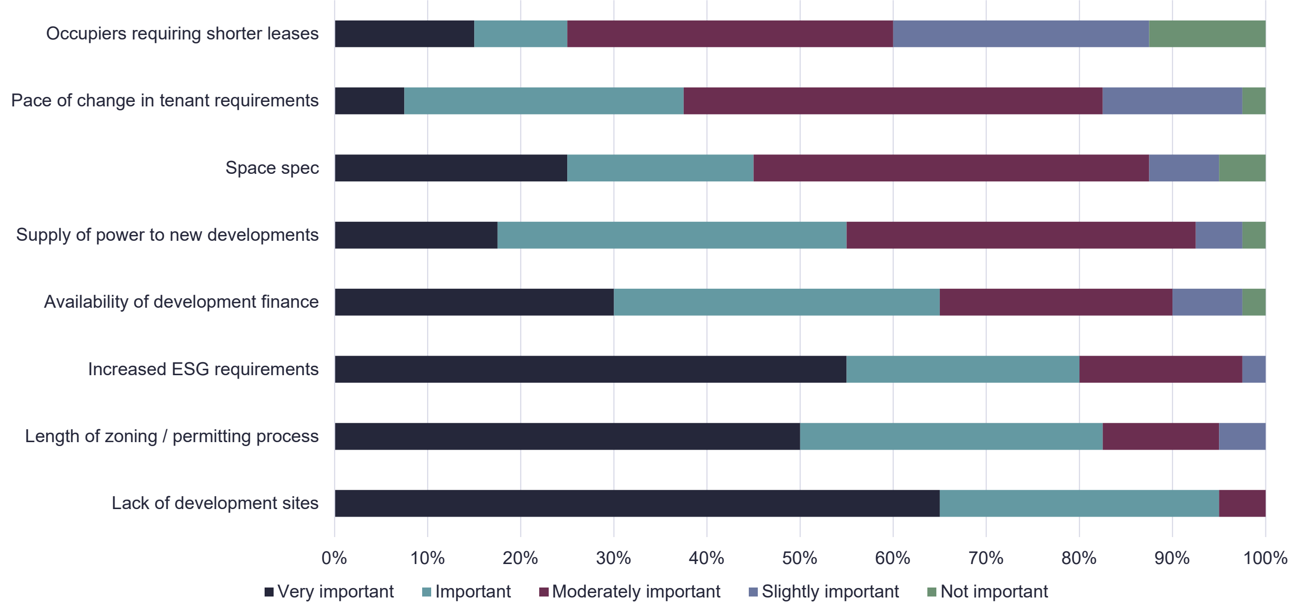
For the last decade, rising rents and declining yields have created an attractive market environment for logistics. The lack of potential new sites and managing cost price inflation were the biggest challenges for developers in this period.

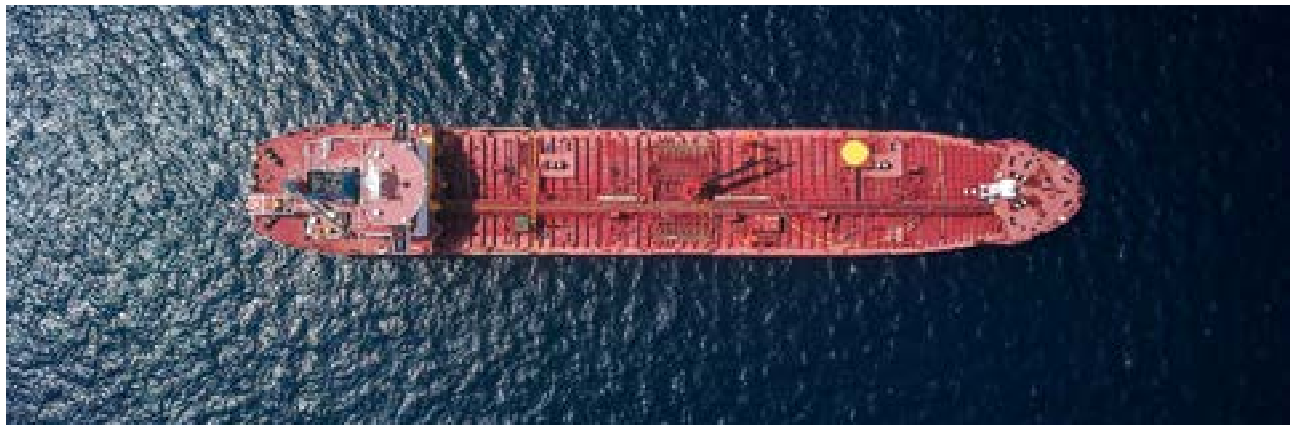
Sourcing new sites has become a greater challenge for developers, rising from 76% in 2022 to 95% in 2023. Developers have also noted the length of the zoning/permit process and increased ESG requirements in their responses, with 83% and 82% ranking them as "important", respectively.

Developers have noted a decrease in the supply of developable land (-55%) and half commented that their business had been impacted by the decline in occupier demand through H1 2023. Cost price inflation is seen as stronger by 40% of developers and the same by 43%. With 53% of developers believing occupiers are more accepting of higher rents, any rental increases could marginally offset cost inflation. Issues around construction delays and the availability of raw materials and labour are all considered relatively equal.

Developers continue to focus on property characteristics, and more technical features remain in focus. Yard depth, floor loading, eaves height and ESG requirements are all important factors for respondents when developing new industrial and logistics properties.

Chart 6: Rate each of the following issues in terms of their level of importance when considering new industrial and logistics developments.





Source: Savills, Tritax EuroBox

Logistics real estate remains mission-critical for occupiers

A challenging macro environment was reflected in our survey with rising costs registering as the main issue for occupiers (42%). This came as no surprise, given the levels of inflation experienced over the last year. Other factors that remain in the spotlight are the availability of labour and warehouse space, supply-chain risk and keeping up with new technology.

This market backdrop has stalled expansion plans for some with 39% of occupiers scaling back or delaying by 1-2 years. Pressures appear to be viewed as short-term, however, as only 12% are scaling back or delaying by 2-5 years and only 3% are on hold indefinitely.

However, there are signs of stabilisation. 42% of occupiers view the macro environment as more favourable than six months ago (compared to 35% a year ago) and 39% of occupiers expect to increase their take-up in the next three years, compared to 25% a year ago. Building requirements remain consistent, with 83% of those looking for new space considering mega- or mid-boxes compared to 78% in 2022. 30% are looking for urban logistics solutions (2022: 32%).

The Census highlights an ongoing evolution in occupier supply chains which is expected to lead to further logistics real estate requirements. Post-pandemic, occupiers are less focused on stock building (with 18% planning to increase stock now compared to 38% last year) and have shifted to longer-term solutions. Looking forward, 33% plan to increase their use of automation and 25% intend to improve their IT systems. Greater adoption of electric and/or autonomous vehicles will also be on the agenda, but it is noticeable that investment is already well advanced with nearly half of companies investing in EVs over the last 12 months.

Chart 7: What changes have you not implemented yet but still plan to do in the next 12-24 months?

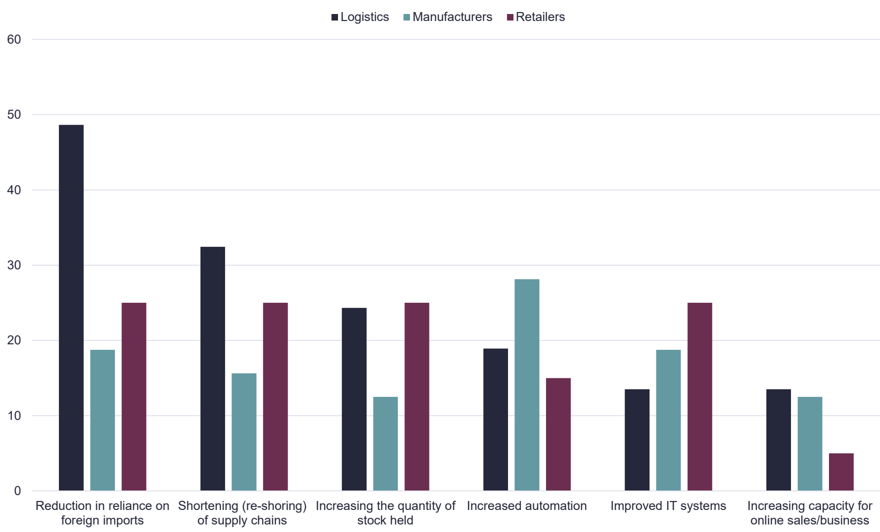
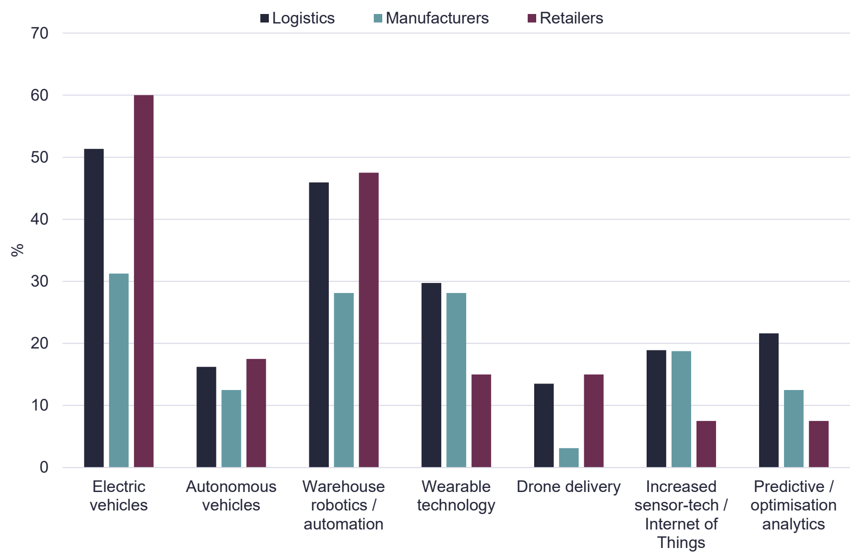


Chart 8: What supply chain technologies have you invested in over the past 12 months?



Source: Savills, Tritax EuroBox

European Real Estate Logistics Census

ESG has moved from ambition to action

Volatile energy and fuel prices over the last 12 months have seen companies increasingly focus on improving efficiency, using more renewables and energy storage. This has pushed ESG even higher up the agenda and further encouraged companies to move from ambition to action. From a physical property perspective, the data shows three things really matter: carbon performance, renewable energy and energy efficiency.

Crucially change is happening now. In the last 12 months, 45% of occupiers have implemented measures to improve energy efficiency and 39% have done something about EV charging. When asked what measures they are likely to implement in the next 12 months, 51% of occupiers rated renewable energy generation and storage as their top priority.

Social factors are also important but the industry as a whole still has some way to go with only 44% currently offering basic amenities in their logistics buildings.

How occupiers rank ESG criteria in importance:

1. **Renewable Energy**
2. **Carbon Performance**
3. **Building Certification/Energy Efficiency**
4. **Staff Wellbeing/Working Environment**
5. **Social Values/Community Impact**
6. **Energy/Power Resilience**
7. **Climate Resilience**
8. **Biodiversity**

Summary

Five key considerations

1. Occupier sentiment appears to be improving: Despite the continued economic uncertainty, 42% of respondents said that business conditions were more favourable than they were six months ago. This compares to just 36% in last year's Census. Notably we picked up a mixed array of responses with agents and landlowners tending to have a more negative view of current conditions.

2 . Investors have become more discerning in the assets they would consider: When asked what was considered important when deploying capital, we found that investors were more likely to consider all factors. Location and rental growth are standout priorities but investors are increasingly concerned with building obsolescence and ESG credentials.

3. The availability of suitable sites remains a key issue for developers: Even as development has slowed in recent quarters, developers have continued to rate the supply of sites as their greatest challenge. We expect this problem to intensify when the market recovers. Planning delays and ESG requirements also ranked highly in terms of the challenges facing developers.

4. EVs, automation and IT improvements are popular supply chain solutions: Investment in new technology has seen an uptick in interest from occupiers this year with a large portion either already invested in these technologies or planning to. Developers should be mindful of the greater power supply and fit-out requirements that these technologies will require.

5. Cost-efficiencies are driving engagement with ESG stock: Even as ESG ranked relatively low on occupiers' priorities, carbon performance, energy efficient and renewable energy ranked on their ESG building requirements. We believe that agents and landlords who can communicate the cost saving impacts of their ESG rated stock will be able to reduce void times and achieve higher headline rents.

Savills Commercial Research
We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

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