European Commercial – Summer 2020

SPOTLIGHT
Savills Research

European Logistics Outlook

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● Occupational Demand ● Investment Outlook ● COVID-19

COVID-19 impact to speed up ecommerce growth by one year

Economic Overview

As Europe starts to think about how it is going to drag itself out of the deepest economic downturn ever recorded, consumers are trying to take stock of their own financial positions and brace themselves for the inevitable short-term pain that lies ahead. Perhaps most significant to this will be the removal of furlough schemes, that have provided vital support through the crisis but are also in danger of having created a cliff-edge moment for the economy. French and German furlough schemes have been extended into 2021, although UK, Italian and Spanish schemes are on course to terminate this year.

Economic growth forecasts continue to fluctuate around the number of new outbreaks, although Focus Economics' August forecasts indicate Eurozone real GDP will fall by 8.2% during 2020 with a 5.5% increase in 2021. The level of uncertainty is very high though and a second wave and further lockdowns will quickly alter the path of any recovery.

For example, Apple's transit mobility data indicates a gradual return to public transport usage as consumers begin to feel more confident about the pandemic and government incentive schemes encourage people back to physical retail, although fears of a second wave have since reduced public transport usage from the June/ July post COVID-19 peaks, noticeably in Paris and Madrid.

Throughout the crisis the logistics sector has provided some respite and it has become an even more vital part of people's lives. Many workers have taken on temporary positions in fulfilment and distribution centres, to help in the response to the pandemic accelerating the demand for ecommerce. We are also observing more anecdotal evidence of short term employment in the delivery sector, for example French light commercial vehicles (LCVs) registrations have increased by 8% yoy in June, in order to meet the rising demand for last mile delivery.

One challenge for the European logistics market is the stagnating levels of continental and global trade. Intra- EU trade growth was relatively flat during 2019, and the World Trade Organisation (WTO) estimate global trade to fall between 13% and 32% during 2020. Although lower oil import prices have provided some respite for European manufacturers, companies are ultimately reviewing their supply chains and looking to nearshore some operations in order to mitigate risk. According to the Institute for Supply Management's (ISM) July survey, 20% of firms are planning or have already begun to re-shore or nearshore some operations.

It has to be said that we are still only dealing with the initial shock of the crisis - as we move into the recovery and rebuilding phases then companies will have a chance for reflection and longer term decisions can be made as stability returns. Increases in online spending have always meant increased demand for warehouse space but the big question for stakeholders in the logistics market will be what the longer-term, stable outlook will be for consumer spending as a whole, and online spending within this. Noting at the same time that it is the key driver for the market but risks in other areas such as manufacturing and production will also have a significant baring.

COVID-19 impact to speed up European online retail sales by one year

Retail sales volatility has reached record levels with online retail sales accounting for unprecedented levels of total retail sales, spiking to as high as 33% in the UK during lockdown period.

The Centre for Retail Research's (CRR) July 2020 forecast Western Europe's six largest economies' online retail sales as a percentage of total sales will rise from 12% in 2019, to 16.2%

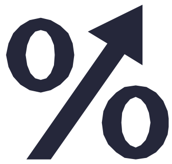
“*Increases in online spending have always meant increased demand for warehouse space but the big question for stakeholders in the logistics market will be what the longer-term, stable outlook will be for consumer spending as a whole, and online spending within this,*”
Marcus De Minckwitz, Regional Investment Advisory.

in 2020, before easing back to 15.3% during 2021 (Chart 1), reflecting a normalisation of consumer patterns as shops reopen and consumers return to the high streets.

Spain and Italy are expected to see the most significant impact given that pre-Covid they had relatively low online sales proportion, which are expected to increase to close to the 10.7% tipping point where Savills observed a marked increase in logistics demand within the UK.

Prior to COVID, the Western European average online retail sales penetration was forecast to reach 15.3% by 2022. However, the CRR's post COVID online penetration rate forecasts indicates that this level will now be reached by 2021, suggesting the "COVID impact" will accelerate the online retail sales growth trajectory by one year.

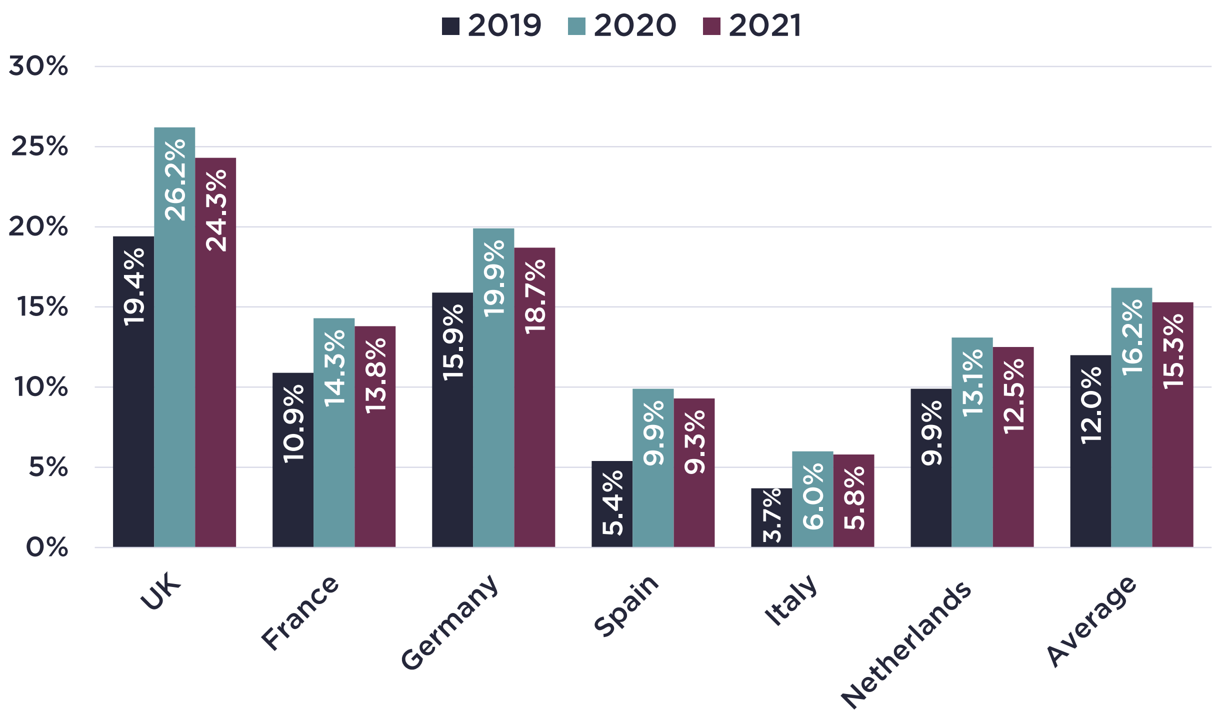
Consumer confidence will play a huge part in determining retail footfall and online expenditure into 2021, particularly around the grocery sector. Mintel estimate that the UK's online grocery sales will grow by 33% yoy in 2020, as Amazon Fresh have provided free grocery delivery service to Londoners for Prime members. Dutch online supermarket, Picnic, has expanded into Germany and is developing an automated distribution centre after attracting €250m of financing in 2019. LIDL and Holland Food Group have also signed for 48,000 sq m and 30,000 sq m respectively so far this year in the Netherlands.



Western European online retail penetration rate is forecast to normalise at 15.3% by 2021.

20% of firms have already begun to re-shore or nearshore some operations.

Chart 1: Online retail sales as a percentage of total (%)



Source, Savills Research, Centre for Retail Research

European logistics demand shows resilience through COVID-19

Occupier demand

European logistics demand reached 12.2m sq m during H1 2020, 4% below the five year, half year average (Chart 2). Portugal (+86%), Romania (+78%), the UK (+41%) and Poland (+31%) performed the strongest against their respective half year averages, however, weaker levels of take up were recorded in France (-36%), Spain (-31%), Netherlands (-27%) and the Czech Republic (-14%). This was largely due to the inability to conduct viewings and sign leases during Q2 because of government lockdowns, although Q1 leasing activity remained fairly resilient.

In the UK, 43% of H1 2020 take-up can be attributed to online retailers, with Amazon alone accounting for 36% of the total. Furthermore, 3PLs accounted for 15%, many undertaking contracts for the NHS.

We have observed an increase in the number of coronavirus related short-term leasing deals. In the UK, 11% of deals were short-term lease agreements as a result of Covid-19, including space to hold excess stock by retailers with a dominant high street presence. In Poland, the number of leasing deals shorter than one year signed during H1 2020 has already exceeded the previous full year values. In Czech Republic, Savills estimate that short term leases accounted for an additional c16-24% of leasing activity during H1 2020. We are also observing a number of food retailers searching for land plots suitable for build to suit development across Central Eastern Europe (CEE) following rising demand for food delivery on online platforms.

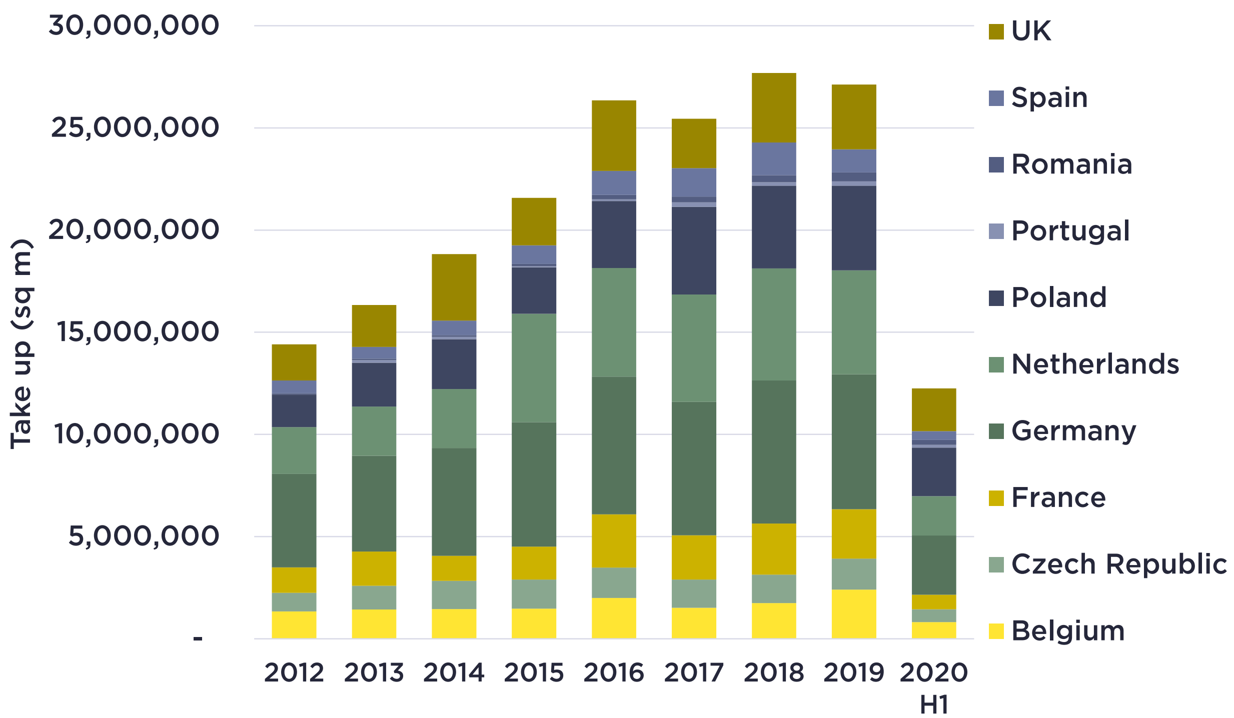
Vacancy rates (%)

Average European vacancy rates increased from 5.1% to 5.8% during the first half of 2020, although this remains low by historical standards, and well below the 12% equilibrium for stable rental growth observed within the UK. Czech Republic (4.4%), Stockholm (4.0%) and Barcelona (4.0%) remain the most undersupplied markets.

A shortage of available space will be the prolonged challenge for many occupiers throughout the remainder of 2020 and into 2021 and we expect to see increases in the proportion of lease regears. In Lisbon for example, 84% of first quarter and 78% of second quarter take up in 2020 was in the form of lease renewals, citing a lack of supply in the market. Some landlords have used COVID-19 as an opportunity to regear leases and increase the WAULT on their portfolios, offering additional months' rent free in exchange for longer commitments.

Business uncertainty however is resulting in occupiers seeking shorter lease terms. In Germany, we have observed occupiers seeking regears for three year terms, rather than standard five year extensions as they look to ride out the economic uncertainty. Landlords however are reluctant to offer shorter lease commitments and therefore incentives for shorter terms have reduced. For many occupiers, existing warehouses are no longer suitable to meet the increased demands of ecommerce. We are seeing a rising number of 5-10k sq m requirements across German cities to meet the level of coverage required for last mile.

Chart 2: European logistics take up (sq m)



Source: Savills Research

Landlords will be paying closer attention to the level of second-hand space which could return to the market amid business failures over the next 12 months. Foodstores and retailers with an established online presence are expected to be more sheltered to business failure than those retailers who were slow to adopt an omnichannel offering.

Development

The level of new speculative space coming through remains limited and developer caution is likely to hold back any speculative announcements until more visibility on the economic impact of COVID surfaces. In Poland for example, of the 1.9 million sq m of development forecast for the remainder of 2020, 62% is currently prelet. Likewise, Czech Republic (55%), Romania (80%) and Sweden (85%) pipelines are majority prelet, with several cases of developers pulling speculative starts.

As construction periods for logistics units usually range between 9-12 months, we expect a more limited level of warehouse completions in 2021. Developers will then take stock and review the extent to which occupier demand levels have normalised as the initial impact of the coronavirus outbreak subsides.

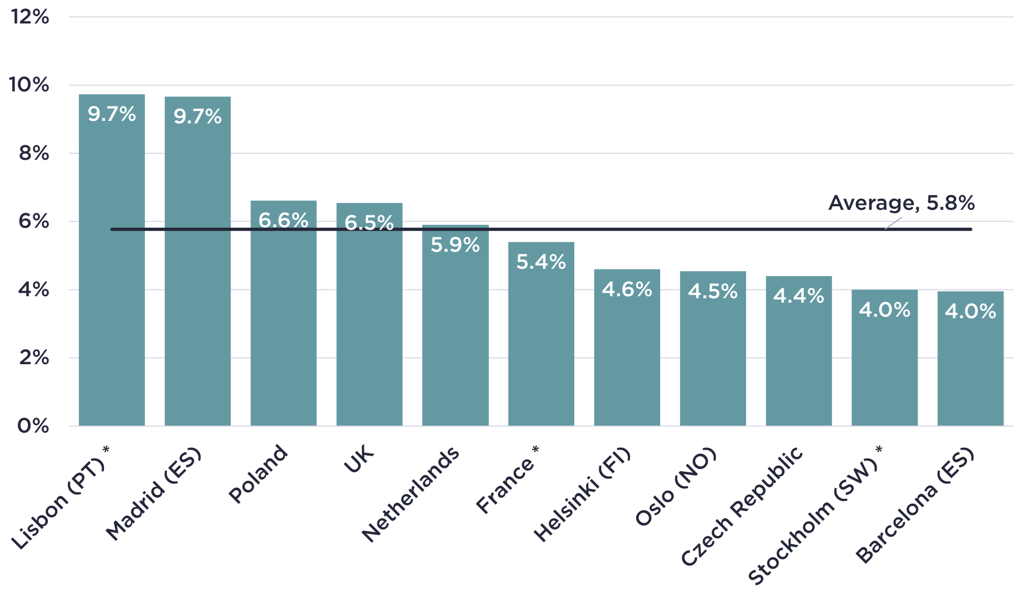
Rents

European prime logistics rents remained stable during H1 2020, with positive growth in London (+8%), Hamburg (+7%) and Frankfurt (+3%) cancelled out by rental declines in Oslo (-7%), Bucharest (-5%) and Upper Silesia (-3%) (Chart 4). However, 15 of the 22 markets we cover reported no headline rental growth during the first half of 2020 and we anticipate more subdued net effective rental growth through 2021 as occupiers take the opportunity to negotiate more favourable incentives.

We anticipate the rental growth trajectory for last mile logistics to remain positive. This is partly due to the shortage of land allocated to distribution in urban areas, as rents are forced to compete with alternative uses.

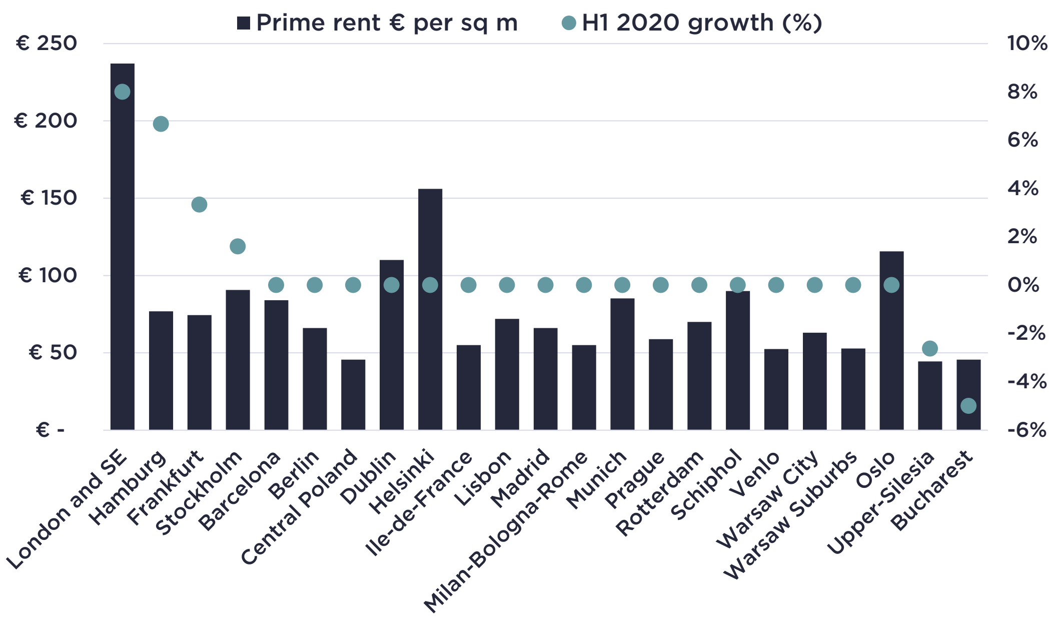
In order to maximise land utilisation, we are observing more multi-storey warehousing developments including G Park, Docklands and SEGRO's Port de Gennevilliers, Paris prelet to IKEA in 2018, as the provision of urban distribution remains limited. Likewise, Amazon have prelet a multi-storey warehouse in Monchengladbach in order to enhance their last mile delivery networks, which has piqued investor interest for the subsector. Across European markets, however, land is generally not constrained enough to make it viable to develop multi-storey warehousing, such as in Singapore.

Chart 3: European logistics vacancy rates (%)



Source, Savills Research, * = indicative vacancy rate

Chart 4: European logistics prime rents (€ per sq m)



Source, Savills Research

Investor demand for long income intensifies

Investment transactions

Logistics investment transaction volumes totalled €13.3bn in Europe during the first half of the year compared to €14.5bn in the same period last year, reflecting an annual decrease of 8% (Chart 5). Equity-rich European institutions remain dominant, and are showing signs of outbidding non-European capital for core assets. Korean investor demand remains strong, although many fund managers have been frustrated by the inability to view assets and undergo due diligence during travel lockdown periods and are increasingly reliant on joint ventures with European based asset managers.

Germany overtook the UK as the most active market, exceeding €3bn during H1 2020 and marking a 12% increase against the same period in 2019. The UK (€2.8bn) and France (€2.1bn) completed the top three, although Poland (+171% yoy) and Netherlands (+23% yoy) recorded particularly strong increase, with transactions volumes totalling €1.1bn and €1.8bn respectively. Large portfolio deals located mainly in the UK, Netherlands, Sweden, Germany, France, Poland and Spain boosted the overall European volume.

Yields

A number of ultra-prime assets let to Amazon have observed yields move sharper than the market prime yields, although we feel these are not reflective of the current market benchmark.

The average prime logistics yield also remained stable quarter on quarter at 4.58% (-2bps), 37bps below last year's level. Madrid and Barcelona (4.85%) experienced a 30bps inward yield shift compared to the previous quarter and Oslo (4.45%) -10bps. Due to the growing investor interest, combined with the lack of product, we expect prime logistics yields to remain stable until the end of the year.

What's more, debt pricing has remained fairly stable with pre-COVID levels for core, best in class logistics assets, with some of the most competitive terms coming from international banks and institutional investors. Investor sentiment remains particularly strong for long let assets to strong supermarket or online retail covenants. More caution remains for retailers with lower online presence.

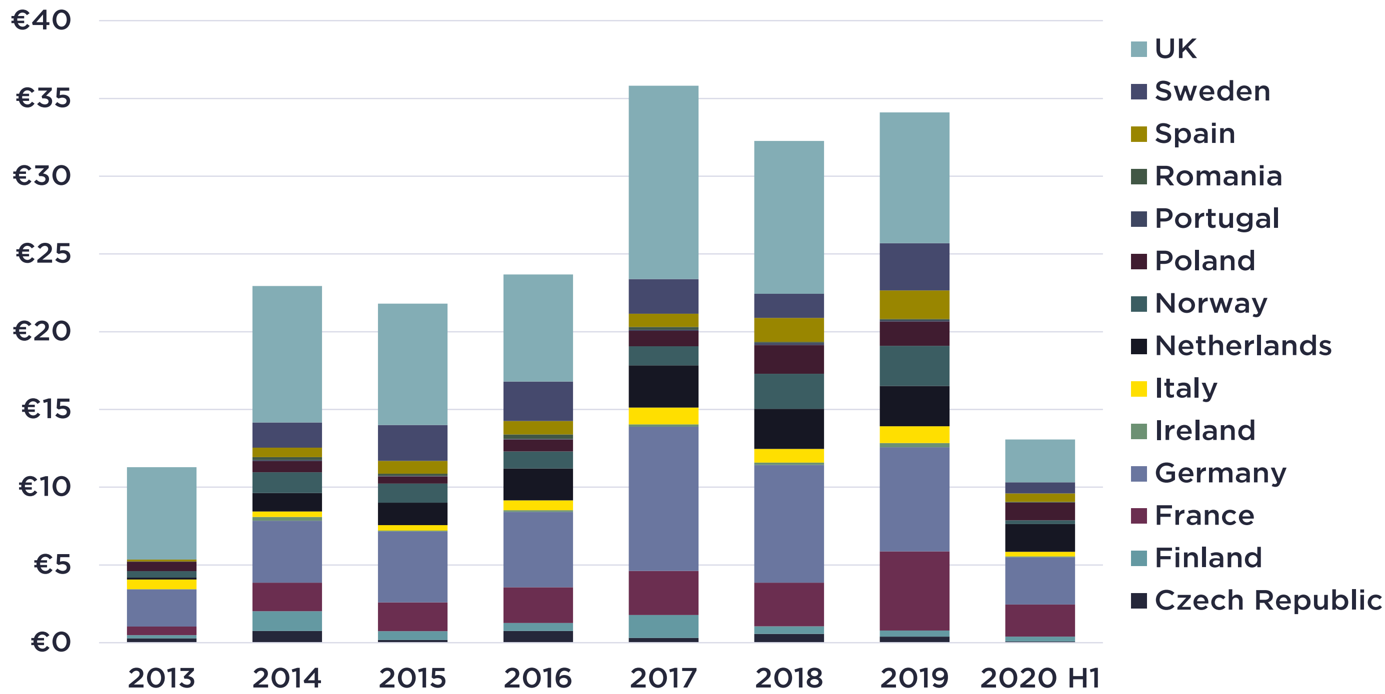
The fundamentals of the logistics sector position it as one of the most resilient through this economic downturn, as investors look to review their asset allocations in favour of the sector. Nevertheless, the logistics sector accounted for 11% of the overall investment turnover during H1 2020, still in line with the five year average. This is because the availability of stock is still unable to keep pace with investors' insatiable demand, constraining investment volumes in the sector.

12.2m sq m of European logistics take up in H1 2020, 4% below the half year average.

European vacancy rate increased to 5.8% during Q2 from 5.1% at end 2019.

German logistics investment transactions increased by 12% yoy during H1 2020.

Chart 5: European logistics investment €bn



Source: Savills

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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