CUSHMAN & WAKEFIELD

PROPERTY TIMES

European logistics gaining momentum

European Industrial & Logistics 2016

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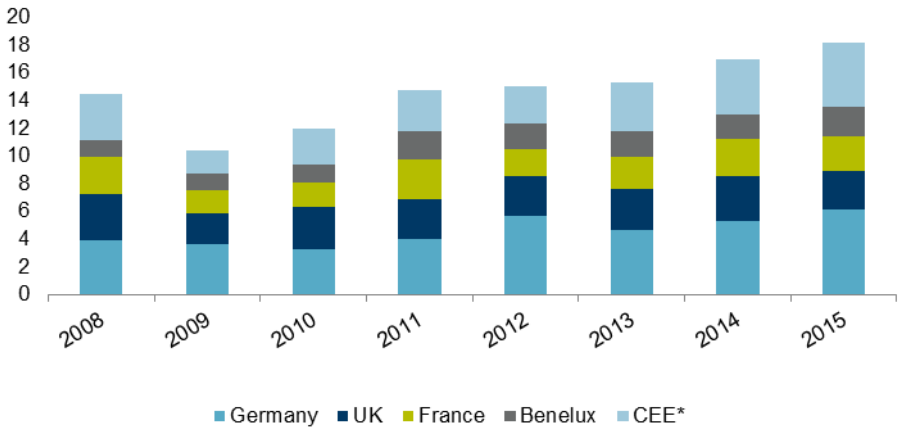
Contents

- The European economy remains in recovery mode. The baseline view is for EU GDP growth of 1.8% in 2015 and to remain around the 2% mark in 2016, supported by low oil prices, weaker exchange rates, better domestic financial conditions and fiscal expansion. Whilst the manufacturing sector is waning across the region, private consumption is expected to benefit from a positive environment and to be the main driver of growth alongside e-commerce.
- Despite the sluggish pace of recovery, the occupier market is picking up. Over 18 million sq m of industrial and logistics space were taken-up in Europe over 2015, setting a new record and representing a 7% increase on 2014. Occupier activity was strongest in Germany where take-up reached 6 million sq m, boosted by strong manufacturer demand, and representing a 17% increase on the previous year. CEE maintained its momentum, with 4.7 million sq m transacted.
- A growing imbalance between demand and supply is more apparent in many countries. Retailers and industrial companies are reshaping their supply chain in favour of built-to-suit solutions in a market where there is a notable lack of modern supply. This has put upward pressure on prime rental values, which are predicted to continue to rise across the region by an average 1.5% per year up to 2020. Peripheral markets, which suffered the most during the crisis, are forecast to witness the sharpest rebounds.
- The investment market showed solid performance, with € 21bn invested in 2015, close to the record of 2014. The UK was the most active European market with € 7.9bn transacted. Overseas investors from North America and Asia, already very active in 2014, increased their exposure to the European industrial market, with a record level of acquisitions (€ 6.2bn). Asian investors were particularly active on large deals and were involved in 7 out of the top 10 transactions.

Figure 1

Industrial & logistics space take-up - main European markets, million sq m



Source: Cushman & Wakefield

* includes Czech Republic, Slovakia, Hungary, Poland, Romania and Ukraine

Author

Massinissa Fedala
Senior Analyst
+33 (0)1 49 64 46 29
massinissa.fedala@cushwake.com

Contact

Magali Marton
Head of EMEA Research
+33 (0)1 49 64 49 54
magali.marton@cushwake.com

Joanna Tano
Head of Operations EMEA Research
+44 (0) 20 7152 5944
joanna.tano@cushwake.com

Economic climate

Different pace of recovery across the region

Despite several geopolitical risks, the European economy remains in recovery mode. The baseline view for EU GDP growth in 2015 is of 1.8%. Whilst we don't expect the European economy to accelerate in the near term, GDP growth should hover around the 2% mark for several years to come.

CEE, already the most dynamic region in 2015 (with GDP growth of 3.6%), should continue to lead the European recovery, with 3% growth forecast until 2020. Despite witnessing a slowdown at the end of the year, the UK economy posted solid 2.2% GDP growth in 2015 and is forecast to outperform the rest of the continent, with average growth forecast at 2.4% p.a. between 2016 and 2020. The UK economy continues to benefit from rising domestic demand and a relatively low unemployment rate, though the EU referendum vote is causing uncertainty and likely to hit growth somewhat in 2015.

By contrast, some core Eurozone markets such as Germany and France are lagging behind, with subdued GDP growth of 1.6% and 1.5% per annum respectively forecast over the same period (Figure 2).

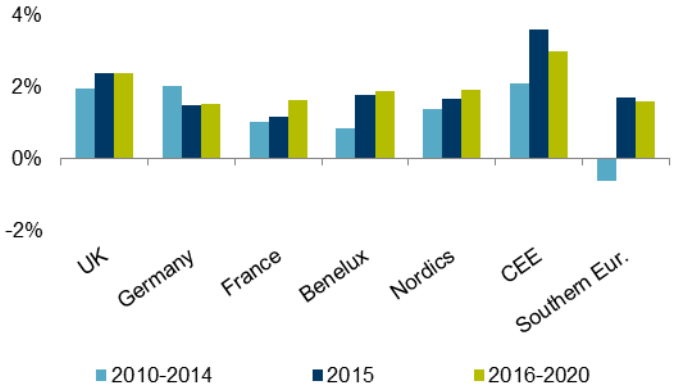
After a robust autumn period, activity in European industry declined towards year end. Germany, the industry leader, registered a drop of 0.8% in its production in Q4. Whereas worries were focused on the slowdown in emerging markets, orders in German factories from countries outside the Eurozone increased by 5.5% in December - a surge that was insufficient to counterbalance a 6.9% fall in orders from Eurozone partners. Whilst German industry was strong during the peak of the crisis, with industrial production rising at 3.7% per year over the last five years, it is now falling in line with 0.7% growth in 2015. The outlook does not show any considerable improvement, with growth of 1.2% forecast over the next five years (Figure 3).

Private consumption main pillar of growth

Private consumption will become the main pillar of growth in most European countries. A combination of low oil prices and interest rates as well as rising wages should support European households' purchasing power in 2016. In addition, despite the European Central Bank's efforts to reach the 2% target within two years, Eurozone inflation remains ultra low and is expected to remain that way in 2016. As a result, private consumption forecasts have been significantly reviewed. Household consumption across Europe is expected to show steady growth over the next five years. Once again, the CEE is expected to get the most out of the current macro environment, with private consumption expected to grow at a strong pace of 3.1% p.a. until 2020 (Figure 4).

Figure 2

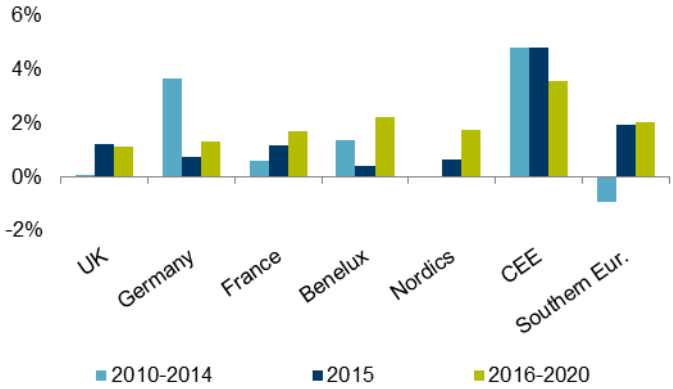
Annual GDP growth



Source: Oxford Economics

Figure 3

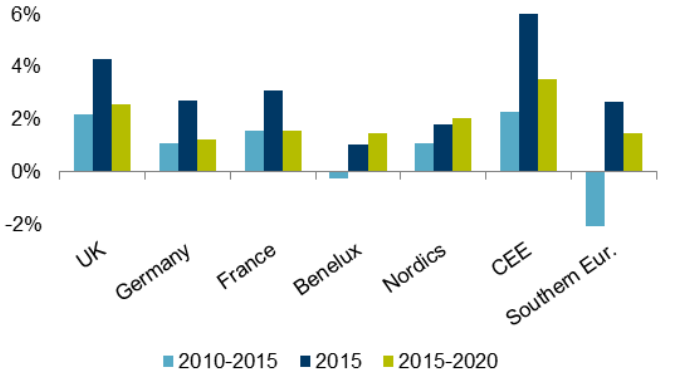
Industrial production growth



Source: Oxford Economics

Figure 4

Retail sales forecast annual growth



Source: Oxford Economics

Occupier market

Strong occupier activity

2015 was a new record year for the European market with overall industrial take-up reaching 18 million sq m, representing a 7% increase on 2014. The letting activity has steadily increased since 2009, when only 10 million sq m was transacted (Figure 5).

Occupier activity was strongest in Germany, where take-up reached over 6 million sq m during 2015. Germany accounted for a 35% share of total take-up in the region and also witnessed the greatest yearly increase, of 17%. The fallout in the Volkswagen scandal and the slowdown in emerging markets have not yet translated into slowing demand. The European market has seen occupiers increasingly widening their scope and looking for modern premises in tier-2 locations.

Lack of modern supply in many markets

By contrast, take-up in the UK was more subdued than previous years, with only 2.7 million sq m transacted in 2015, representing a 15% fall on a year ago. Nevertheless, demand from e-retailers, supermarket chains and 3PLs remained solid. Built-to-suit solutions are becoming increasingly common across the region, as a relative lack of modern supply is dampening market activity.

In France, overall take-up for the year reached 5 million sq m, a similar level to that recorded in 2014. Built-to-suit solutions were favoured by occupiers looking for new modern premises, as a growing share of the French stock is fast becoming obsolete. Corporates remained focused on the North-South axis with a large part of the activity concentrated in the Paris region. Hypermarket chains, which are increasingly reshaping their supply chains, are the main drivers of demand.

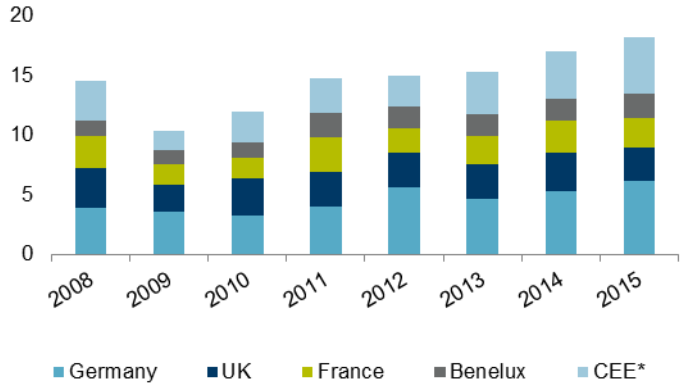
Occupier activity in the Benelux reached 2 million sq m in 2015, a 15% increase on 2014. In particular, established logistics hubs in the region witnessed solid performance, given the shortage of quality space and the relative low level of speculative development.

CEE posted a new record in 2015, with overall take-up reaching 4.7 million sq m, representing a 17% increase on 2014. Poland, in particular, is establishing itself as a major player in the European market, accounting for almost half of total take-up in the region in 2015 (i.e. 2.5 million sq m). Poland is competing with France and the UK for second position in the European ranking of take-up activity. Contrary to most western countries, developers are more willing to launch speculative developments in Poland, supporting a market which attracts large international occupiers, most notably online retailers looking for relatively lower operating costs.

Finally, Czech Republic performed strongly during the year, with take-up reaching 1.4 million sq m, representing a whopping 55% increase from the previous 2014 record level.

Figure 5

Industrial / Logistics space take-up, million sq m



Source: Cushman & Wakefield

* includes Czech Republic, Slovakia, Hungary, Poland, Romania and Ukraine

Rental values back to positive territory

In line with a recovering economy, rental values are expected to enter a growth cycle in the coming years. Across Europe, these are expected to grow at an average rate of 1.5% p.a. up to 2020. With the exception of Berlin, where rents are expected to remain stable following falls in the last five years, the rest of the markets are forecast to return to positive territory (Figure 6).

Peripheral markets, which suffered the most during the crisis, are expected to experience the sharpest rebounds in the next five years. Dublin is forecast to be the market to improve the most, with rental values expected to increase by 5.3% p.a. up to 2020. The lack of modern premises and available land for new development in key locations is putting upward pressure on land values.

In line with a slowing economy, southern markets registered the sharpest decreases in rental value across Europe over the past five years (Figure 6). These are expected to stabilise in the coming years, with rental values predicted to rise at rates of 2.2% in both Madrid and Milan. Both markets are currently gaining momentum after witnessing difficult years in the occupational markets.

Shortage of supply will drive rental value growth

Over the next five years, rents in the Benelux markets are expected to increase between 0.8% p.a. in Amsterdam and 1.8% p.a. in Brussels. A shortage of good quality supply is the main driver for rental value growth. In France, however, rental values are expected to remain almost flat. They have remained stable for a number of years and will continue to be amongst the lowest in Europe.

Figure 6

Industrial rental values growth (% p.a.)

Source: Cushman & Wakefield

Investment market

Another record year for investment transactions

With EUR 21 bn invested, the European industrial investment market posted another solid year in 2015, only slightly below the EUR 22bn registered in 2014, the all-time peak. Across all sectors, EUR 246bn was invested during 2015, a 27% increase on the previous year. As a result, the industrial segment market share decreased from 11% in 2014 to less than 9% in 2015 (Figure 7).

Location-wise, the UK was the main European investment hotspot during 2015, with EUR 7.9bn of inflows, despite a slight decrease in activity between 2014 and 2015 (-11%). The UK alone represents more than one third of the European industrial investment market (Figure 8). This market concentrates a sizeable amount of local players that were very active in 2015, such as Legal & General Property, LondonMetric and Standard Life. Each of these players committed volumes of between EUR 250m and EUR 375m through several transactions. Overall, British investors purchased EUR 6.4bn in their domestic market in 2015.

Germany was in second position, with EUR 4.2bn invested in 2015. Contrary to the UK, the German market was boosted by demand from foreign investors, which represented over half of the overall invested volumes. Following the acquisition from Blackstone of a EUR 300m portfolio in Q4 2015, a number of major industrial players elected Germany as their main European target destination in 2015. Similarly, Germany also attracted newcomers from Asia. A Malaysian pension fund acquired a distribution warehouse portfolio in Germany for EUR 200m and the Korean ADF purchased a distribution centre operated by H&M near Hamburg for EUR 100m.

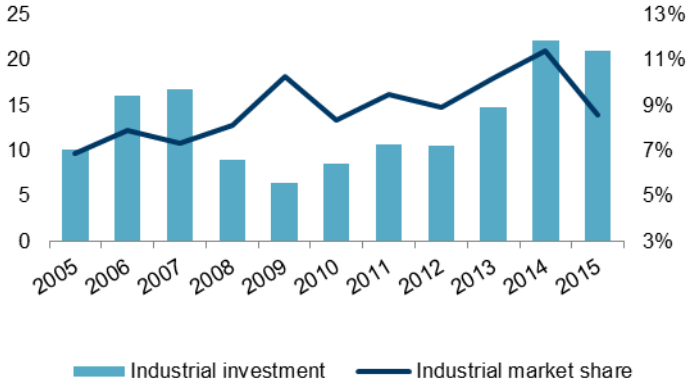
Overseas investors dominant on large deals

Contrary to the retail segment where foreign capital dominates, the industrial market remains dominated by local players. However, the share of cross-border investors has been growing steadily for several years. Having been almost absent during the crisis peak, foreign source of capital hit a record share of 43% in 2015 (Figure 9). This improvement is largely due to previously unseen volumes of European money flowing across Europe in the last couple of years. Overseas investors have seen their exposure to the European industrial market triple, with around EUR 6bn acquired in 2014 and again in 2015.

Cross-border investors are taking the lion's share of large deals, accounting for 57% of deals of above EUR 200bn in 2015. Seven out of the top 10 transactions recorded in Europe in 2015 were purchased by North American or Asian investors.

Figure 7

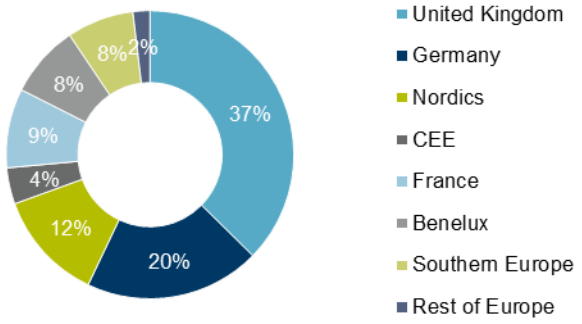
European industrial investment market, €bn



Source: Cushman & Wakefield

Figure 8

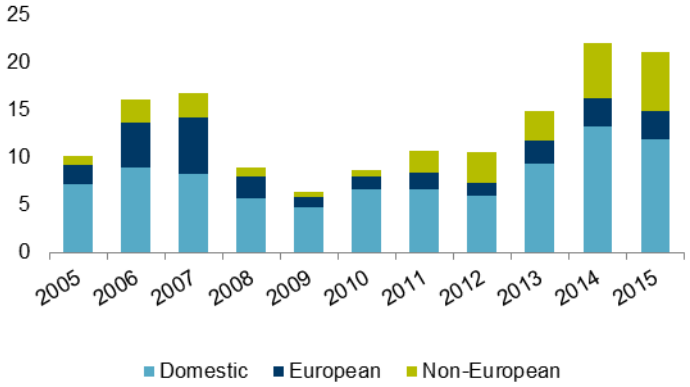
European industrial investment market in 2015, €bn



Source: Cushman & Wakefield

Figure 9

European industrial investment market, €bn



Source: Cushman & Wakefield

Yields

Prime yields nearing new lows in most markets

European industrial markets are gradually converging to the same point of the cycle. At the end of the year, yields remained unchanged in 43 markets out of the 58 included in our monitoring. In Q4 2015, Spanish and French markets joined the Belgian, Italian and some CEE markets which had all started to stabilise during the first half of the year. On average, prime yields across Europe only shrank by 6 basis points between Q3 and Q4 2015. This is half the average compression recorded during the first part of the year. Over the year as a whole, average yield compression for prime European industrial premises was of 41 basis points.

Prime yields have hit their historical lows in one third of the markets surveyed, and another third is at less than 50 basis points from their historical floor. Room for further yield compression is narrowing. Peripheral markets, notably Spain and CEE, remain at an early stage in the cycle led by German markets, almost all of which have reached the bottom. (Figure 10).

However, the current environment differs from the previous peak of the cycle in 2007, which benefited from easier diversification with other asset classes and cheap finance. The average prime European industrial yield is still 200 basis points above the prime retail yield average and 180 basis points above the office one (Figure 11). The historical trough is likely to be pushed down, notably in the Dutch and German cities. There, prime yields are still moving in, whereas they have already hit their historical trough in Q4 2015.

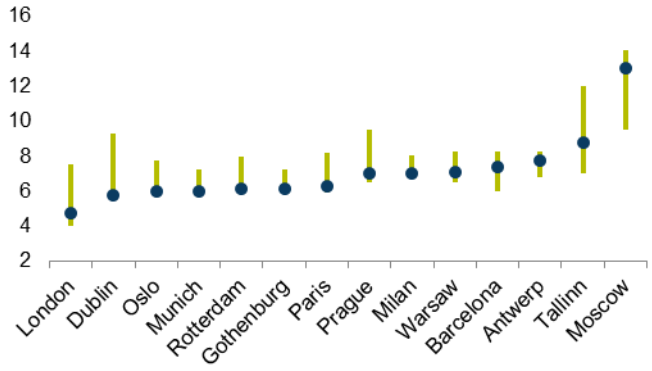
Prime yields are expected to remain unchanged in 2016 in two thirds of the European markets, notably in the UK and France. They are forecast to move in in Spain and a number of CEE markets (the Baltics in particular), but also, to a lesser extent, in Germany and the Netherlands, before stabilising across the board in 2017. The imbalance between sustained demand coming from widening sources and structurally limited supply should put downward pressure on yields, especially for Grade A buildings.

The industrial market, and logistics assets in particular, continue to represent a highly desirable alternative for investors looking for return and positive rental growth prospects.

Figure 10

European prime industrial yields

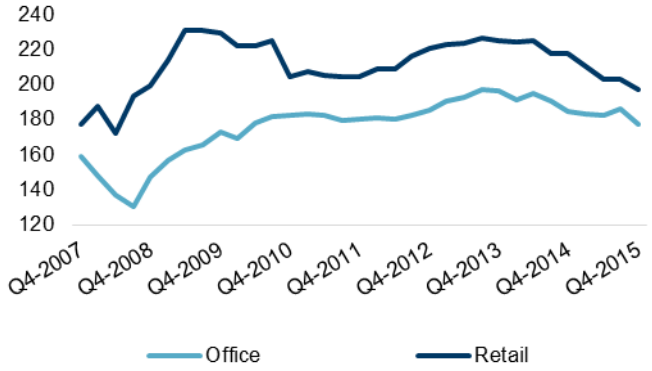
(Q4 2015 = dot, Q2 2005 – Q4 2015 max and min = line)



Source: Cushman & Wakefield

Figure 11

Prime yield spread between industrial and other asset classes – in basis points



Source: Cushman & Wakefield

Definitions

Classification
Warehouses are classified according to their technical characteristics (hardness at ground level, unimpeded height, etc.), their accessibility (distance from the motorway, not being shut into an urban area), and their capacity for growth (adaptation to present and future ICPE standards and to the constraints of insurers).

New building
A building that has never been used. Also called "first-hand" in contrast with "second-hand" buildings

Non-speculative building
A building for which all the steps preliminary to launching the project have been taken (purchase of the land, preparatory studies, obtaining of the building permit, etc.), while actual construction will only begin once a user has committed to all or part of the project.

Old or second-hand building
A building that has already been occupied by a user. Also called "second-hand" buildings in contrast with "first-hand" or new buildings.

Operating licences
Licences required to operate a warehouse building. There are around a hundred different kinds, the most frequent being numbered as follows: 1510 (Covered warehouses), 1530 (Wood and/or paper stocks), 2662 (Honeycombed Plastics storage), 2663 (Storage of manufactured plastics, tires), 1412 (Container storage of flammable gases or aerosols), and 1432 (Container storage of inflammable liquids).

Owner-occupier project
A building whose occupier is the owner

Speculative building
A building whose construction is begun without previous sale or letting to one or several users.

Take-up
The total deals, whether rentals or sales, carried out by users, including pre-let, turnkey rentals, and owner-occupier projects

Turn-key transaction
A building whose construction begins after a definite commitment from an occupier/tenant, even if a developer's project existed previously without construction having begun. These operations are included in take-up only when the preconditions (such as permits and financing) have been fulfilled.

Warehouse
A building for stocking, distribution, or light assembly. Such premises are ranked in different categories: Class A for a highly functional or "new generation" warehouse, Class B for a building up to the standards of a modern warehouse, and Class C which includes all other warehouse buildings. Classification is done according to a number of criteria, such as the building's construction date, ceiling height, manoeuvring area, hardness of the floor, etc.

EMEA

John Forrester
Chief Executive
+44 (0)20 3296 2002
john.forrester@cushwake.com

Robert Hall
Senior Director - Industrial & Logistics EMEA
+44 (0)20 3296 3100
robert.a.hall@cushwake.com

Mark Webster
Partner, Head of Logistics and Industrial
+44(0)20 7152 5519
mark.webster@eur.cushwake.com

Jan-Willem Bastijn
Head of EMEA Capital Markets
+31 20 800 2081
janwillem.bastijn@cushwake.com

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Global Headquarters
77 West Wacker Drive
18th Floor
Chicago, IL 60601 USA
phone +1 312 424 8000
fax +1 312 424 8080
email info@cushwake.com

Cushman & Wakefield EMEA
125 Old Broad Street
London
Office Address, Office Postcode
phone +44 (0)20 3296 3000