

Market Insights Industrial Sector Outlook

2017

The industrial sector was largely undisturbed by the referendum result and enjoyed another strong year of performance. A key driver of performance was the imbalance in demand and supply. In total, c. 20m sqft of new space entered the market in 2016 (the majority being logistics space), however this was not sufficient to satisfy the rise in demand. The slight slowdown in take up immediately after the referendum was fully recovered in the subsequent quarter, which resulted in an increase in total take up from 35.6m sqft in 2015 to 37.9m sqft by the end of 2016. Most of this demand was driven by retailers expanding their online platforms. The fall in sterling was also perceived to be a positive factor which helped stimulate activity in the UK manufacturing sector. As a result, the sector delivered positive rental growth for the year.

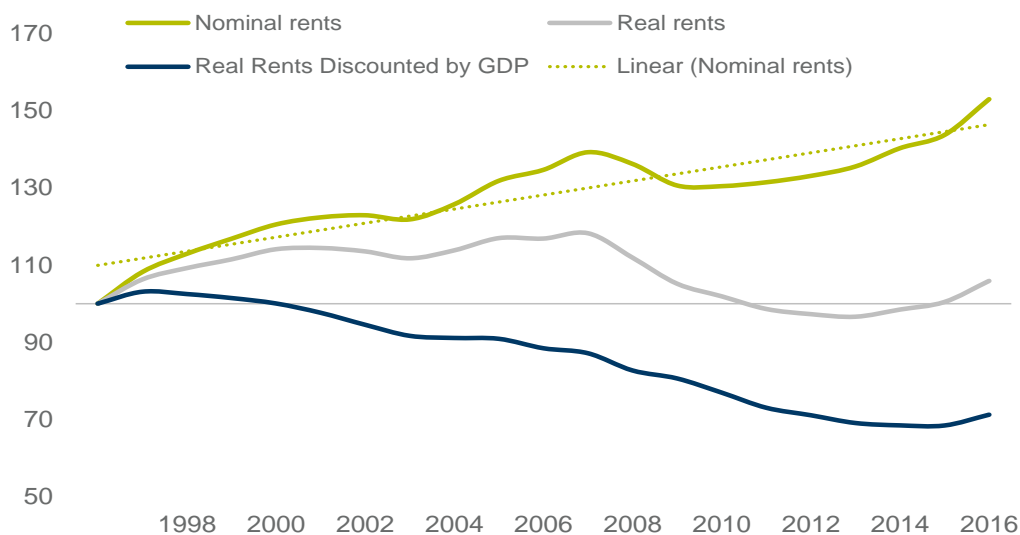
How much further can industrial rents go?

There are good reasons to believe that rental growth will be sustained in 2017. Whilst in nominal terms, rents have surpassed their long term trend, in real terms (when adjusted for depreciation and economic growth) rents are yet to match real output growth and therefore still look “economically” affordable. Moreover, leading indicators for rental growth remain in positive territory. The RICS Survey on industrial investment enquiries and occupier demand continues to move in an upward direction and is far stronger for the industrial market than any of the other main use sectors.

The domestic nature of the industrial sector and robust fundamentals should support growth prospects.

Unlike the office market which has a greater dependence on international occupiers, the industrial sector’s domestically orientated occupier base should help minimise the impact of Brexit on performance. The higher inflation outlook could weigh on demand prospects (as the decline in real incomes limits consumer spend), but this should be partially offset by the increased demand from exporters supported by a falling pound.

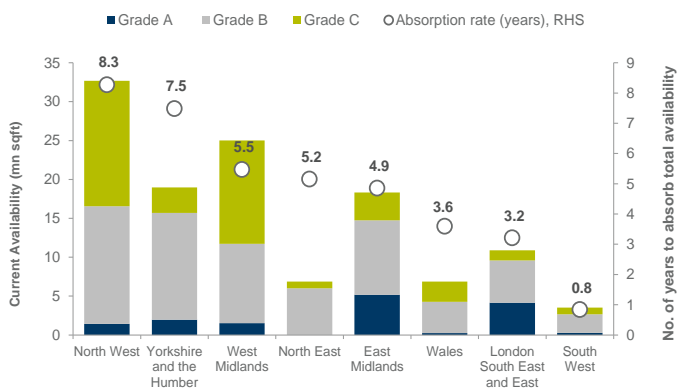
Index of Industrial rents, Source MSCI, ONS



Where is the imbalance between availability and demand greatest nationwide?

An assessment of absorption rates across the UK (current availability over five year average take up), implies that in almost every region there is a noticeable shortage of grade A industrial space. Absorption rates look most favourable in the South West, London and South East and should help support rental growth on better units in core locations.

Number of years to absorb available space (by region), Source: Cushman and Wakefield Research



Solid occupational demand to last over 2017 as retailers increase their online presence.

Looking forward, we see the sector being affected more by changing occupier space requirements than the repercussions of Brexit. Although the ramifications of Brexit are expected to be felt more harshly by UK consumers in 2017, we are optimistic that households will continue to source goods online at comparably cheaper prices. Online retail sales accounted for c.16% of all retail sales in 2016, and the latest projections by the ONS forecast online sales to grow to 26% by 2025. Therefore the prospects for occupier demand from retailers, supermarkets and third party logistics providers should remain positive, and stronger for industrial space in easily accessible locations.

Efficiency gains to support logistics sector in the near term.

Technology will play an increasing role in modernising stock and driving supply chain efficiencies. This will be most apparent on larger sized industrial units. Retailers typically require high levels of automation and robotics to increase efficiency, hence buildings with extra mezzanine levels that provide additional storage space is essential. There could become a point when the demand for this type of stock potentially reaches saturation point and corrects, by which point requirements could shift to smaller hubs that facilitate the last mile delivery channel to service impatient consumers that require their goods at shorter delivery times, but for the time being, this still seems to be a way off. Amazon remains one of the largest and most acquisitive retailers and accounted for 30% of total logistics take up in 2016, and even removing Amazon from the statistics, take up from other internet retailers remains buoyant.

Supply prospects challenged by a lack of finance and a change of use.

Supply shortages will remain a dominant feature of the industrial market in 2017. A lack of finance available for new developments will mean projects will need to be self-funded by developers, during a period where the costs of construction and imported goods are forecast to become increasingly more expensive.

Demographic trends to shape future supply pressures.

Over the longer term, future demographic trends are expected to put pressure on the supply of industrial stock, as existing stock is withdrawn from the market and converted into higher value alternate uses such as residential. This will be particularly acute within greater London. The Capital's population is expected to rise to 10 million people by 2031, with the greatest shifts in population flows expected to occur in and around East London. Outside of the Capital a similar erosion of industrial supply is expected to occur in areas forecast to see high rates of population growth over the next decade.

On the whole, the industrial sector is likely to be more resilient in this period of Brexit related uncertainty, compared to the rest of the market. We do not expect the sector to be completely immune to Brexit, but favourable market fundamentals should help to offset these risks, making the keenly priced yields seem justified. We expect factors such as the quality of the building, its location and proximity to transport links will determine the strength of industrial property's performance prospects.

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