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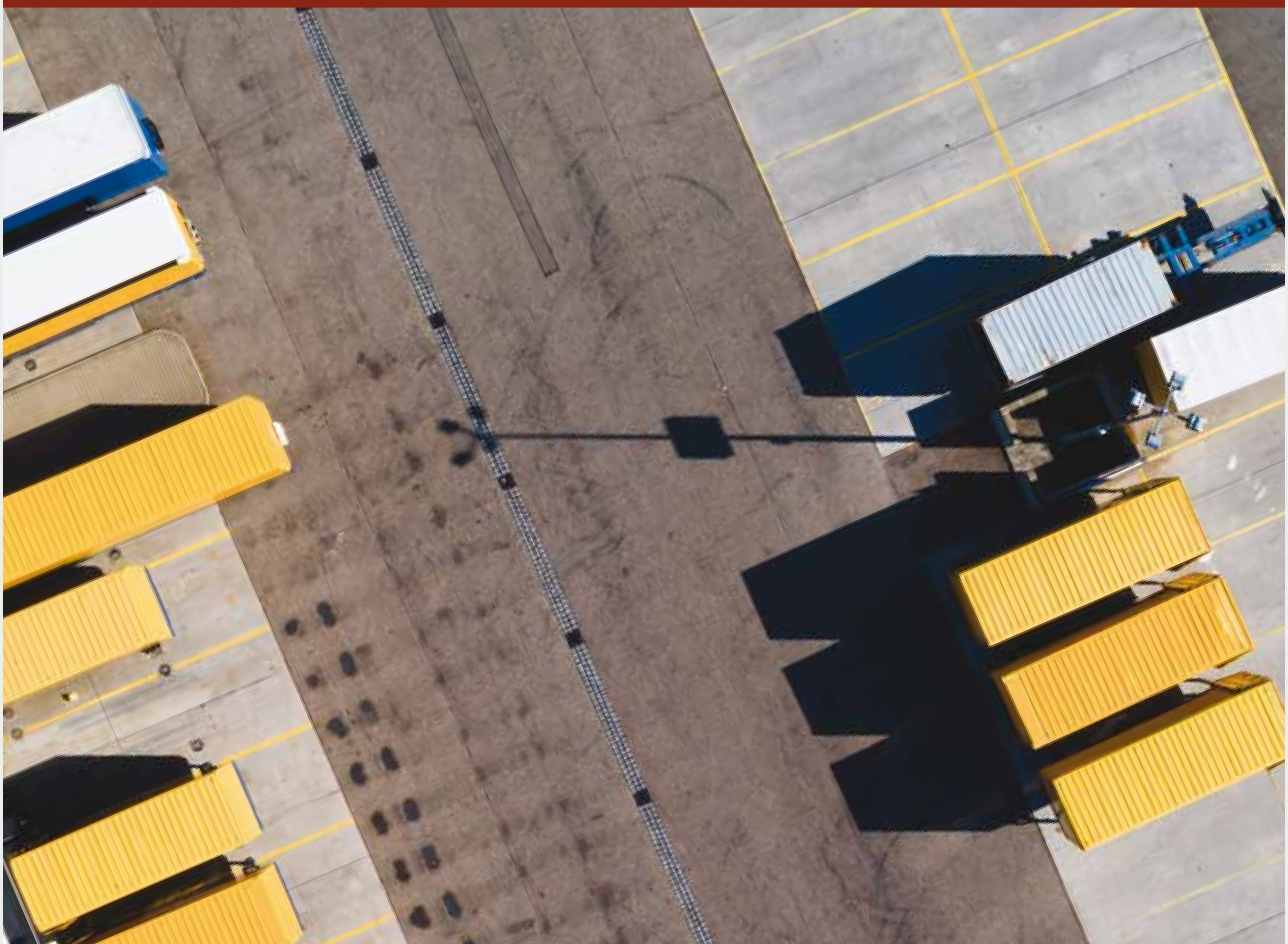
FOR THE WORLD'S PRIVATE REAL ESTATE MARKETS



INVESTING IN LOGISTICS & DISTRIBUTION

A special supplement to *PERE* magazine

UK logistics keeps its balance

Concerns over Brexit and increased development have done little to upset the equilibrium of a market where tenant and investor demand remain vigorous, say Oxenwood's Jeremy Bishop and Stewart Little. Stuart Watson reports

In July 2018, London-based investor and asset manager Oxenwood Real Estate secured its first big logistics portfolio exit, selling £207 million ($268 million; €236 million) of real estate to Singaporean REIT Ascendas. Jeremy Bishop and Stewart Little, who co-founded the business almost five years ago, assess the prospects for the UK industrial sector in 2019 and consider how mid-size managers can best attract and deploy capital in the asset class.

50% share of new-build UK logistics space taken up by retailers in 2018

Amazon expands UK presence: the online giant recently took on logistics space in northern England

***PERE**: How resilient is the demand for logistics space in the UK?*

Stewart Little: There is strength and depth in the UK occupational market thanks to the continuing march of online retail. While overall consumption and spending is level or even slightly down, the shift away from traditional high-street stores into e-commerce is happening at great pace. Fashion retailer Next is usually a good bellwether for the fortunes of our retail customers. In the third quarter of 2018, their sales were up 1.5 percent overall, but their online sales increased by over 11.5 percent. Over time, as lease events come up in physical store portfolios, the move away from bricks-and-mortar in favor of retailers' online business will gather momentum. Meanwhile, as levels of automation and the use of just-in-time delivery concepts come in to play, building heights and configurations are changing. Consequently, around 50 percent of new-build space in 2018 was occupied by retailers, and that will continue to drive development. In our underwriting, we spend lots of time focusing on power and labor supply. Those factors will create challenges at some established logistics locations and will open up others. This year Amazon took two large buildings in the north of England. That's not because it is close to the markets they are delivering to. Amazon has gone there principally because there is an available labor supply, and they have also chosen locations of former heavy industry where I would expect excess power capacity.

***PERE**: What are the principal challenges that will confront UK market participants in 2019?*

SL: Broadly speaking, at present the UK market for larger buildings is in a state where demand is a little ahead of overall supply, but it is only in the last couple of years that development and development funding have really picked up. That has happened as confidence in occupational demand has increased, but also development funding for trader-developers to build speculative space has only returned quite recently. New entrants to the UK market, like developer Panattoni, will probably increase the pace of speculative construction, and the potential for increased supply may present a challenge. However, the risk of oversupply is not as great as it was in 2005-06 because there is more demand now from online retail and other new entrants to the market.

Jeremy Bishop: Often one hears about a speculative development financing, but when you delve into it a little more deeply you find there is an income-producing building next to the speculative one, or some other form of cross-collateralization. There is a degree of protection against loose financing, which is a blessing. Brexit is causing some investors to adopt a wait-and-see posture. For other capital allocators, particularly from overseas, Brexit is of less consequence because they are driven by diversification outside their home markets or an opportunistic currency situation. Occupiers say it is a big issue, and contingency planning is driving short-term requirements, but I do not foresee a disaster because of Brexit. We have a very resilient sector and there are vast quantities of capital looking at logistics at the expense of the other asset classes, so it feels like there is a degree of insulation.

"If you really drill into what tenants want then you can find very sensible investments with value-add-type returns"
Jeremy Bishop

***PERE**: What type of investors are keen to allocate capital to UK logistics?*

JB: There is a broad base of investors in UK logistics: UK institutions, REITs and local authorities, as well as international buyers, notably from Asia, Korea and now the Middle East. Middle Eastern investors frequently seek diversification and have grown to view the asset class as increasingly acceptable, whereas in the past they have often invested in offices and residential. Korean investors are taking a bit more risk. Traditionally, they have bought very prime long-let buildings, but we have seen some taking a more core-plus or value-add approach to the asset class. On top of that, there are private equity houses that want to get in, or which have invested already and want to top up or add a bit of development exposure to their portfolio. Then you have examples of UK family offices. It is really diverse.

SL: When we started our careers 25 years ago, the dominant share of UK institutional investors' property portfolios was invested in office and retail, with a little bit of industrial. We expect to see weightings increased toward the logistics sector and that will give depth to the market for exit strategies for the likes of us that are trying to find, buy or build product for institutional buyers.

"We expect to see weightings increased toward the logistics sector and that will give depth to the market for exit strategies"
Stewart Little

***PERE**: How does a mid-size company like Oxenwood carve out a niche in a market where there is a lot of emphasis on big ticket fundraises?*

SL: Before the global financial crisis, many global investors really had only the pooled funds in which to invest their capital if they wanted access to the sector. Now they want a greater degree of control, but they still want access to the asset class in different geographies. If you are an international investor looking to access UK and European logistics today then there are not many smaller specialist businesses with expertise and the ability to co-invest. You can go into the private equity funds, but if you want a one-on-one bilateral relationship with an operating partner, which a lot of investors prefer at the moment, then companies like us benefit from that.

Little: we spend lots of time focusing on labor and power supply

JB: Investors like operating partners with entrepreneurial flair, and that can deploy capital skillfully, but also with a disciplined institutional reputation. When it comes to securing product, there are always opportunities that are mispriced. If you really drill into what tenants want then you can find very sensible investments with value add-type returns. However, for overseas investors, it can be challenging without a local partner. There is a shortage of people who can operate well in this market, compared to the number of investors from all over the world that want to invest in logistics here.

Bishop: there is a broad base of investors in UK logistics

***PERE**: You have recently begun to invest outside the UK, with acquisitions in Germany and Ireland. Which markets offer the best potential for investors in the coming year?*

SL: Germany is hotly sought after at the moment. It is a manufacturing-based economy and close to the main European ports. We would look at France and Spain, and given the underlying economy and the way in which it supports German consumption we think Poland is interesting. There is probably a 250-basis point yield differential between the same asset in Germany and Poland, which is quite compelling for an investor.

JB: E-commerce penetration in most continental markets is behind that in the UK, so there is further mileage there. For our income-based capital partners, compared with the UK, financing in Germany and other European markets is extraordinarily cheap and that drives a very healthy cashflow from high-grade covenants. For someone willing to take a euro versus sterling view, it makes sense because the cash-on-cash yields are superb. □

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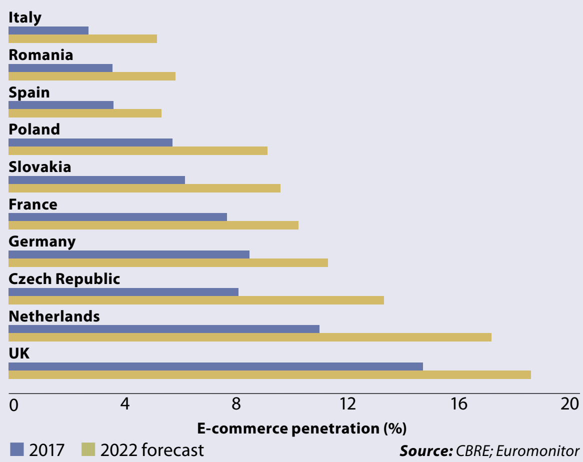
E-commerce penetration is projected to rise across Europe in the next five years, presenting more opportunity for logistics players



Source: *CBRE; Euromonitor*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