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KEYNOTE INTERVIEW

Following the occupier's lead

Oxenwood Real Estate co-founders Jeremy Bishop and Stewart Little explain why they are tracking tenant demand into urban logistics and continental European markets

Oxenwood Real Estate, the London-headquartered specialist logistics investment manager co-founded by Jeremy Bishop and Stewart Little, is now a little over five-years old, and the business is poised to enter a new, expansionary phase. In March last year, the firm agreed a £200 million ($261 million; €234 million) capital increase from its long-time investment partner, Bermuda-based Catalina Holdings, to fuel Oxenwood's drive into value-add investing and fund further forays into continental Europe. *PERE's* Stuart Watson asks Bishop and Little to explain their new direction and evaluate the prospects for the UK and European logistics markets.

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Q Why is this a good time to go higher up the risk curve and do more value-add investing?

Jeremy Bishop: The change of approach is tenant-driven. As retail becomes less about bricks-and-mortar and more about e-commerce, occupiers still have a tremendous amount of work to do in adapting and perfecting their supply chains, and we want to be able to generate returns for our investors by supporting them to do that. We started the business doing investments in tenanted buildings and have gradually gone up the risk curve by buying shorter leases and extending buildings. When it came to re-upping with Catalina Holdings, we suggested to them that this was a good time to do some slightly higher-risk opportunities.

The free return from market movement in favor of investors has expired. Now, to generate decent returns you have to look at development profit and/or income growth. For investors that will take on a little more risk, we think those return criteria can be generated from the more urban and fringe-urban middle and final-mile assets supported by growing online sales. In the main, the capital provided by Catalina is core or core-plus, but we have a sleeve which is less defined, and which allows us to do value-add and create returns through development.

We also have a value-add relationship with another capital partner, Aimco, and we are seeking to further diversify our sources of capital to do more capex-intensive repositioning projects. Investors like logistics real estate because of the income growth it provides, particularly in the urban segment, and the structural tailwinds mean they are willing to take the risk for value-add returns.

Stewart Little: Where we have had conviction in markets, we have found ourselves comfortable taking on vacancy, building extensions and developing new space. In the last two years, smaller buildings in more urban, more liquid locations have benefited from higher rental growth and greater demand. There are more occupiers seeking buildings of around 100,000 square feet than there are wanting 500,000 square feet, so our focus has shifted.

We are currently building our first speculative development, a 75,000 square foot unit in Warrington, near Manchester. That is a manifestation of how our strategy is evolving, to focus on more liquid markets by size and by geography. We are still invested in larger buildings – we will acquire them if that is what occupiers want – and we continue to look at the strategic land market, but the gravitational pull is toward meeting the needs of occupiers with smaller buildings in urban areas.

Q How are changing occupier needs shaping locational decision-making?

SL: The need for power is becoming ever more relevant in the location choices occupiers make today. It now sits alongside labor availability at the top of their list. Some of the locations in the south of England and the Midlands, which have been established investment destinations for 20 years, are short of power and labor. In areas where we have previously seen heavy industries, like coal mining, there are large sites with latent power supply and labor that is accustomed to shift work, so we might see those becoming tomorrow's locations for the first-mile national or regional piece.

In the last-mile market, occupiers need to get as close as possible to consumers to fulfil expectations about delivery times, but power supply will become more important there too. Diesel and combustion engine delivery vehicles will be hit by increased taxation or outright banning, so more power will be needed for electric vehicles as well as automation. That will affect calculations about which are the optimum locations.

Q What are the prospects for the UK logistics market in 2020?

JB: Some investors were very wary of the UK in 2019. I am a Brexit optimist because even in the few weeks since the election I feel that the appeal of the UK to outside investors in real estate has changed profoundly and logistics real estate prospects remained largely uncoupled from the overall sentiment.

A trade agreement with the EU still needs to be concluded, but the UK is much stronger economically than it has sometimes been given credit for, and I think it will respond very well to having a government with the ability to get things done. Since 2010, we

Case study: Weybridge, Surrey

Value-add repositioning for e-commerce

The Surrey town of Weybridge lies just within the M25 orbital motorway to the south west of London in the sweet spot for commuters into Waterloo Station, and also for logistics firms looking to serve that quadrant of the UK capital. In June 2019, Oxenwood's joint venture with Catalina Holdings paid £16.4 million ($21.4 million) to buy an 80,000 square foot warehouse from occupier Northamber, a distributor of IT equipment.

The tenant will remain on a short-term lease while Oxenwood secures planning permission to extend the unit by a further 40,000 square feet before it is refurbished and re-let. "That plays into our urban logistics strategy," explains Little. "We expect to pre-let the building before the refurbishment is complete to household-name occupiers looking to serve London for last-mile e-commerce. We have been surprised by the degree of interest and we expect to be able to increase rents by around 30 percent from our underwriting expectations."

"The free return from market movement in favor of investors has expired"

JEREMY BISHOP

Case study: Radzymin, Warsaw

Capturing yield compression in Poland

In October, Oxenwood made its debut purchase in Poland, acquiring a 91,500 square foot courier delivery center newly developed by Panattoni and occupied by DHL Parcel Polska on a 10-year lease for €13.5 million ($15 million). "We like the fundamentals of Warsaw and the growth in back office functions there. That will be the type of activity that drives e-commerce demand, so to have a DHL parcel facility servicing north Warsaw is good business," says Little.

The acquisition was made at a yield of around 6.25 percent. "Poland is a market where yields are very attractive relative to those in neighboring Germany. Near Berlin you would probably have been buying that building at around 4 percent, so that is 200-plus basis points of arbitrage," he adds. "Even in the comparatively short period we have owned it, we have seen significant yield compression."

It is unusual for Oxenwood to underwrite cap rate compression in today's market, says Bishop, but in this case, we felt that there was sufficient investor demand to do so. "It is probably the only building in our portfolio over the last 18 months where we thought there may be some yield compression as a contributor to our forecast return. Some of the others have seen some yield shift, but this has been principally a function of our value-add initiatives, lease extensions for example." ■

have mostly had coalition or minority governments, which have found it difficult to act decisively. I believe that the UK is going to become a better place for business and I expect the emphasis on Brexit to subside.

SL: The confidence of international logistics operators in their ability to provide just-in-time delivery across the English Channel has been fractured since the referendum. As a consequence, there has been a shoring up of supply chains, and the sector in the UK has benefited from that as occupiers take on more space for stockpiling and inventory management.

That will continue to support demand over the next year or two. However, where there is a perception of very strong demand – 2019 will see the biggest take-up in the sector ever in the UK – there is always a risk of over-development in some areas or size brackets, and unguided capital can sometimes slip up on that risk of oversupply. Logistics is shielded to some degree from the difficulties of the retail sector because many tenancies are third-party logistics operators with retail contracts underneath, but there must be some risk of contagion coming into the logistics sector.

Q Why are you looking to expand your continental European holdings?

SL: Many investors and occupiers look at logistics on a pan-European basis. Our continental European strategy is based on the opportunities that arise through occupier relationships. For example, one of the occupiers in our UK portfolio has asked us to help to source two locations on the continent.

JB: We don't propose to do development in Europe just yet. The strategy is about taking tenant relationships and deploying them into income-producing assets. We are not trying to conquer the entire European continent in a day. So far, we have been focused on Germany and Poland, with an opportunistic acquisition in Dublin. It is possible to obtain some very favorable pricing on financing for German assets, and we are making a major effort to build up our holdings there.

It will remain a stable, low interest-rate environment for underwriting investments in both the UK and Europe. I hope there will be some growth in the UK that may give rise to interest rate increases. In Germany, there are negative interest rates on fixed-income instruments, and while I do not like to predict further cap rate compression, that might just happen in Germany. However, you have to ask if there will come a point when real estate investors say: "No, it does not matter what the arbitrage with fixed income is, yields are low enough for an illiquid asset like real estate."

SL: If yields are still falling, investors must believe there will be growth in rents. E-commerce has not yet really taken off in continental Europe in the same way as it has in the UK.

As a consequence, there may yet be huge growth in online consumption in Germany, France and Spain in particular, which will drive the need for the sector to provide new space in markets where there has hitherto been little speculative development, and will support rental growth. That might prompt further yield compression as people identify and buy into that growth story. ■


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