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EUROPEAN LOGISTICS:

warehousing the future

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Why and where to buy logistics in Europe

The logistics business sector is one of the biggest industries in Europe. It generates a revenue of more than EUR 900 billion annually, represents just under 7% of total GDP and employs more than 7 million people.[1]

Increasing geopolitical tensions could mean more trade restrictions worldwide. However, new trade routes and economic development initiatives offer opportunities for expanded transportation and logistics networks in Europe. Projects such as the New Silk Road, which will stretch from China to Europe, will forge links between locations previously isolated from each other, potentially creating demand for new logistics hubs along the way.

Technology is changing consumption, production and supply chains, with e-commerce growing rapidly across Europe. Prologis research found that e-commerce retailers require three times more logistics space than store-based retailers.

Europe's ongoing urbanisation is fuelling competition for land and demand for smart logistics solutions. The more expensive and complicated processes of last-mile logistics are spurring growth of cross-docked distribution centres on the edges of towns and cities as a go-between for national and pan-regional distribution centres.

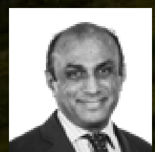
Increasingly automated factories and logistics warehouses may enable traditional, labour-intensive manufacturing to move closer to consumers, allowing for more efficient use of land. Furthermore, autonomous vehicles could help revolutionise logistics supply chains and transportation.

Logistics properties have an attractive risk-return-profile compared to offices and high street retail. The yield gap between prime logistics assets and prime office and retail properties is relatively high. Moreover, logistics assets often deliver triple-net leases with fully index-linked rents.

Investment in European logistics assets allows for real estate portfolio diversification: compared to office and retail properties, logistics properties deliver high distribution. In addition, total returns are more stable for logistics than for office and retail properties.

We see opportunities in cross-docked logistics facilities of 2,000-10,000 square metres (sqm) in or on the fringes of major European cities, mega-distribution centres of 60,000-100,000+ sqm in traditional logistics locations close to or between urban areas and modern, mid-sized distribution centres.

In this paper, we explore various structural shifts from which the logistics sector is benefitting and feature interviews with experts, highlighting key insights into their respective markets.



Kiran Patel
Chief Investment Officer

1 Sources: Eurostat, Alliance for European Logistics

KEY RECOMMENDATIONS

BELGIUM

- Focus on assets in prime locations in the Brussels region and along the Antwerp-Brussels-Ghent axis. Home in on major urban areas that allow for shorter delivery times and cost efficiency gains in distribution.

FRANCE

- We recommend targeting mega-distribution centres as well as modern, mid-sized centres in established logistics locations with excellent transport links in the main logistics corridor around the urban areas of Paris, Lyon, Marseille and the northern region.
- Seek cross-docked logistics facilities in or on the fringes of major cities such as Paris, Lyon, Lille, Orléans and Marseille.
- Consider selective opportunities for better returns through partnering with local developers requiring funding for part-speculative schemes or forward-funding pre-let schemes.

GERMANY

- Target mega-distribution centres in major logistics hubs and points in the supply chain close to or between urban areas (e.g., Ruhr, Hanover, Hamburg, Halle/Leipzig, Rhine-Main).
- Seek cross-docked facilities in well-connected locations in or on the fringes of major conurbations such as Berlin, Hamburg, Frankfurt, Munich and the Ruhr area. Also consider growing secondary cities such as Freiburg, Münster and Nuremberg.
- We expect strong competition for attractive sites, so liquid secondary cities and conurbations may offer higher yields.
- Focus on well-connected multimodal locations, modern and flexible Grade A properties and tenants with strong covenants.

THE NETHERLANDS

- Target newly built, modern and flexible distribution centres with good transport links, particularly in established hubs in southern regions such as Noord-Brabant and Limburg (Venlo).
- Look for urban logistics opportunities in the densely populated Randstad area.
- As availability of product remains a concern, we see value in forward-funding pre-lets and in local developer partnering for speculative development.

THE NORDICS

- Look for modern, last-mile urban logistics facilities close to major Nordic cities, including Stockholm, Gothenburg and Malmö.
- Focus on XXL warehouses where demand is driven by third-party logistics (3PL) and large online retailers.

POLAND

- Seek build-to-suit fulfilment and distribution centres on 10+ year leases with good quality covenants and significant tenant capital expenditure investment that can be used by third parties in the top five locations: Warsaw, Katowice, Poznan, Wroclaw and Central Poland (Lodz).
- Target generic, single-let warehouses on long-term leases and near major highways such as the A2/A4, S3/A6 and A2/S3.
- Consider highly customised, multilevel warehouses only when they are designed and let to tenants with good covenants and on long-term leases.

SPAIN AND PORTUGAL

- While both countries have more limited links to global economic activity, we recommend focusing on the capital city regions of Madrid and Lisbon. These major population centres have good infrastructure links and prosperous market environments.

THE UK

- Target logistics property around top-ranking cities on the Savills IM Dynamic Cities Index, particularly London, Cambridge, Edinburgh and Oxford.
- Seek mega-distribution centres in the golden triangle, and 3PL close to ports.

BE CAUTIOUS OF…

- Out-of-town, multilet generic warehouses in Poland
- The current logistics property ownership structure in Poland, which consists of five dominant investors and developers

Brexit

We think a UK-EU divorce deal allowing for a period of transitional arrangements followed by a form of free trade agreement is most likely. However, in the case of a hard Brexit scenario it is likely that UK-EU supply chains may be interrupted.

US

Measures to reduce America's trade deficit under President Donald Trump could affect Eurozone economies such as Germany, and further US trade protectionism could lead to European supply chain disruptions and tit-for-tat response measures.

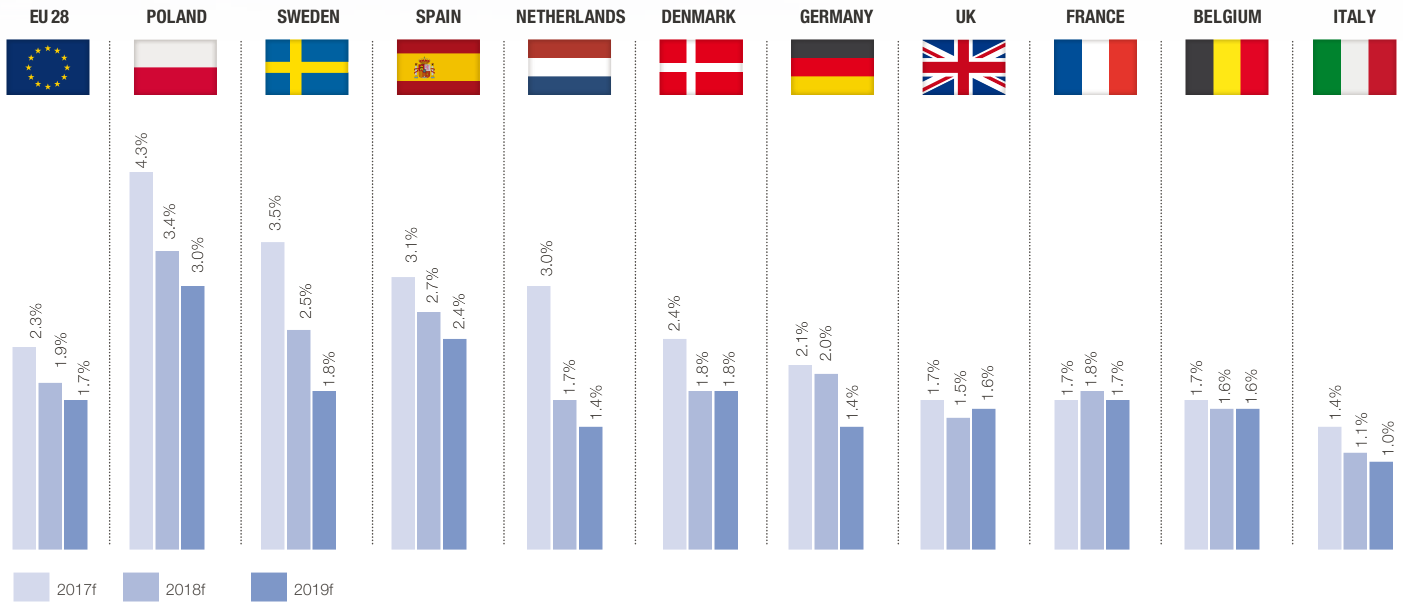
Turkey

Turkish President Tayyip Ergoğan could allow the 3 million refugees currently held back from migrating to the EU to leave Turkey. This may cause a rise in border controls that would also significantly disrupt logistics supply chains.

Global recovery is boosting the European logistics market

The European logistics market is benefitting from the steady recovery of European economies since the global financial crisis (GFC). More recently, global GDP has picked up momentum, producing stronger tailwinds for the European Union. According to Capital Economics, GDP growth has become broad based, with both consumer spending and investment posting gains. Growth is strong outside the Eurozone, too, with strongest rates expected in Poland and Sweden going forward (figure 1).

FIGURE 1:
GDP GROWTH FORECAST (%)



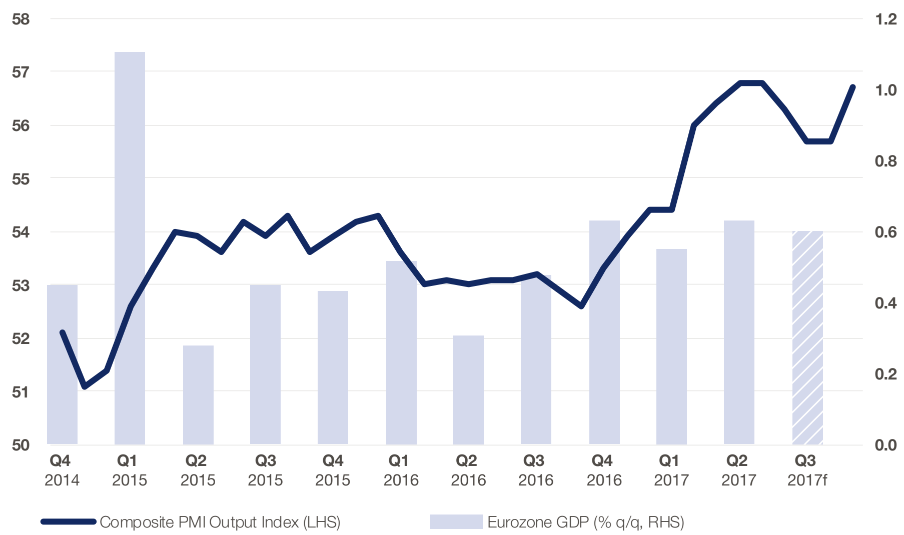
Sources: Oxford Economics, Savills Investment Management
Note: 'f' denotes forecast

According to Markit, Eurozone composite PMI remained high in Q3, only slightly below its spring peak (figure 2). The main recovery driver has been domestic demand. Furthermore, the strength of exports as well as both intra-area trade and trade with non-Eurozone economies have been dominant drivers.

Strong labour market recovery, including increasing employment and decreasing unemployment rates, are also driving household spending. Such trends are fuelling further job growth, and Oxford Economics expects real income and consumer spending growth over the next six months.

Economic recovery helps boost global trade flows despite, for example, more protectionist US trade policies. All European logistics segments – from cargo to air and land freight – may benefit from this global economic recovery.

FIGURE 2:
COMPOSITE PMI AND EUROZONE GDP



Sources: Markit, Macrobond, Savills Investment Management
Note: 'f' denotes forecast

European logistics offers an attractive risk-return profile

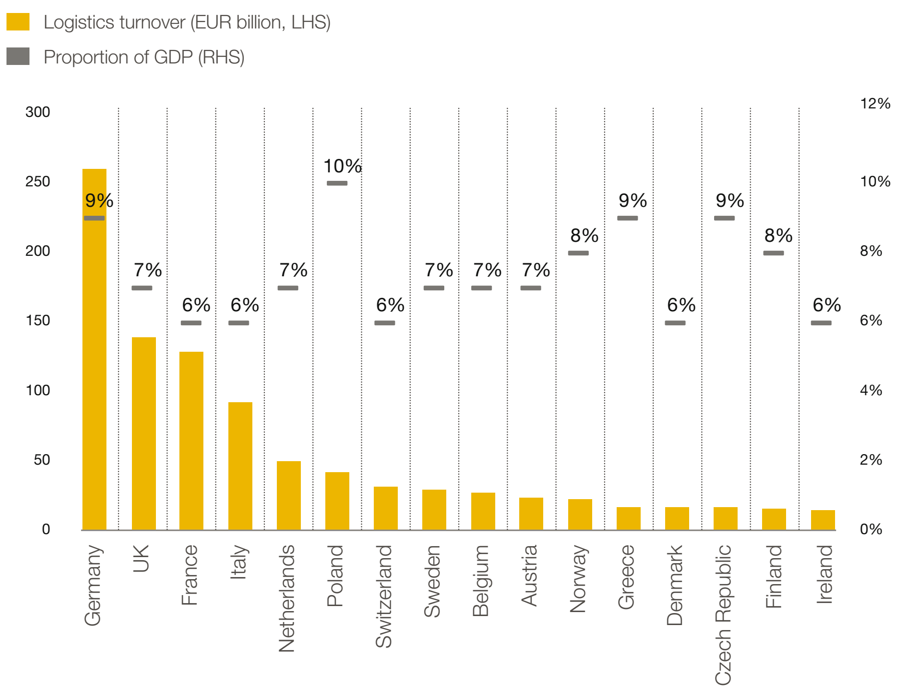
> ACCORDING TO EUROSTAT AND THE ALLIANCE FOR EUROPEAN LOGISTICS, THE LOGISTICS SECTOR IS THE SINGLE BIGGEST EU INDUSTRY: IT GENERATES A REVENUE OF MORE THAN EUR 900 BILLION ANNUALLY, REPRESENTS JUST UNDER 7% OF TOTAL GDP AND EMPLOYS MORE THAN 7 MILLION PEOPLE.

Globalisation, global trade and international division of labour have supported European logistics sector growth over the last few decades. According to Deutsche Bank Research (DB Research), global trade has outperformed the global economy over the long term, and trade within Europe still takes the lion's share of worldwide commerce.

Increasing geopolitical tensions could mean more trade restrictions worldwide. However, new trade routes and economic development initiatives such as the New Silk Road offer opportunities for expanded transportation and logistics networks in Europe.

Depending on geographic location and size of national industrial sector, European logistics sector proportion of GDP ranges from 6% in Denmark, France, Ireland, Italy and Switzerland to 10% in Poland (figure 3).

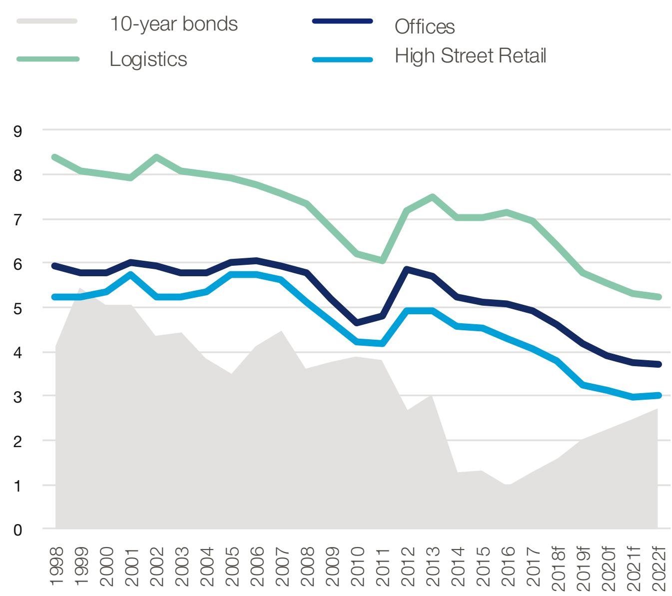
FIGURE 3:
LOGISTICS TURNOVER AND PROPORTION OF GDP (2016)



Sources: Oxford Economics, Savills Investment Management

European logistics properties have an attractive risk-return profile compared to offices and high street retail. The yield gap between prime logistics assets versus prime office and prime retail properties remains high (figure 4). Furthermore, sites currently used for cross-docking in growing conurbations could gain significant value because of the increasing competition for land.

FIGURE 4:
WEIGHTED PRIME NET YIELDS (EUROPEAN AVERAGE) VERSUS WEIGHTED EU 10-YEAR GOVERNMENT BONDS (%)

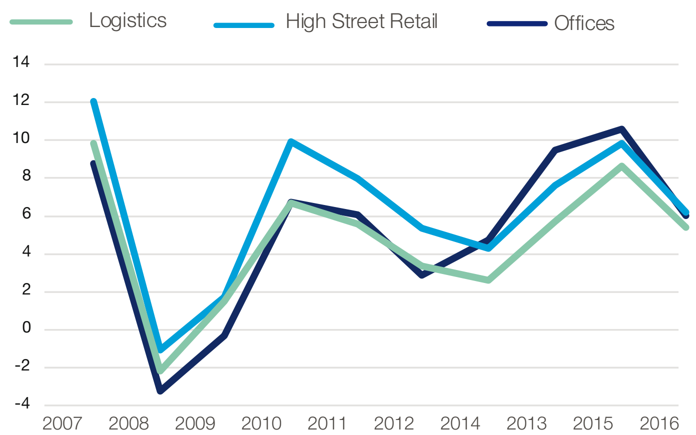


Sources: PMA (Autumn 2017), Savills Investment Management
Note: 'f' denotes forecast

Total returns for European logistics properties are more stable than total returns for office and retail properties. According to MSCI, the unweighted standard deviation for logistics properties in 14 European countries between 2007 and 2016 amounted to 4.7%, compared to 5.2% and 6.4% for office and retail properties, respectively (figure 5).

While tenant improvement costs for office refurbishments in Europe typically range between EUR 300 and EUR 500 per sqm, they are much lower for logistics properties (typically below EUR 100 per sqm). Investment in logistics assets is crucial for real estate portfolio diversification, which, ideally, helps reduce risk via investment in various countries, sectors and lease lengths. Investment in logistics assets usually delivers stable cash flows through long leases: 10-year lease terms are much more common in the sector, and investors benefit from usually triple-net leases with fully index-linked rents.

FIGURE 5:
AVERAGE STANDARD DEVIATION OF TOTAL RETURNS (%, UNWEIGHTED)



Sources: MSCI, Savills Investment Management
Note: includes Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Italy, Netherlands, Poland, Portugal, Spain, Sweden and the UK

The New Silk Road: a long-term economic development corridor

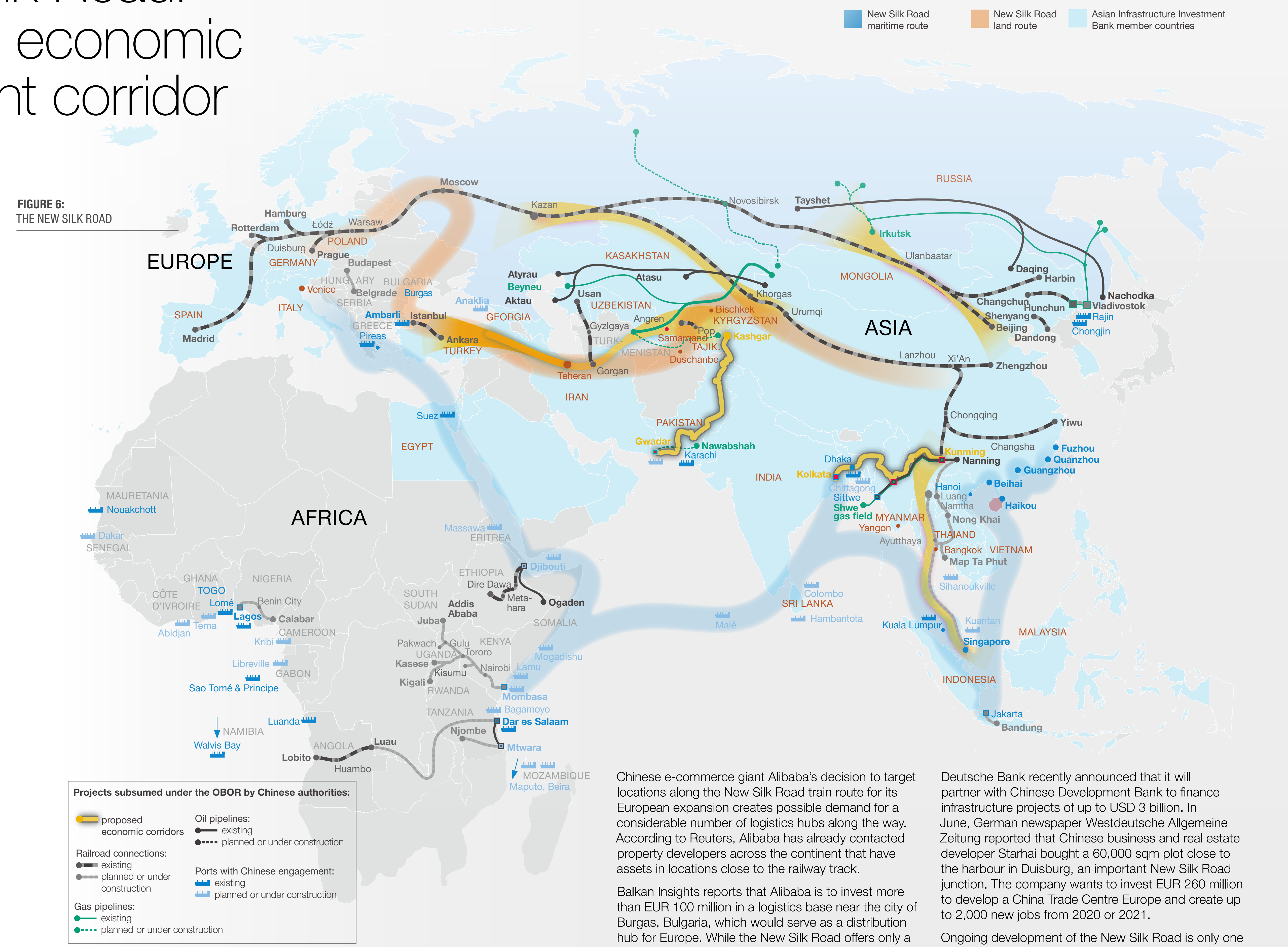
The New Silk Road – or One Belt, One Road (OBOR) initiative – is an emerging network of railways, highways, pipelines, special economic zones, commercial centres and logistics hubs spanning from Central China to Western Europe (figure 6). According to the Royal Institution of Chartered Surveyors (RICS), the area connected by the New Silk Road includes about 70% of the world's population, 75% of world energy resources and 70% of global GDP.

According to the Mercator Institute for China Studies (MERICS), a key word promoted by the Chinese government is 'connectivity,' the central purpose of the New Silk Road. The initiative offers opportunities to bring economic development to parts of the world that have been isolated from one another. The success of this project hinges on geopolitical stability among neighbouring countries such as Russia, the Ukraine, Azerbaijan and Armenia.

The planned construction of a new Belgrade-Budapest railway by Chinese companies can clearly be attributed to the OBOR. Furthermore, rail services between China and Europe are increasing in number and frequency. These services are connecting various cities in China with destinations in Poland, Germany, the Netherlands, Belgium, France and Spain.

According to MERICS, OBOR projects in the EU often involve container terminals and railways. For example, the China Shipping Group Company (COSCO), a logistics giant, acquired a controlling share in the Greek Piraeus Port Authority in 2016. COSCO and other Chinese port companies have also invested or announced intent to invest in seaports in Belgium, the Netherlands, Italy, Portugal, Spain, Croatia, Slovenia, Latvia and Lithuania. Whereas the OBOR has not been picked up at the level of national discourse in countries such as Germany or France, local or regional authorities in Duisburg, Hamburg and Lyon (Rhône-Alpes) have been proactive.

FIGURE 6:
THE NEW SILK ROAD



Sources: MERICS, Savills Investment Management

Note: The Asian Infrastructure Investment Bank is a multilateral development bank that aims to support infrastructure building in the Asia-Pacific region.

Chinese e-commerce giant Alibaba's decision to target locations along the New Silk Road train route for its European expansion creates possible demand for a considerable number of logistics hubs along the way. According to Reuters, Alibaba has already contacted property developers across the continent that have assets in locations close to the railway track.

Balkan Insights reports that Alibaba is to invest more than EUR 100 million in a logistics base near the city of Burgas, Bulgaria, which would serve as a distribution hub for Europe. While the New Silk Road offers only a longer-term return on investment, Alibaba's move could pave the way for new businesses and, thus, demand for logistics facilities along the route.

Deutsche Bank recently announced that it will partner with Chinese Development Bank to finance infrastructure projects of up to USD 3 billion. In June, German newspaper Westdeutsche Allgemeine Zeitung reported that Chinese business and real estate developer Starhai bought a 60,000 sqm plot close to the harbour in Duisburg, an important New Silk Road junction. The company wants to invest EUR 260 million to develop a China Trade Centre Europe and create up to 2,000 new jobs from 2020 or 2021.

Ongoing development of the New Silk Road is only one example of economic development initiatives that could spur further demand for European logistics.

Technology-driven consumption fuelling demand for modern logistics real estate

> ACCORDING TO PROLOGIS, EACH EUR 1 BILLION OF ADDITIONAL ONLINE SALES GENERATES AROUND 77,000 SQM OF NEW LOGISTICS DEMAND.

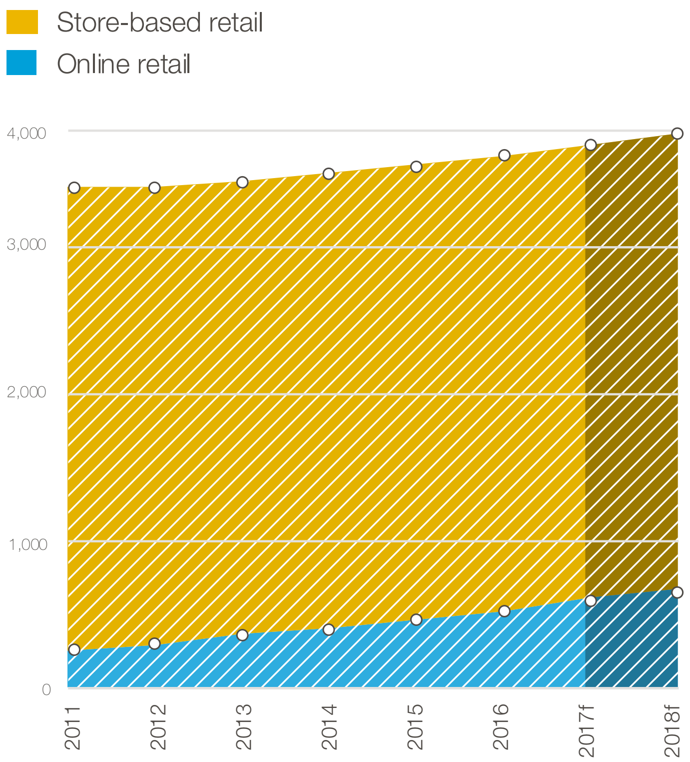
Logistics providers are optimising their services to meet increasingly technology-driven retail consumption, with start-ups competing to digitalise aspects of the logistics supply chain from manufacturing to last-mile delivery. Booming-e-commerce offers excellent opportunities for growth in modern logistics real estate such as mega-distribution centres, smaller urban facilities within city limits and click-and-collect pick-up points.

Customer requirements regarding availability, choice, speed and flexibility create need for additional points in the logistics supply chain. Prologis research found that e-commerce retailers require three times more logistics space than store-based retailers, for example. This can be attributed to high inventory turnover, wider product range and greater need for outbound shipping space and logistics capacity for customer returns (figure 7).

According to Prologis, each EUR 1 billion of additional online sales generates around 77,000 sqm of new logistics demand. This translates to potential demand growth amounting to 15 million sqm in Europe over the next five years. Furthermore, e-commerce growth could mean more than 200,000 new logistics sector jobs across Europe.

While overall retail turnover is expected to rise, online sales are forecast to grow disproportionately (figure 8). The Centre for Retail Research reports that the average share of Internet retail in Europe stood around just 8% in 2016. However, Produce Business UK expects the online share to grow to 15-25% by 2030. The standardisation of same-day delivery raises the stakes for logistics providers and parcel services.

FIGURE 7:
SALES BY RETAIL CHANNEL, EU-28 (EUR BILLION)

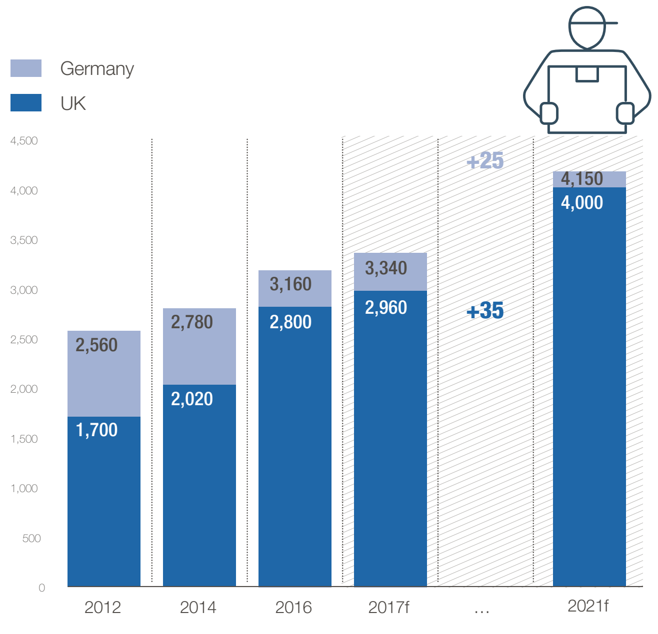


Sources: Oxford Economics, Ecommerce Europe, Savills Investment Management
Note: 'f' denotes forecast

According to research by the Mintel Group, 2.8 billion packages and parcels were delivered in the UK in 2016 and, according to Bundesverband Paket und Expresslogistik (BIEK), almost 3.2 billion were delivered in Germany in the same period. These figures include business-to-business, business-to-consumer and consumer-to-consumer deliveries. Both the Mintel Group and BIEK expect further parcel delivery growth amounting to about 4.0 billion in the UK and 4.2 billion in Germany through 2021 (figure 8).

Increasing parcel shipping likely presents further growth opportunity for European logistics. In particular, parcel services such as FedEx, UPS and DHL will increase demand for both mega-distribution centres and urban logistics.

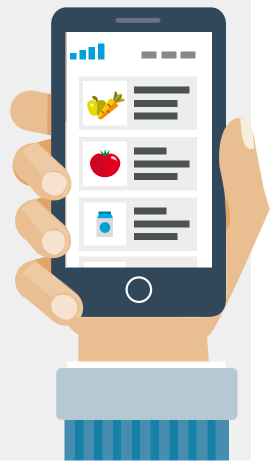
FIGURE 8:
NUMBER OF PARCEL DELIVERIES IN THE UK AND GERMANY (BILLIONS)



Sources: Mintel Group, BIEK, Savills Investment Management
Note: 'f' denotes forecast

SPOTLIGHT: AMAZONFRESH

- An increasing number of retail segments will be affected as millennials age and expect to shop when, where and how they want, with the grocery segment leading the pack, especially in the UK. According to Savills, 4.4% of the UK grocery market is online based compared to just 0.8% in Germany. But Amazon and DHL recently teamed up to roll out AmazonFresh, Amazon's nearly decade-old grocery arm, in Berlin and Hamburg. Munich followed suit in November 2017.
- According to Conlumino, AmazonFresh entered the European market and introduced its services to nearly 70 London postcodes in 2016. IGD Retail Analysis recently reported that the provider has expanded to 260 postcodes since, with the service also available in Surrey and Hampshire.
- The expansion of online retail is causing a rethinking of many logistics networks, as online retailers such as AmazonFresh seek to distinguish themselves by providing increasingly rapid delivery. Urban populations are also increasing, largely fuelled by the demographic most likely to shop online.
- Business Insider reports that Amazon is seeking 1,300 small warehouse units in urban locations near major cities across Europe. This stems from the increasing consumer demand for shorter delivery times, such as the one-hour Amazon delivery service that was first launched in the UK in 2015. While the retail giant usually operates its last-mile facilities independently, it uses third parties such as DHL and UPS in areas of high demand.
- The expansion of AmazonFresh may mean additional demand for warehouses capable of cooling groceries, and other urban logistics formats. Even traditional brick-and-mortar grocery retailers are launching online platforms, creating further logistics demand potential.



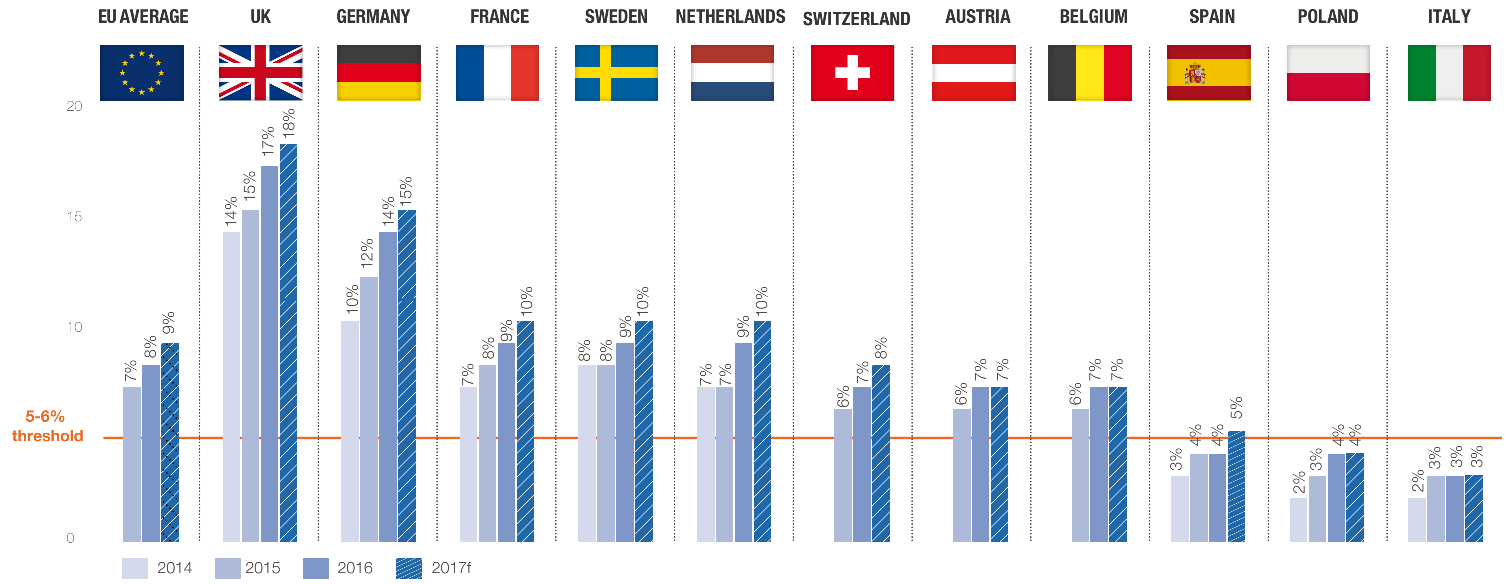
Urbanisation requires smart logistics solutions

> CITY DWELLERS ARE GENERALLY TECH SAVVY AND COMFORTABLE SHOPPING ONLINE, WHICH IS DRIVING THE NEED FOR INNOVATIVE LAST-MILE DELIVERY CAPABILITIES AND SMART URBAN WAREHOUSING.

Rising urbanisation across the globe is resulting in higher city population densities and changing consumer spending behaviour. Investors are therefore increasingly targeting cities rather than overall countries. We believe that cities that are adapting well to urbanisation, highlighted in the Savills IM Dynamic Cities Index, will lead the next real estate cycle.[1]

1 Savills IM Dynamic Cities Index identifies 6 factors, modelled using 60 indicators, that make cities attractive to talent, resilient to disruptive technology and a leader in the knowledge economy. For more analysis, visit www.dynamiccities.savillsim.com.

FIGURE 9:
ONLINE MARKET SHARE BY COUNTRY
(% NATIONAL RETAIL)



Sources: Centre of Retail Research, Savills Investment Management
Note: 'f' denotes forecast; no 2014 data available for Austria, Belgium, the EU and Switzerland

Such trends make urban logistics a winning sector for European investment, particularly where Internet sales as a proportion of total retail sales are rising (figure 9). This is certainly the case in the UK, Germany, France, Sweden and the Netherlands, but countries such as Spain, Italy and Poland are catching up as they reach the 5-6% threshold of Internet sales.

City dwellers are generally tech savvy and comfortable shopping online, which is driving the need for innovative last-mile delivery capabilities and smart urban warehousing, as an increasing number of parcels are delivered to an increasing number of residents in ever decreasing time windows.

Higher-valued residential, office, retail and leisure property is causing scarcity of land. This is pushing land prices up and making it more expensive for developers to build logistics properties. Moreover, large areas of former manufacturing and warehousing land are lost to higher-value uses every year, due to local authorities facilitating conversions of old industrial buildings into residential units. AECOM reported that in London, for example, roughly 1,300 hectares of former industrial land was converted into other uses between 2001 and 2015.

Emissions are a major concern for growing cities. Due to the need to improve air quality and limit health risks, an increasing number of European cities have introduced low-emission zones. Furthermore, Paris, Madrid and Athens have vowed to ban the use of diesel vehicles from their city centres, with London pledging to prohibit petrol and diesel cars from 2040. In response, parcel servicer Deutsche Post DHL Group recently acquired electric vehicle manufacturer StreetScooter to become a market leader in green logistics. This could lead to a consolidation of operators in particular areas, driving high demand for logistics space.

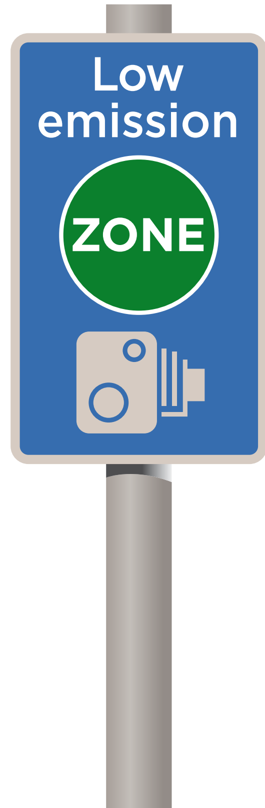
FIGURE 10:
DHL CROSS-DOCKED FACILITY

Sources: DHL, CBRE

The more expensive and complicated processes of last-mile logistics are spurring growth of cross-docked distribution centres on the edges of towns and cities as a go-between for national and pan-regional distribution centres.

In particular, cross-docking facilities and parcel delivery centres of around 2,000-10,000 sqm in the vicinity of major cities and conurbations will become increasingly important to enable next-day, same-day or even same-hour delivery on selected items (figure 10). Urban distribution centres within city limits are increasingly necessary to fulfil these promises.

Online retailers have started to include smaller urban warehouses (facilities up to 2,500 sqm) in their network in order to shorten delivery routes and provide quick delivery services to online customers.



Digitalisation and the rise of robots

> “THE INCREASING USE OF ROBOTS IN PRODUCTION COULD LEAD TO A RETURN OF MANUFACTURING INDUSTRIES FROM OTHER PARTS OF THE WORLD TO EUROPE.

Digitalisation and automation are transforming operations within both warehouses and greater logistics supply chains. Manual handling is increasingly replaced by highly efficient robots and other automated solutions, which help minimise defects for higher levels of productivity and help reduce operating costs. Having a reliable power supply is crucial.

In the newest generation of mega-distribution centres from online retailers such as Amazon and Zalando, workflows are turned upside down. Robots carry entire shelves and take them to the packers, enabling operators to package the shelves and, thus, store more goods in the same area. Additionally, distribution centre height is better utilised, and wide aisles are no longer needed. Robot versus human workers likewise allow enlargement of fire sections, further boosting space efficiency.

In automated storage and retrieval systems (ASRS), computer-controlled systems automatically place and retrieve loads from defined storage locations. They are becoming increasingly essential to maximise space efficiency in warehouses, as available land near cities is ever more scarce. High, multilevel shelves and narrower aisles enable incremental and scalable expansion of storage. ASRS helps reduce labour costs while increasing safety. Such storage capacity is invaluable given the volume of e-commerce orders.

Colliers International predicts that multistorey warehouses – already common in densely populated, land-constrained urban centres in Asia – should become more common in Europe in the next couple years. Indeed, they already exist in London, Paris and Munich. However, local regulations around building heights could impact trends in multistorey facilities.

DHL research forecasts that it is not a matter of if but rather when robots will revolutionise parcel sorting hubs, distribution centres, last-mile facilities and delivery vans. But because the current worldwide share of automated warehouses is just 5%, human labour will still be relied on to a certain extent for loading and unloading trucks, handling containers and manually sorting odd-sized parcels and goods.

Digitalisation and the Internet of Things promise great benefits for logistics operators and consumers. For example, radio frequency identification technology is key for security, managing inventory, reporting, sorting, conveying and shipping (table 1).

The use of big data will lead to anticipatory logistics, where manufactures and retailers are able to predict customer needs. An example of this is Amazon seeking to anticipate its highest-demand goods based on user research, which can inform how Amazon equips its trucks for one-hour delivery services. Other companies may conduct similar analyses and ship goods or parts to distribution centres that are closest to customers who are most likely to purchase particular products. This enables faster deliveries and, thus, increases customer satisfaction. Furthermore, an accurate prediction of demand enables lean inventory management and more efficient use of resources.

TABLE 1:
INTERNET OF THINGS IN LOGISTICS

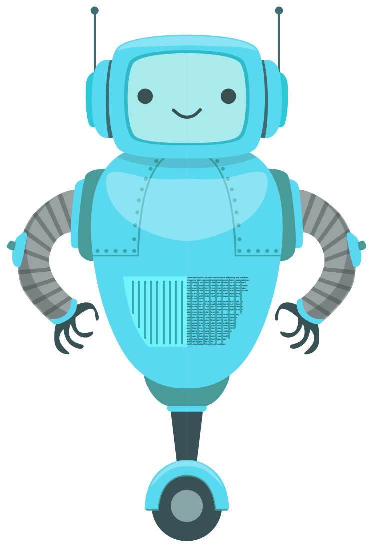
TECHNOLOGY PUSH	LOGISTICS SOLUTIONS
Mobile computing is growing steadily, with more mobile phones expected in 2020 than people in the world.	Transparency and integrity control along the supply chain: the right products at the right time, place and cost, and in the right quantity and condition
With the move towards 5G, wireless communication will reach a new level of maturity.	Integrity control, especially for business customers' sensitive goods
Sensor technology has become more mature and affordable in the logistics industry.	Detailed shipment tracking to provide consumers transparency in real time
Cloud computing and big data technologies will enable new data-based services.	Transparency of logistics networks and assets providing efficiency and optimisation

Sources: DHL, Savills Investment Management

The increasing use of robots in production could also lead to a return of manufacturing industries from other parts of the world to Europe. As wages in Asia have been rising significantly since the peak of the off-shoring process in the 2000s, cost-saving benefits have become less clear. Oil prices have been rising since then, too. Consequently, various companies are considering shifting manufacturing or assembly of goods back to Europe in order to supplement automated production.

While this trend is likely to have a negative overall impact on low-skilled workers in particular, reshoring and nearshoring could be positive for the European logistics sector as a whole. While cost was the dominating factor in supply-chain optimisation in the past, delivery speed and adaptability to market trends have become almost equally important.

Trends in automation could lead to demand for taller buildings. One example is Amazon's almost fully automated distribution centres, where robots operate on three floors, and a higher amount of goods can be stored in the same space. The same is true for logistics properties operated by an ASRS. Consequently, the need for mega-distribution centres of 100,000+ sqm could decrease. Furthermore, the increasing usage of robots in the workplace could reduce the space needed for staff amenities, including parking facilities.



Insights from...

Artur Mokrzycki

Head of Capital Markets
Panattoni Europe

> The remuneration gap between Western and Eastern Europe will remain significant and will probably not disappear in the foreseeable future.

What factors are influencing European logistics markets?

Many new factors are significantly influencing Europe's logistics/industrial scene. Prominent trends include: 1) the expansion of online distribution, 2) the introduction of new technologies such as driverless transportation and 3) the significant (but slowly narrowing) labour cost gap between Western and Central Europe (CE).

Traditional bricks-and-mortar retail distribution will shrink in many places, replaced by e-distribution carried out using logistics facilities such as fulfilment or parcel distribution centres. With new transportation technologies, shipping will become economically rational from distant locations.

Some specific logistics centres (e.g., for food, pharmaceuticals and one-hour delivery) will remain around the big urban centres, while large hubs will be located and operated farther afield.

We expect European logistics to continue operating in a borderless, more pan-European rather than national environment, which will help improve the cost and time efficiency of supply chains.

CE will remain a popular destination for all types of logistics and light industrial purposes, at least to the extent that the distance from the final destination remains manageable. CE labour costs, today four times lower than in Western Europe, will increase and boost local spending power. But the remuneration gap between the west and east will remain significant and will probably not disappear in the foreseeable future.

We are seeing low vacancy rates and generally high take-up across Europe. Will development be robust enough to keep up with demand over the next few years?

We believe the development sector will be able to respond to any type of demand. However, in certain locations, limited land or labour supply – or high operating costs – may force present occupiers to relocate their activities from historically well-established locations. New markets will emerge as increasing volumes of capital target the logistics/industrial sector in general, and many specific investment strategies are already betting on this trend.

How can logistics providers attempt to future proof in the face of rapid technological change?

Third-party logistics providers are operating in a rapidly evolving supply chain environment where clients are expecting many novel, high-value-add services to be provided with constant time and cost optimisation.

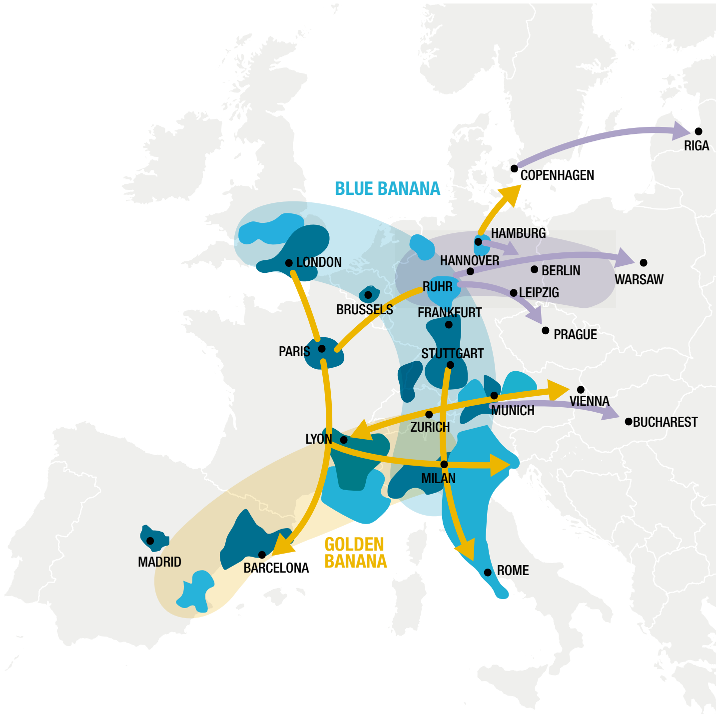
Flexibility and zero defaults must be available for next-day, same-day and one-hour deliveries. Environmental regulations will exercise additional pressure on the sector.

In such a context where significant investment or concentrations will be necessary, new players betting on innovations such as information technology and robotics will emerge, and should be a key focus of logistics providers and operators.

Logistics corridors of Europe

The so-called Blue Banana is a corridor that stretches from north of London through Belgium, the Netherlands, western Germany and Switzerland, ending in Milan (figure 11). This corridor is home to more than 110 million people and includes the most important traditional European economic centres and logistics hubs.

FIGURE 11:
INDUSTRIAL AND LOGISTICS CORRIDORS IN EUROPE



Sources: bulwiengesa, Savills Investment Management
Note: Darker blue indicates conurbations and logistics hubs

According to bulwiengesa, the other corridor of interest – known as the Golden Banana – refers to a Southern European conurbation lying between Valencia, Spain, and Genoa, Italy, along the Mediterranean coast. Since the fall of the Iron Curtain, Eastern European economies have developed rapidly, and several new industrial and logistics corridors have emerged, such as that connecting Germany's Ruhr area with Berlin and Warsaw (in our view, the purple banana in figure 11), and that linking the Ruhr area, Leipzig and Prague.

Poland is one of the most important countries for the logistics business in Europe due to its relatively low labour costs, availability of development sites and the overall importance of the sector for the Polish economy.

According to PMA, in most of Europe's key 30 logistics markets, investible stock totals less than 5 million sqm. Only the metropolitan areas of London, Madrid, Milan and Paris have investible stock in quantities above this threshold (table 2). However, the traditional logistics corridors of Europe could move eastwards to meet the New Silk Road's westward reach, forming a new economic corridor. This could give rise to new economic centres and logistics hubs outside of the UK, Benelux, France, Germany and Italy.

TABLE 2:
MODERN LOGISTICS STOCK (SQM)

TIER 1 >5 million	TIER 2 4-5 million	TIER 3 2.75-4 million	TIER 4 2-2.75 million	TIER 5 <2 million
London	Barcelona	Berlin	Amsterdam	Budapest
Madrid	Birmingham	Brussels/ Antwerp	Dusseldorf	Dublin
Milan	Frankfurt	Copenhagen	Lille	Luxembourg
Paris	Hamburg	Stockholm	Lisbon	Munich
	Lyon	Warsaw	Manchester	Rome
			Marseille	Edinburgh/ Glasgow
			Prague	
			Rotterdam	

Sources: PMA, Savills Investment Management

Insights from...
Jon Crossfield

Head of Strategic Partnerships

Savills Investment Management

> Some tenants are even building themselves and then structuring sale and leasebacks based on 'book cost' so as to minimise rents rather than create profit.

What key characteristics are large-sized occupiers seeking on the Continent?

Efficiency of operations and minimising costs are increasingly important, particularly for large occupiers. Tenants are aware of the changing investment landscape and the value of their lease. The fall in yields is allowing both tenants and developers to build-to-suit at 'low' rents and, yet, still make a margin. The fall in yields and rise in build-to-suit is helping keep rental growth in check in certain markets.

Depending on use of the unit (e.g., last mile or fulfilment), location, flexibility and transport links will remain key factors. Labour supply, laws and cost are increasingly important and a key driver – you may need 1,000-3,000 employees operating 24/7 at an e-commerce fulfilment centre.

What factors are shaping large-sized occupiers' geographic focus?

Depending on country and type of operation, there are a number of factors shaping the decisions. The increasing need for last-mile delivery and speed of delivery will mean that being located close to the larger urban populations will remain key for most. Planning constraints and conversion of industrial land to other uses are leading to supply shortages and, in many urban locations, are increasing rents.

Few sites exist for the largest occupiers close to urban locations, and where they do exist, it is unlikely they can compete with rents from smaller occupiers. Even in non-urban but strategic locations with motorway access, it is not easy to build, and often sites will only be released on the condition that significant employment will follow. For e-commerce, the availability of suitable labour force is key, and tenants are targeting cities or towns where this exists and where they do not have to fight with other occupiers. Employees can often be transported in from a large area or even across borders.

What trends are you observing in Poland and Germany?

Germany remains the largest market in Europe, with the lowest yields and highest tenant and investor demand. The market is seeing strong occupational demand and an ever-evolving range of designs from urban cross-docking to large multilevel units, as occupiers and third-party logistics providers seek to optimise their future strategies.

Poland is an increasingly active market and increasingly seen to be a cheaper logistics location from which to service both Germany and the rest of Western Europe. H&M, Zalando, Amazon and BMW are all examples of this trend. Key attractions are: cheaper and more flexible labour supply (at circa one-third of cost), good roads and, in some locations, better land supply.

What is the outlook for speculative development?

High demand and limited supply mean there is an increasingly strong case for speculative development in certain locations and for certain sized units. The market will respond to this, although we expect it to be rather cautious and not result in over supply. Due to the specific nature of many of the very large units, these are unlikely to be built speculatively and will remain build-to-suit. If such tenants need units, they can still be delivered in 9-12 months, assuming the sites and permits exist.

Pan-European logistics: occupier market

According to JLL, logistics take-up in Europe reached more than 19 million sqm in 2016, a new record high, despite political uncertainty around the Brexit vote. In H1 2017, European industrial and logistics activity remained lively. Warehouse take-up increased by more than 22% year on year (y/y), according to BNP Paribas Real Estate (BNPPRE). Spain and the Netherlands recorded the highest growth rates across Europe. This can mainly be attributed to a positive economic recovery including increasing exports, retail sales and consumer spending. Therefore, JLL expects the pan-European logistics market to achieve another record annual take-up in 2017.

According to BNPPRE, take-up was mainly driven by demand from 3PL and retail tenants. JLL reports that 3PL generated 36% of overall logistics take-up in 2016. Retail companies ranked second with a share of 28%, followed by the manufacturing sector (17%) and online retailers (12%).

While demand for new logistics facilities is high, supply is hardly keeping pace, particularly for large units. Thus, vacancy rates in most European countries fell further in H1 2017, and despite y/y increases in supply, it did not balance out the high levels of logistics demand (table 3). Consequently, the number of owner-occupier activities is on the rise, according to BNPPRE.

JLL estimates that the overall logistics vacancy rate in Europe stood below 5.8% at the end of H1 2017, and it is expected to decrease further: speculative developments remain limited, as new supply is expected to continue to be predominantly build-to-suit in 2017. While there was 12.5 million sqm of new logistics space under construction in H1 2017, only 21% of this is speculative. This is why the overall vacancy rate could fall to about 5.5% despite accelerating development activity.

TABLE 3:
LOGISTICS VACANCY RATES ACROSS EUROPE (H1 2017)

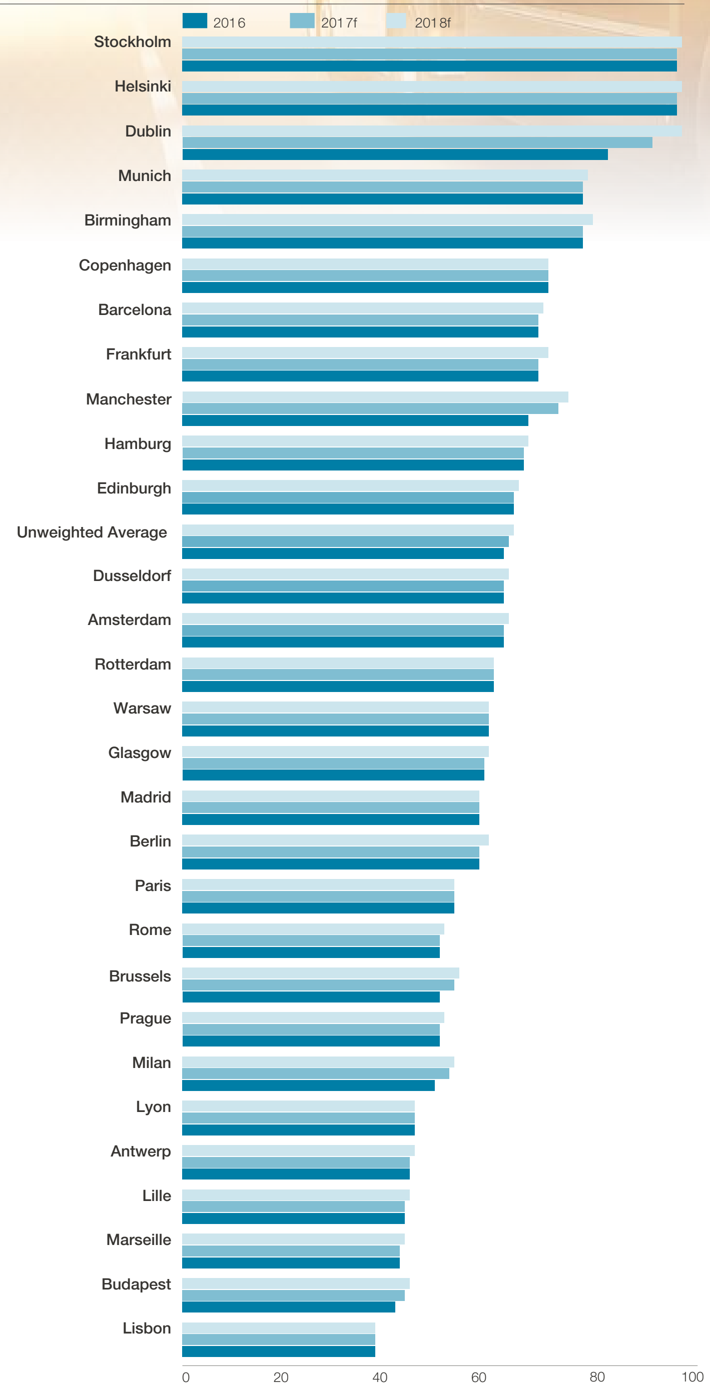
<5%	Change y/y	5-10%	Change y/y	>10%	Change y/y
Brussels	stable	Hamburg	stable	Moscow	down
Milan	stable	Zagreb	down		
Bratislava	down	Budapest	down		
Barcelona	down	Warsaw	down		
London	stable	Poznan	up		
Munich	stable	Birmingham	up		
Madrid	down	Stockholm	up		
Lyon	down	Rotterdam	down		
Bucharest	down	Gothenburg	down		
Paris	down	Wroclaw	up		
Prague	up				
Frankfurt	stable				

Sources: JLL, Savills Investment Management

According to PMA, prime headline rents remained stable in most markets across Europe in 2016 despite increasing demand for logistics space and a scarcity of available modern properties. However, prime industrial rents in Dublin jumped 13% y/y to EUR 85 per sqm per year, and by 6% to EUR 74 per sqm per year in Copenhagen. Despite the Brexit vote in June, prime industrial rents in London grew by almost 3% to EUR 141 per sqm per year.

While PMA forecasts an increase in prime headline rents for almost all markets, it expects a marginal rental decline for London and Birmingham in 2017. As of 2018, logistics rents are expected to grow across Europe (figure 12).

FIGURE 12:
LOGISTICS PRIME HEADLINE RENTS (EUR PER SQM PER ANNUM)

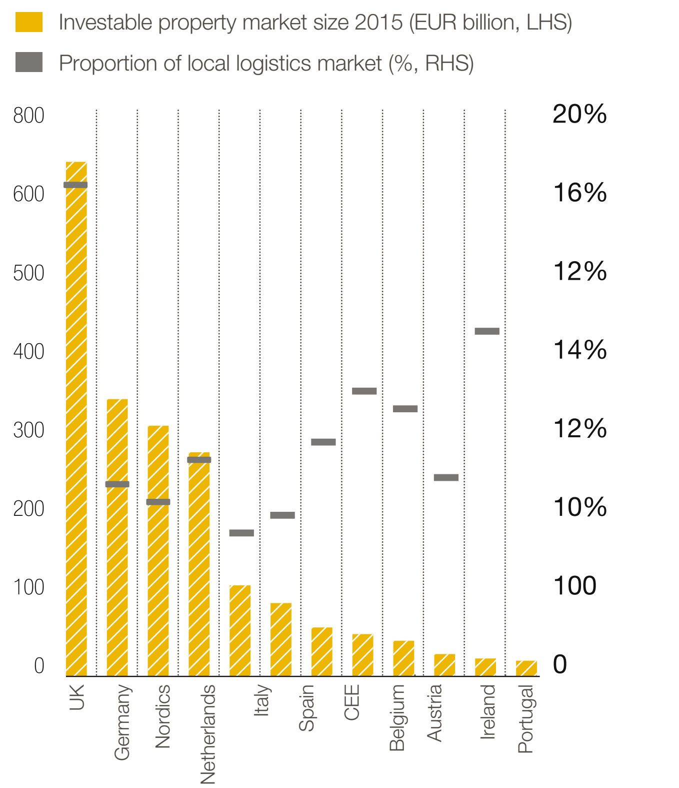


Sources: PMA (Autumn 2017), Savills Investment Management
Note: 'f' denotes forecast

Pan-European logistics: market size and liquidity

MSCI estimates that the total size of the investable commercial real estate market in Europe amounted to slightly more than EUR 2 trillion at the end of 2015. Taking the latest available sector breakdown into account, the size of the investable industrial and logistics market amounted to about EUR 200 billion in 2015 (figure 13).

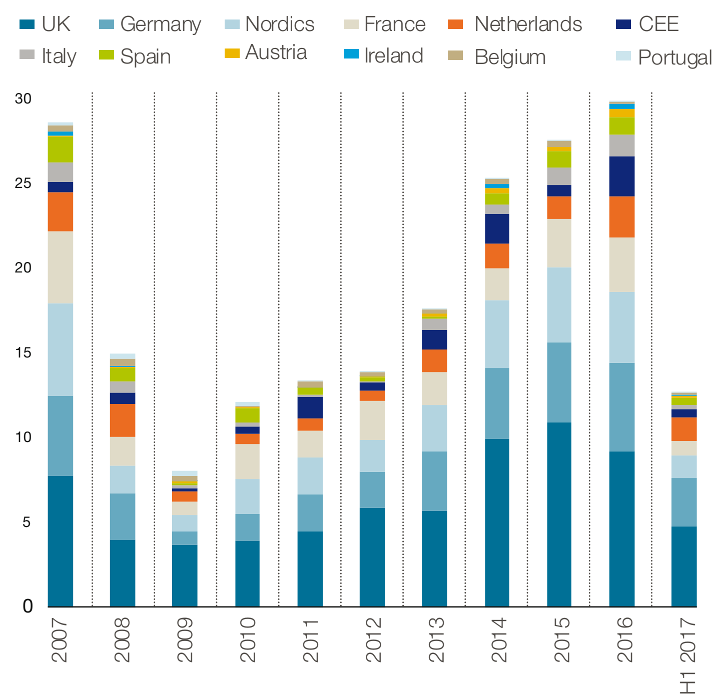
FIGURE 13:
INVESTABLE LOGISTICS MARKET SIZE (EUR BILLION)



Sources: MSCI, Savills Investment Management

According to Real Capital Analytics (RCA), the total pan-European investment volume reached EUR 29.9 billion in 2016 and, thus, exceeded the 2015 record by 8% (figure 14). The lower investment volumes in the aftermath of the Brexit referendum were offset by strong transaction activity in Central and Eastern Europe, France, Austria, Ireland and Germany. According to RCA, more than EUR 9 billion in industrial and logistics assets changed hands in the UK in 2016. By the end of H1 2017, more than EUR 12.6 billion had been transacted, of which almost 40% can be attributed to the UK.

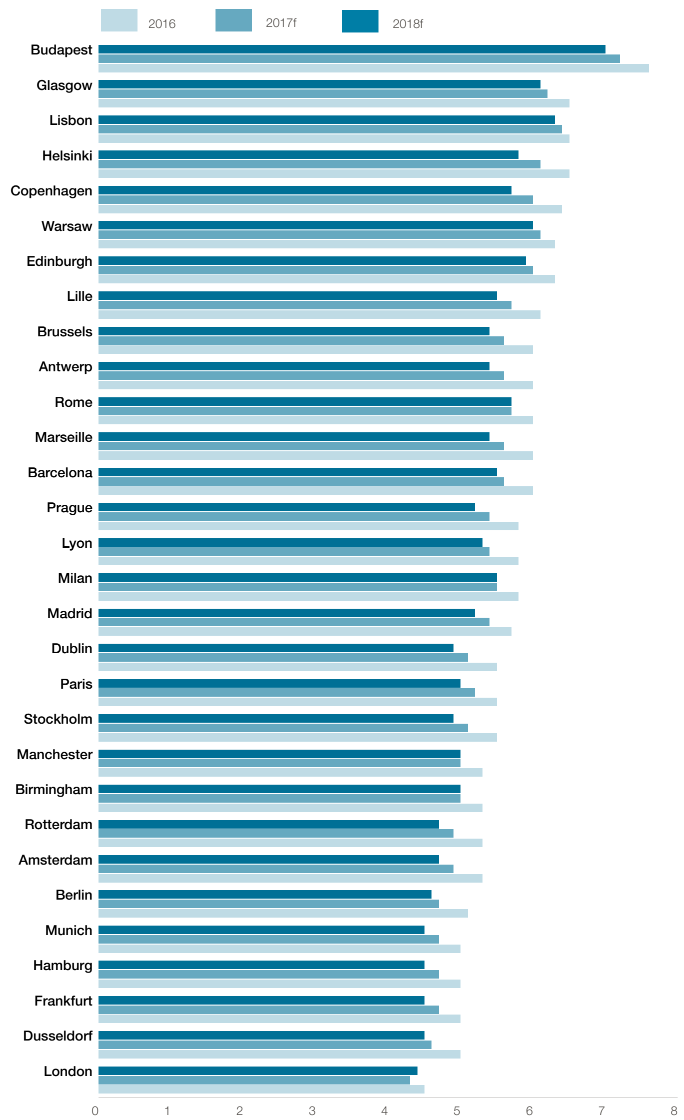
FIGURE 14:
INVESTMENT VOLUMES ACROSS EUROPE (EUR BILLION)



Sources: RCA, Savills Investment Management

Due to the high demand for logistics properties but scarce supply, logistics yields are declining further across Europe (figure 15). According to PMA, prime logistics yields across Europe dropped from 7.6% on average at the end of the GFC to 5.7% on average at the end of 2016 due to increased investor demand for modern properties. PMA forecasts that prime yields will fall further, to 5.1% on average in 2019 and 2020 before slightly increasing again.

FIGURE 15:
PRIME LOGISTICS YIELDS ACROSS EUROPE (%)



Sources: PMA (Autumn 2017), Savills Investment Management
Note: 'f' denotes forecast

Insights from...
Wolfgang Schneider

Real Estate Consultant

BNP Paribas Real Estate

“The cities and locations that will prove most popular for logistics will not be selected merely based on the advantages their locations present, but also based on political decisions regarding zoning policies.

What demand-supply trends are you observing in European logistics?

Demand is set to remain high in the medium term, and we even expect it to intensify due to a number of factors including the improving overall economic situation in Europe, which will have a direct impact on demand for logistics space. We are also seeing an ongoing trend towards outsourcing in the industrial sector, which will drive demand as well.

The most significant factor over the next few years, however, will be e-commerce. There is no doubt that e-commerce demand will be considerably higher going forward. Recent forecasts expect the share of retail picked up by e-commerce to continue to grow, particularly in the food sector, which will trigger extensive demand for logistics space.

What cities do you think are set to become logistics winners?

That will depend on three factors, the first being access to transport, particularly the motorway network. The second is proximity to large conurbations, and the third, availability of suitable lots. In other words, the cities and locations that will prove most popular for logistics will not be selected merely based on the advantages their locations present, but also based on political decisions regarding zoning policies.

Who are the standout logistics occupiers in the last-mile delivery space, and what type of properties are they vying for?

There are a number of occupier types that are particularly active. Logistics service providers and dispatchers are starting to handle order picking and are generally looking for traditional and flexible distribution warehouses, but are typically only willing to sign relatively short-term leases. Retailers are among the most active potential occupiers, with increasing interest in large-scale and central warehouses in strategic locations.

However, we are also seeing considerable interest on the part of courier, express and parcel (CEP) service providers, which are increasingly on the lookout for locations in conurbations or for smaller properties enabling direct delivery to the customer. A good example can be seen in the growing popularity of cross-docked facilities. We can expect to see intensified demand coming from, in particular, retailers and CEP service providers.

Insights from...
Daniel Hohenthanner

Director of Investment, Germany

Savills Investment Management

“Flexible and creative solutions are emerging to cope with supply constraints, including Amazon Prime renting some 2,200 sqm in a centrally located office building in Munich for logistics purposes.

What should we expect in the yield spread between logistics and other commercial real estate sectors over the next five years?

In Europe, the yield spread between office and logistics has varied from 140 basis points to around 215 basis points over the last 10 years. The corresponding gap between logistics and retail (high street) was even higher, between 220 basis points and 305 basis points. This positive yield spread makes the logistics asset class attractive, especially for investors seeking a high distribution.

Given this continued logistics sector attractiveness, we expect that the inflow of investment capital will remain high for that asset class over the next five years. Subsequently, we expect a yield gap on the lower end of the previously described spread.

AmazonFresh moved to Germany this year, and e-commerce has been a primary driver of logistics demand in Germany recently. How might this affect demand for last-mile logistics space?

In 2011, market leader Deutsche Post DHL started with the nationwide roll-out of a new type of logistics property, the so-called ‘mechanised delivery bases.’ These small, standardised cross-docked facilities within conurbations are designed to help bridge the last mile of the logistics supply chain in the context of rapidly increasingly e-commerce. Hence, a completely new asset class has come to the market along with increasing demand for centrally located sites.

With players such as Amazon Prime and AmazonFresh, the demand for such centrally located sites will continue to increase. The megatrend of urbanisation also presents increasing demand for residential and commercial buildings, which compete for the same sites and locations.

Flexible and creative solutions are emerging to cope with supply constraints, including Amazon Prime renting some 2,200 sqm in a centrally located office building in Munich for logistics purposes. Also in Munich, AmazonFresh is beginning to construct one of the first two-storey logistics buildings in Germany.

How can the logistics sector take advantage of locations that are no longer needed for retail given the rise in online sales?

It is conceivable that vacated big-box stores might be used by e-commerce traders such as AmazonFresh. Usually, these are located close to the customer, and the corresponding infrastructure (cooling, delivery ramps) already exists.

In the context of increasing demand for urban logistics, does the higher cost base in such cities offer sufficient risk-adjustment for returns?

Land prices are higher in larger conurbations than in locations outside such agglomerations due to the scarcity of available land for logistics purposes. Hence, rental and capital values are correspondingly higher.

On the other hand, central locations offer better opportunities for a further increase in land prices. Subsequently, the average distribution might be lower during the holding period, but total return figures should be higher in such locations.

Insights from...

Harry de Ferry Foster

Fund Director, The Charities Property Fund

Savills Investment Management

> Regional logistics plays in the UK include the M62 corridor from Manchester to Hull and the M6 from Liverpool to Warrington.

How attractive is the UK logistics sector investment outlook? Are there any dark clouds on the horizon?

Logistics is in great shape and will continue to do well, as tenant and investor demand is probably stronger than it's ever been – the steady income stream is attractive. New players are entering the market all the time, but one cloud on the horizon is that the speculative development tap is being turned on.

There are probably less than 12 months of supply left in the pipeline, but Amazon has been taking 25% of all big sheds, and this will end one day and supply will increase. Optimism and enthusiasm from agents is at an all-time high – everyone thinks it is a one-way bet – and that means investors should tread carefully to pick the right asset in case demand and, therefore, pricing soften.

How is e-commerce shaping the logistics landscape?

We can see the effect that logistics is having on the UK retail market. Competition between e-commerce retailers is largely dominating the field. Retailers can serve the same customers and geographic range they used to, but with, say, 200 stores versus 500. This underscores the shift to online retail. In the UK, we're buying logistics over high street, but online retail spend is higher in the UK than elsewhere in Europe. Headwinds in the retail sector equals tailwinds in logistics.

Where are the UK logistics hotspots?

Drive times are crucial. You can access about 90% of the UK in four hours from prime Midlands locations, so these tend to be favoured. But you get regional plays as well, such as the M62 corridor from Manchester to Hull and the M6 from Liverpool to Warrington. There is also considerable demand in major cities from smaller, last-mile urban logistics operators serving all the main cities and other regional cities like Bristol and Newcastle.

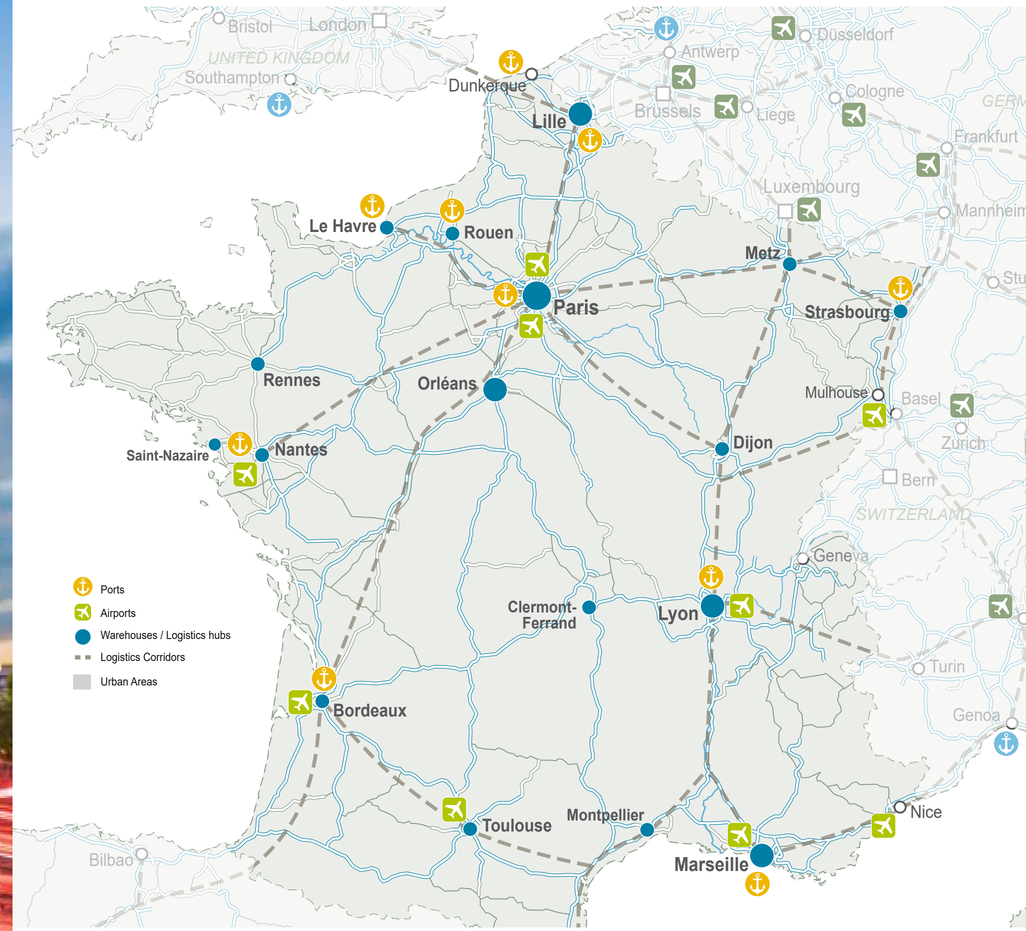
What type of units are most desirable in the UK?

We like buying units of roughly 5,000 to 10,000 sqm close to urban centres, which developers aren't building because they are more expensive to build. There is also more demand for these units, as there is a bigger pool of occupiers wanting smaller space just as there are more small companies than larger ones.

There is also a notable yield differential: larger units are bought at a premium because it enables big institutional investors to deploy significant amounts of capital. From a manufacturing perspective, we favour warehouses, as often investment in machines is worth a lot more than the buildings they're housed in, and it is very costly for tenants to ever relocate.

FRANCE

MAIN LOGISTICS HUBS IN FRANCE



Source: BNPPRE European Logistics & Industrial Real Estate Handbook 2017

The main logistics corridor in France ranges from the north to the south of the country, connecting the economic heartland around Paris with Northern Europe's Blue Banana and Southern Europe's Golden Banana. The so-called 'Dorsal' logistics corridor follows the main north-south (A1, A6, A7) and east-west (A8, A9) transport lines, reflecting the fact that road transport makes up 80% of the modal split in France, according to BNPPRE.

France is the third largest consumer market in Europe and has around 60 million sqm of warehouses larger than 5,000 sqm, according to BusinessFrance. CBRE estimates that modern stock amounts to around 34 million sqm. The most important logistics markets are the Paris region – France's main retail and tourist destination, with 11.1 million sqm of modern space – followed by Lyon (Rhône-Alpes) with 5.1 million sqm, plus Lille (Nord-Pas-de-Calais) and Marseille (Alpes-Côtes-d'Azur), each with 3.2 million sqm of modern stock.

Demand for logistics space in France weakened somewhat in H1 2017 compared to 2016. Occupiers were likely reluctant to make commitments due to uncertainty around the French elections in April and June 2017, when right-wing populist Marine Le Pen was in the running for president. However, France's economic outlook has improved since this year's elections, and GDP growth forecasts were revised slightly upwards, pointing to a small growth acceleration.

In recent years a combination of structural changes, reorganisation of supply chains, functional obsolescence and a shortage of large units have served to shift demand away from Greater Paris and towards the regional markets. Regional markets' share of total take-up increased from around 50% in 2010 to 75% in H1 2017, according to BNPPRE. However, after a period of relative weakness, take-up in H1 2017 remained more resilient in Greater Paris than in the regional markets.

The supply of vacant space has remained largely stable, at around 3.2 million sqm since mid-2015, according to BNPPRE. Half of the existing supply is Grade A, but there is still a lack of large, modern logistics space. Development is slowly improving, but speculative developments are being quickly absorbed and have been insufficient to meet the growing demand for large units.

Turnkey schemes – which accounted for more than 50% of total take-up in 2017, according to CBRE – remain the quickest route to modern, high-quality space for many occupiers. Amazon's turnkey deal of 107,000 sqm near Amiens is a key example. At the end of Q1 2017, planning permissions were on hand for 1.7 million sqm in France, of which 589,000 sqm is in the Paris region.

In Greater Paris, prime rents currently range between EUR 45 and EUR 65 per sqm, according to CBRE, whereas in the other markets they range between EUR 32 and EUR 55 per sqm.

The logistics market's higher yields compared to other asset classes – combined with France's positive economic fundamentals and market liquidity – attract investors. Due to the lack of quality supply, some investors continue to enter the French logistics market by forming joint ventures, partnerships or mergers and acquisitions. In H1 2017, the overall logistics transaction volume reached EUR 2.5 billion, according to RCA, and is on the verge of a new record.

Due to high investor competition, prime logistics yields in France have been continuously declining since 2013 and reached a new record low in Q2 2017, according to JLL, CBRE and BNPPRE. Prime net initial yields in the Paris region range between 5.00% and 5.50%, and yields in the main regional markets range between 5.50% and 7.00% compared to 6.00% to 7.75% in the secondary markets.

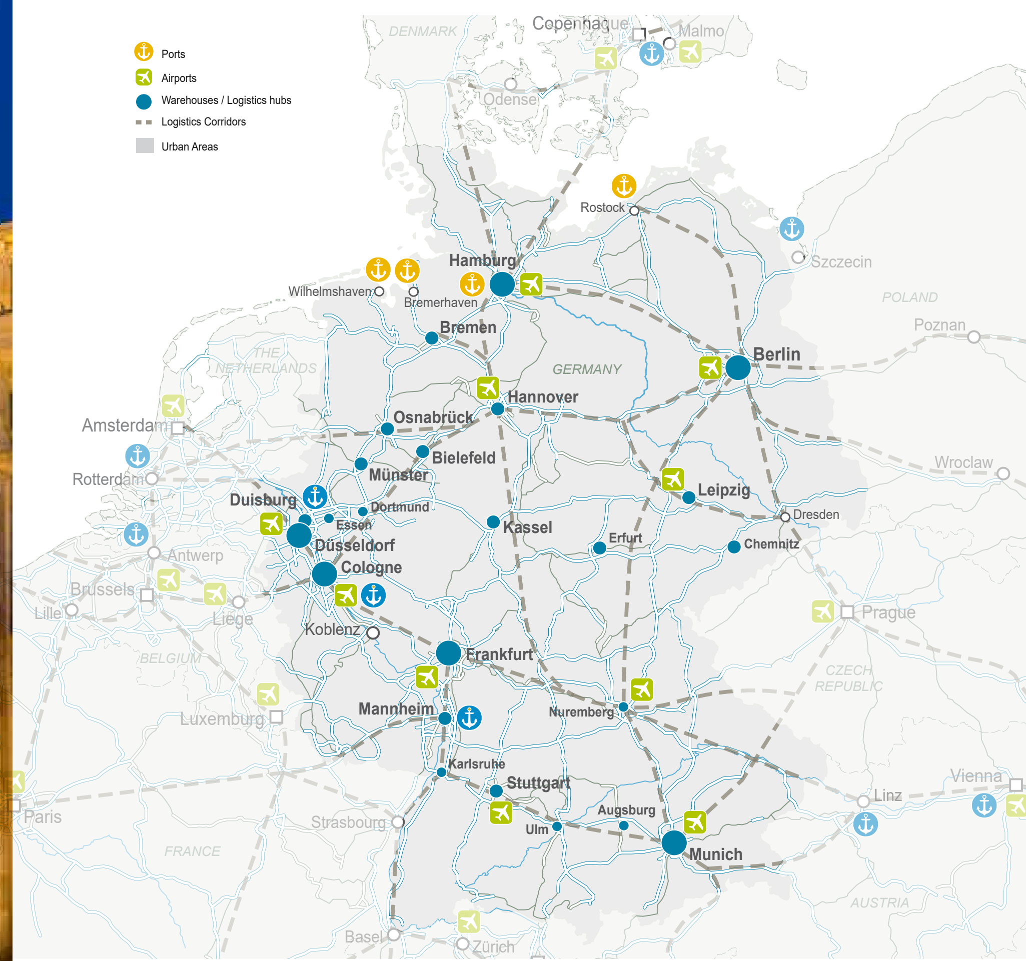
While primary risk factors are associated with the implementation of President Emmanuel Macron's economic reforms, the uncertain geopolitical environment and the strength of the euro, the outlook for the French economy has improved since the Spring 2017 French elections. Furthermore, we believe there is some rental upside in the main logistics hubs where scarcity of appropriate product prevails. PMA expects rental growth of around 1.5% over the next five years, similar to the European average. We expect downwards pressure on yields to persist.

OUR RECOMMENDATIONS

- We suggest targeting mega- as well as modern, mid-sized distribution centres in established logistics locations with excellent transport links around the urban areas of Paris, Lyon, Marseille and the north. We also like cross-docked logistics facilities in or on the fringes of major cities such as Paris, Lyon, Lille, Orléans and Marseille.
- Selective opportunities are also available through partnering with local developers requiring funding for part-speculative schemes or through being able to forward fund pre-let schemes.

GERMANY

MAIN LOGISTICS HUBS IN GERMANY



Source: BNPPRE European Logistics & Industrial Real Estate Handbook 2017

Germany's logistics sector has grown faster than the overall economy in recent years. Against this backdrop, it is unsurprising that logistics real estate is about to become an established asset class in Germany.

Given the country's polycentric structure, including multiple large conurbations and several regions with strong manufacturing sectors, Germany hosts a number of logistics hubs.

Logistics and Real Estate 2016, a study by bulwiengesa and four other partners including Savills, identifies 28 relevant logistics regions and ranks them by attractiveness. Hamburg comes out on top, followed by Munich, Berlin, Düsseldorf and Rhine-Main/Frankfurt.

Among logistics regions showing increasing attractiveness are Augsburg and Nuremberg. While regions at the top of the list primarily offer opportunities for risk-averse investors, the remaining regions provide potential for higher yields and above-average capital value growth.

According to Savills, approximately 5-6 million square sqm of logistics space was taken up annually over the last five years, culminating in a record high of more than 6.5 million sqm in 2016. Regarding take-up figures to date, Savills predicts that 2017 turnover will again surpass 6 million sqm.

Savills observes that demand is equally driven by two sectors: manufacturing and retail/wholesale. Manufacturing has been a traditionally strong pillar of the German economy and differentiates the country from many of its peers. The retail/wholesale sector, on the other hand, has grown markedly since the GFC, with e-commerce acting as a particularly dynamic logistics demand driver more recently.

Savills reports that demand for logistics services in Germany is rather well balanced between the export-oriented manufacturing sector and the retail/wholesale sector. This makes the logistics market less vulnerable to economic fluctuations in one of these sectors.

The scarcity of modern logistics space and appropriate sites, however, present challenges across the board. This is particularly relevant for companies seeking locations next to major conurbations where single-channel and multichannel e-commerce operators have increased demand to new highs. Consequently, land prices have increased in these regions over the past five years, most of all in Munich, where the upper limit is EUR 400 per sqm, according to Savills.

However, the significant increase in exit multiples has allowed developers to keep rents rather stable, reports Savills. Furthermore, the low margins in the logistics and retail sectors have thus far hindered rents from increasing notably. Prime rents range between EUR 60 and EUR 78 per sqm per annum, according to Savills – roughly the same level as five years ago. But rents are likely to increase over the longer term due to demand-supply imbalance.

Taking the last five years together, Savills reports that more than EUR 12 billion was invested in logistics properties. The last three years saw an investment volume of about EUR 3 billion per annum, yet that mark has already been surpassed in 2017: by the end of H1, more than EUR 5 billion had been invested, according to Savills.

This astounding growth is a result of both an increase in demand as well as expanding supply. Aside from the residential sector, no other real estate category has experienced a level of construction activity approaching that of the logistics sector this year, reports Savills.

More than 3 million sqm of newly built logistics space came to the market annually over the last five years, a level of construction that should prevail over years to come, reports Savills. However, even the historically high construction volume was and still is insufficient to satisfy demand.

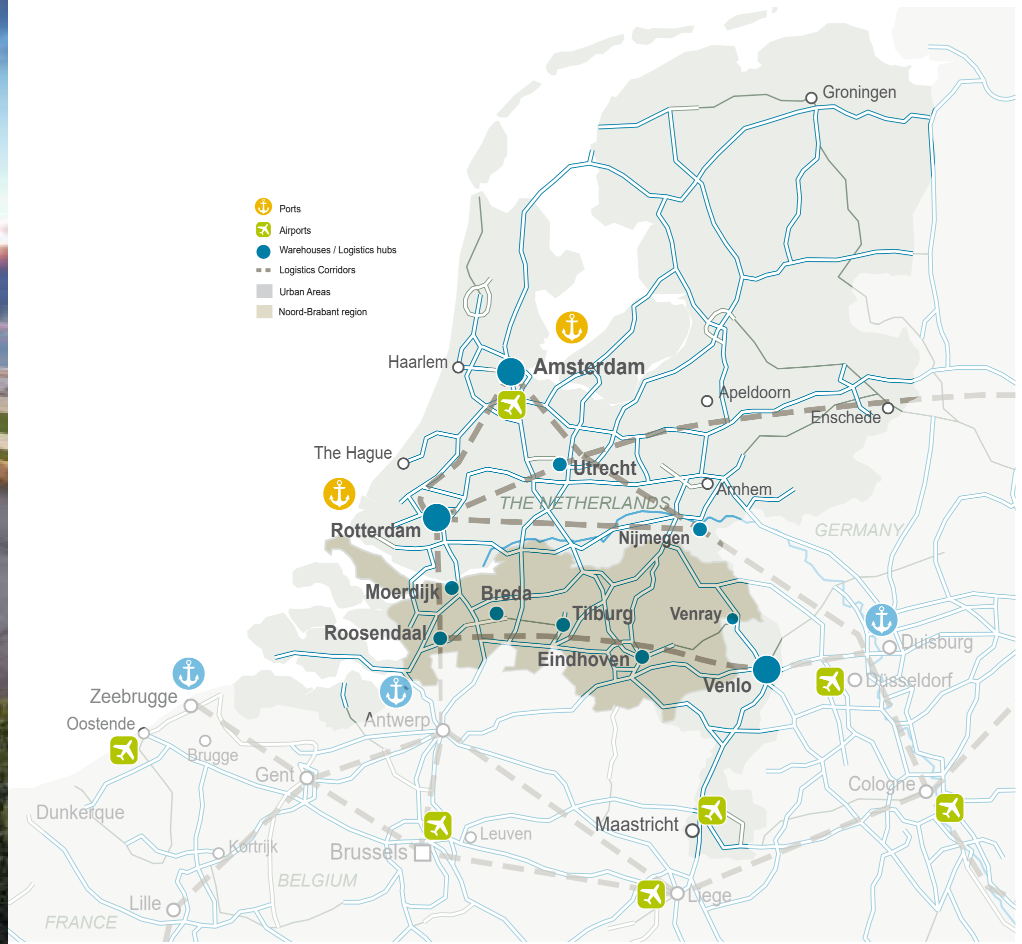
Consequently, initial yields have dropped significantly, and Savills expects downwards pressure to remain. At the end of Q2 2017 prime yields stood at 5.0%, according to Savills – a decrease of 30 basis points (bps) y/y. Furthermore, Grade B properties experienced an even stronger yield compression, hardening by 50 bps y/y to 5.8% in Q2. Savills projects that yields will harden further in the quarters to come, albeit at a slower pace, before bottoming out in 2018-19.

OUR RECOMMENDATIONS

- Regarding mega-distribution centres of 60,000-100,000+ sqm and modern, mid-sized distribution centres, we prefer major logistics hubs and points in the supply chain close to or between urban areas. Such regions include the Ruhr, Hanover, Hamburg, Halle/Leipzig and the Rhine-Main.
- In terms of cross-docked logistics facilities of 2,000-10,000 sqm, we prefer well-connected locations in or on the fringes of major conurbations such as Berlin, Hamburg, Frankfurt, Munich and the Ruhr area. We also like growing secondary cities such as Augsburg, Freiburg, Münster and Nuremberg. The potential risk of limited third-party use of build-to-suit cross-docked facilities could be offset by increasing land values.
- Investors ought to be prepared to pay higher prices in order to secure attractive deals and sites. Investors should likewise consider liquid secondary cities and conurbations, which may offer higher yields.
- Crucial factors of successful investments are, among others, well-connected multimodal locations, modern and flexible Grade A properties and tenants with strong covenants. Crucial factors of successful investments are, among others, well-connected multimodal locations, modern and flexible Grade A properties and tenants with strong covenants.

THE NETHERLANDS

MAIN LOGISTICS HUBS IN THE NETHERLANDS



Source: BNPPRE European Logistics & Industrial Real Estate Handbook 2017

With 646,000 jobs and an added value of EUR 53 billion annually, according to Savills, the Dutch transport and logistics sector plays an important role in the national economy.

Over the past 20 years, total Dutch logistics stock has almost tripled, reports Savills, reaching approximately 29 million sqm in 2017. Of this stock, about 30% is located in the Noord-Brabant province, which can be characterised as the major Dutch logistics destination. The region benefits from its proximity to both Rotterdam and Antwerp harbours, excellent multimodal infrastructure, economic strength and logistics industry professional development facilities.

Five of the nine leading Netherlands logistics locations are in Noord-Brabant. The nine clusters together make up 57% of the total market, according to Savills. Venlo (in the Limburg province) accounted for the largest share (340,000 sqm) of total take-up between 2016 and H1 2017.

Savills reports that logistics take-up reached 1.4 million sqm in 2016. At 1.7 million sqm (including still-to-be-delivered product), take-up for H1 2017 is already higher, and 2017 is set to be a record year.

Since 2015, around 3.2 million sqm of new logistics space has come under development, of which 71% is owned by investors, according to Savills. Furthermore, this year approximately 0.5 million sqm of new logistics space will be constructed on a speculative basis; another 0.4 million sqm is planned for 2018 and 2019.

While many of the new starts are build-to-suit, some are speculative developments aimed to meet online retailers' or logistics service providers' fast-growing need for logistics space.

Despite the increase in speculative development, vacancy has dropped considerably over recent years and is now around 8%, reports Savills, much of which is older stock. For modern logistics stock (dated from 2010 onwards), vacancy is just 1.6%.

Headline rents have remained fairly stable over recent years. The highest rental levels can be found in the Schiphol Airport area, having reached EUR 95 per sqm annually for prime properties, according to Savills. At other major logistics destinations, prime rents range between EUR 40 and EUR 65 per sqm annually. Incentives vary per location but are often between 10% and 15% at the major sites.

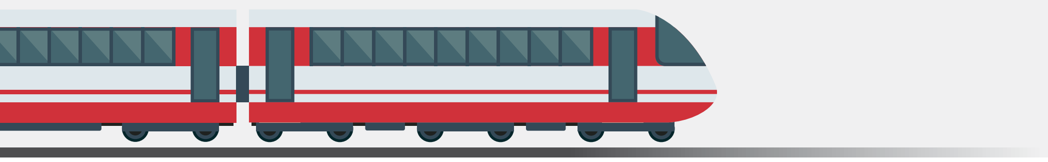
Total investment volume for H1 2017 is almost EUR 800 million, reports Savills. Venlo is leading by far with an investment volume of EUR 182 million.

Continuing a trend seen in 2016, this year foreign investors should continue to be involved in many of the new developments. Investors willing to move up the risk curve are more likely to target speculative developments.

The scarcity of prime investment product should continue to place downwards pressure on yields at all major logistics sites. This trend continued in H1 2017, according to Savills, with gross prime yields contracting to 5.1%. Gross yields for secondary locations start at 6.75%.

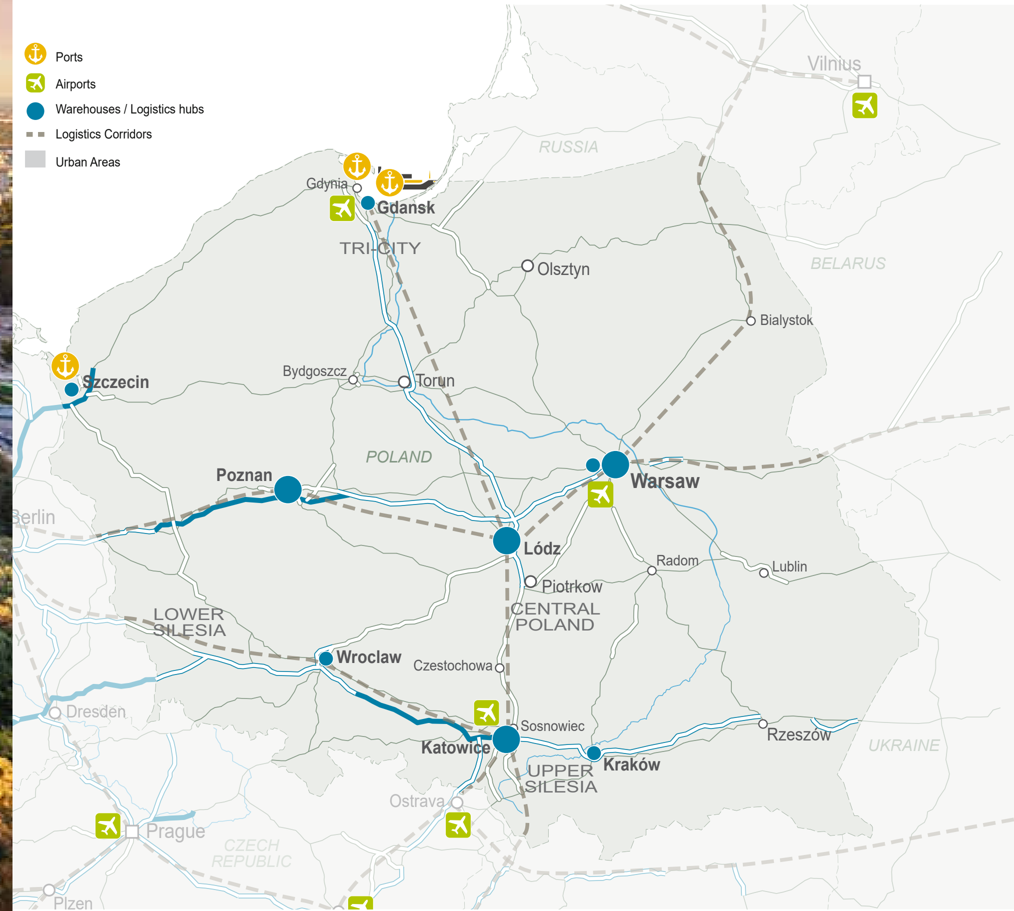
OUR RECOMMENDATIONS

- We prefer newly built, modern and flexible distribution centres with good transport links, particularly in established hubs in southern regions such as Noord-Brabant and Limburg (Venlo).
- In our opinion, fast-growing e-commerce also offers opportunities for urban logistics in the densely populated Randstad area.
- As availability of product remains a concern, we see value in forward funding pre-lets and in local developer partnering for speculative development.



POLAND

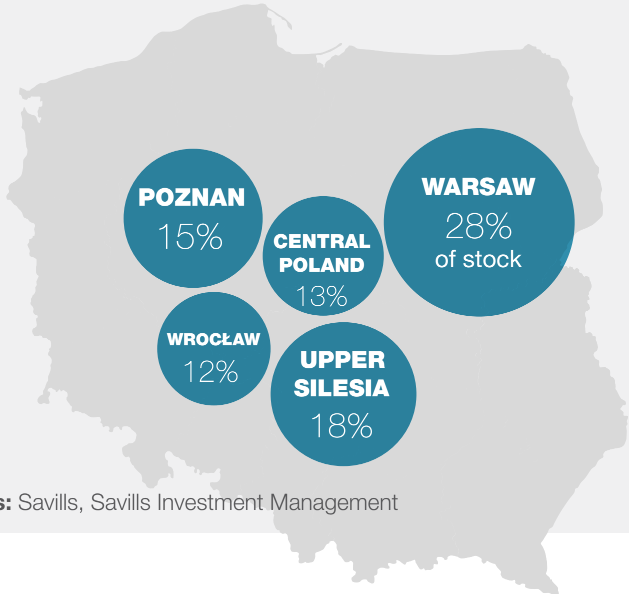
MAIN LOGISTICS HUBS IN POLAND



Source: BNPPRE European Logistics & Industrial Real Estate Handbook 2017

The Polish logistics market, the largest in the Central and Eastern European region, accounted for around 16% of Poland's total investment volume between 2013 and 2016, according to Savills.

With around 12 million sqm of modern logistics space across Poland, the majority of supply is concentrated in the five most developed markets.



Sources: Savills, Savills Investment Management

Big-box logistics projects are generally located along motorways and exit roads outside of the administrative borders of the largest Polish cities, but there are also multiple projects within city borders, often for smaller occupiers such as small-business units (SBUs).

The logistics market has been developing at a double-digit pace for several years. Historically, the majority of warehouse space was located in the Warsaw area. However, regional markets have been growing more dynamically and account for over two-thirds of the current market, reports Savills.

During H1 2017 almost 800,000 sqm reached completion, 117% above the level noted in H1 2016, according to Savills. There is now approximately 1.6 million sqm under construction across Poland, over two times more than at the end of H1 2016. The highest development activity is in Warsaw, followed by Upper Silesia and Szczecin. Build-to-suit activity has increased outside the main logistics hubs, especially near the western border.

At 5.9%, the countrywide vacancy rate at the end of H1 2017 remained low, reports Savills, representing only a slight increase of 50 bps y/y. The highest rate was noted in Szczecin (8.9%), whereas the lowest was observed in Central Poland (0.5%).

Demand is driven by 3PL providers, retail operators with increasing e-commerce offerings, companies seeking light-industrial property as well as the automotive industry. Demand has been strong for several years, exceeding 2 million sqm per year, according to Savills.

Savills reports that in H1 2017 the total volume of leasing activity reached approximately 1.8 million sqm, a 47% y/y increase. Most of the space was leased in two Warsaw zones (25% of the total volume), followed by Central Poland (24%) and Upper Silesia (19%).

Headline rents in the main logistics destinations are stable and vary from EUR 31.20 per sqm to EUR 49.20 per sqm per annum for big-box units, according to Savills, with higher rents observed in the case of SBU projects in Warsaw Zone 1.

Investment activity has been muted so far in 2017: only EUR 2.3 million has been transacted, reports Savills. However, by the end of the year investment volume should reach a similar level to recent years, or even exceed it due to ongoing transactions.

According to Savills, prime yields are now around 6.75-7.00% for optimally located modern warehouses single let to financially strong tenants for at least 10 years. In the case of well-located multilet warehouses, prime yields are around 7.50-8.00%, provided they are leased at market rental levels.

OUR RECOMMENDATIONS

- We prefer build-to-suit fulfilment and distribution centres on 10+ year leases with high quality covenants and significant tenant capex investment that can be used by third parties in the top five locations: Warsaw, Katowice, Poznan, Wroclaw and Central Poland (Lodz).
- We also like generic, single-let warehouses that are on long-term leases and near major highways such as the A2/A4, S3/A6 and A2/S3.
- Investors should consider highly customised, multilevel warehouses only when they are designed and let to tenants with good covenants and on long-term leases.
- Investors should be aware of the fact that having a significant market footprint is key to success: the current ownership structure consists of five dominant investors and developers.
- Avoid out-of-town, multilet generic warehouses.

UNITED KINGDOM

MAIN LOGISTICS HUBS IN THE UK

Source: BNPPRE European Logistics & Industrial Real Estate Handbook 2017

Research from Savills and the UK Warehousing Association indicate that as of June 2017, the UK had 39.4 million total sqm of available units larger than approximately 10,000 sqm.

Given the political uncertainty that engulfed the UK after the 2016 vote to leave the EU, it was encouraging to see take-up reach record levels that year. Following the depreciation of sterling after the referendum, the UK saw an uptick in inflation. However, indications are that inflation has now peaked.

The impact of referendum negotiations and an unexpected general election – which resulted in a lack of outright majority for the Conservative Party government – is still being felt, however. It should, therefore, come as little surprise that logistics sector transaction levels have softened.

Two key demand drivers linger: the continued shift towards multichannel retailing and the continued investment in and growth of the UK automotive manufacturing sector.

On the supply side, development remains restrained, although it is picking up in some areas. This means that overall, supply levels are still way below any previous peak. According to Savills, latent demand should lead to higher take-up in the second half of the year, and there is little evidence to suggest a development boom is planned.

Savills reports that there were approximately 335,000 sqm under construction across 20 different units in the UK as of H1 2017. Furthermore, the northwest region has the most supply, although 73% is of generally poor quality. The southeast has the highest amount of speculative stock, according to Savills: of the 10 speculative units currently on the market, 5 achieved practical completion in H1 2017.

Given that many global investment markets have been increasingly volatile over the last 12 months or so, the UK logistics market is starting to see a more diverse investor base for prime assets. Indeed, Savills reports that overseas investors accounted for 26% of all transactions as of June 2017 compared to 22% as of June 2016. We expect overseas investor interest to increase in the short term.

Any shock to the UK logistics market is likely to come from the demand side, predicts Savills, particularly from the retail sector. Indeed, based on the long-term average, according to Savills almost 50% of logistics occupier demand comes from retailers, either high street, online or grocery. Moreover, 65% of UK GDP is related to consumer spending. Consequently, based on historical norms it is possible that the UK logistics sector would suffer should the UK experience a post-Brexit downturn.

However, the real estate implications of the continued shift to online retail are likely yet to come. Indeed, in the case of a future economic downturn consumers may turn to the online sector, which many perceive as offering better value. This could, in turn, balance out demand for logistics real estate in the UK.

Manufacturing wise, the UK government is keen to promote the prowess of the UK automotive sector, and many companies are investing in further manufacturing bases in the UK. The effect on logistics real estate could be profound as companies increasingly require space to meet demand for just-in-time deliveries.

OUR RECOMMENDATIONS

- Lack of available supply combined with continued strong, e-commerce driven demand make logistics an attractive sector in the UK.
- We prefer logistics properties with the potential for intensification. We also recommend that investors target units near cities such as London, the Big 6 (Birmingham, Bristol, Edinburgh, Glasgow, Leeds and Manchester), Oxford and Cambridge.
- We also prefer locations around major transport corridors and port locations, particularly south of Birmingham.

Other countries of interest

BELGIUM

In 2017, demand for logistics remained strong, with e-commerce, multimodal logistics platforms and improvements in supply chain productivity being key drivers of market activity. The outlook for yields is stable, but exceptional locations within the wider Brussels region and the Brussels-Antwerp axis along the A12 and E19 highways could see yield compression. Prime rents are expected to remain stable. However, in the Brussels region where demand is high and available product limited, rents could increase further in 2018. H1 2017 saw two large-size owner-occupier industrial transactions, which boosted the year-to-date volume by 65% compared to H1 2016, according to JLL.

SPAIN

E-commerce is growing in Spain, which is increasing demand for mega-distribution centres and last-mile solutions. Yields in the main cites of Madrid and Barcelona continue to look attractive compared to more core locations across Europe. According to JLL and Cushman & Wakefield, Barcelona logistics yields have been stable in 2017, with rents steady to increasing, according to Cushman & Wakefield. Prime rents are at the higher end for prime logistics in Madrid and Barcelona; however take-up is strong, particularly in Madrid, with a 163% increase over H1 2017, according to BNPPRE.

NORDICS

Across the Nordics, increasing e-commerce means the number of parcel returns is rising. There is a growth opportunity for logistics property as the footprint required increases alongside rising parcel returns. The rise in e-commerce means increasing demand for modern, well-located logistics facilities. The demand for instant delivery has shifted occupier focus from big-box units towards smaller, light-industrial facilities.

CBRE reports an investment volume of EUR 1.8 billion for industrial and logistics across the Nordics in H1 2017. Urbanisation and rising demand for quick deliveries are expected to shift focus to last-mile logistics solutions. More storage space will be required closer to population centres. In Sweden, Finland and Denmark, approximately 85% of the population live in urban areas and cities, according to the World Bank. The number is slightly lower in Norway, at 81%.

In **SWEDEN**, investor appetite for logistics is strong, but take-up is limited by lack of supply. Retail and 3PLs are the main sources of demand due to the rapid growth in e-commerce. Prime yields in Stockholm were 5.4% in Q2 2017, according to Cushman & Wakefield.

In **FINLAND**, investment volumes remain rather low, mainly due to the lack of available prime product. Demand is strong from both domestic and international investors, according to Cushman & Wakefield, with prime yields at 6.0% in Helsinki.

The demand for logistics in **NORWAY** is increasing. The Oslo region in particular is on a path to solid performance, supported by strong demand for warehousing players and online retailers. According to Cushman & Wakefield, prime yields are 5.5%.

In Copenhagen, **DENMARK**, yields for the best logistics facilities range between 5.50% and 5.75%, according to CBRE. Rising private consumption and e-commerce are increasing demand for logistics property.

Challenges for the logistics sector

RISING POPULISM AND PROTECTIONISM

Populism continues to gain momentum, both throughout Europe and in the United States. Many observers interpret this trend as a growing dissatisfaction with globalisation and the establishment, and one of the main drivers in Europe is a long period of subdued economic growth in many countries since the GFC.

Populist policies based on trade restrictions and excessive public spending involve the risk of low economic growth combined with high inflation. We therefore recommend a defensive, income-focused approach towards commercial real estate in which dynamic European cities and urban logistics, for example, offer long-term investment opportunities.

KEY GEOPOLITICAL RISKS

Brexit
The UK government triggered Article 50 of the Treaty of Lisbon on 20 March 2017, officially informing the EU of the UK's intention to withdraw its EU membership. However, it remains unclear when and how Brexit negotiations will play out. We think a UK-EU divorce deal allowing for a period of transitional arrangements followed by a free-trade agreement is likely. Nonetheless, in the case of a hard Brexit scenario, UK-EU supply chains may be interrupted.

Spain
While firms may be cautious about investing in Catalonia after the recent independence referendum and subsequent political unrest, this has now largely settled, and we do not expect a significant impact on commercial real estate. According to JLL and Cushman & Wakefield, Barcelona office, retail and logistics yields have been stable in 2017, with rents steady to increasing.

Turkey
Turkish President Tayyip Ergoğan could allow the 3 million refugees currently held back from migrating to the EU to leave Turkey. This would cause a rise in border controls that could also significantly disrupt logistics supply chains.

United States
US President Donald Trump has so far made several trade policy plays, including negotiations with China, tariffs on Bombardier jets, withdrawing from the Trans-Pacific Partnership agreement and vowing to renegotiate the North American Free Trade Agreement. Measures to reduce America's trade deficit could affect Eurozone economies such as Germany, and further US trade protectionism could lead to European supply chain disruptions and tit-for-tat measures in response.

> Populist policies based on trade restrictions and excessive public spending involve the danger of stagflation, or low economic growth combined with high inflation.

Why invest in European logistics

European logistics properties have an attractive risk-return-profile compared to offices and high street retail. Total returns for European logistics properties are more stable than total returns for office and logistics property. Furthermore, sites currently used for cross-docking in growing conurbations could gain significant value because of increasing competition for land.

Compared to office and retail properties, logistics properties deliver stable and comparatively high distribution. On the one hand, net initial yields are significantly higher than in the other sectors. On the other hand, even if single-tenant properties have enhanced re-letting risk, opportunity costs are lower compared to office and retail properties due to significantly lower tenant incentive costs.

Logistics providers are optimising their services to meet increasingly technology-driven retail consumption, with start-ups and e-commerce giants such as Amazon competing to digitalise aspects of the logistics supply chain from manufacturing to last-mile delivery. Rapid e-commerce growth offers excellent opportunities for growth in modern logistics real estate such as mega-distribution centres, smaller urban facilities within city limits and click-and-collect pick-up points.

Logistics properties are benefitting from increasing demand from growing sectors such as 3PL, manufacturing and, particularly, e-commerce, while supply is still limited. Development is accelerating significantly in European countries such as Poland, Spain, Germany and the Netherlands, but vacancy rates in most of these markets remain below 5%.

Going forward, economic development projects such as the New Silk Road will help forge geographic connections and create potential demand for new logistics hubs along the way.

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ABOUT SAVILLS INVESTMENT MANAGEMENT

Savills Investment Management is an international real estate investment manager with offices in Amsterdam, Copenhagen, Frankfurt, Hamburg, Hong Kong, Jersey, London, Luxembourg, Madrid, Milan, Munich, Paris, Shanghai, Singapore, Stockholm, Sydney, Tokyo and Warsaw.

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