FORSTERS

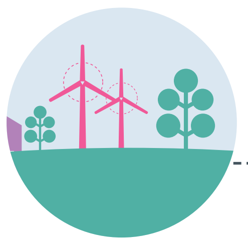
Outside the Box

Supporting an Industrial Evolution

Contents





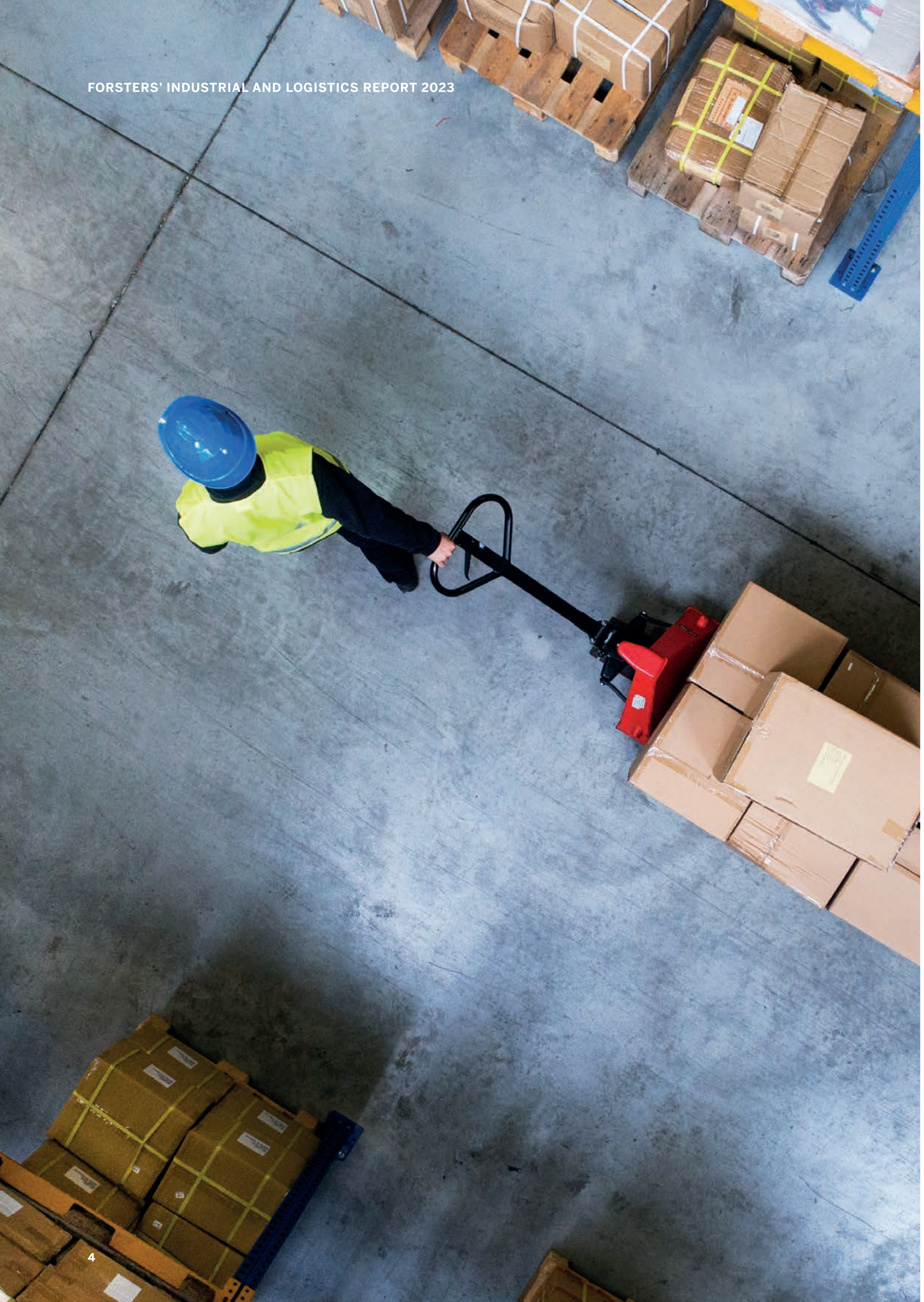



FORSTERS

About this report

During the first quarter of 2023, Forsters surveyed over 60 UK-based professional investors and developers in UK real estate assets in order to assess current market sentiment. We also explored how the respondents felt the sector could be supported in order to thrive in a more challenging economic climate.

The issues raised by the research were then further examined through interviews with four leading market figures, which feature in this report.



Adapting to compete

The industrial and logistics sector is the backbone of the UK economy. What cannot be sent down a fibre optic cable needs to travel over road, rail, air or water.

E-commerce has grown and shaped the sector – carrying both what we order and what we return – after an earlier evolution when businesses came to rely on just-in-time logistics to deliver parts and materials as and when they were needed.

In serving these growing demands, the real estate sector must compete for land and investment. Those close to the sector know that it is equally important to secure labour, construction materials and electrical power at reasonable rates.

In competing for occupiers, the real estate sector must understand what features those occupiers need versus what would simply be nice to have – and what they may be willing to pay for through a premium on their rent. Where there is an insufficient supply of those features, there could be a gap in the market.

Notwithstanding challenging economic conditions, the industrial and logistics sector is proving robust and, supported by continuing occupier demand, opportunities remain for those who are knowledgeable, agile and well-funded. It is those market participants who will be best placed to adapt to the shifts taking place in uses, formats, locations and external pressures.

This report seeks to share knowledge by identifying some broad opportunities, the challenges to be overcome and the sector's expectations of policymakers and funders.

We'd like to thank everyone who contributed, with special thanks to David Turner, Co-Founder and Equity Partner at DTRE, Ben Coles, Chief Executive at Wrenbridge, Victoria Turnbull, Joint Managing Director at Opus Land and Phil Irons, Managing Director of Transactions for the UK and Ireland at Patrizia.

We look forward to discussing the contents of this report with our clients and industry contacts, as the sector continues to adapt and evolve.

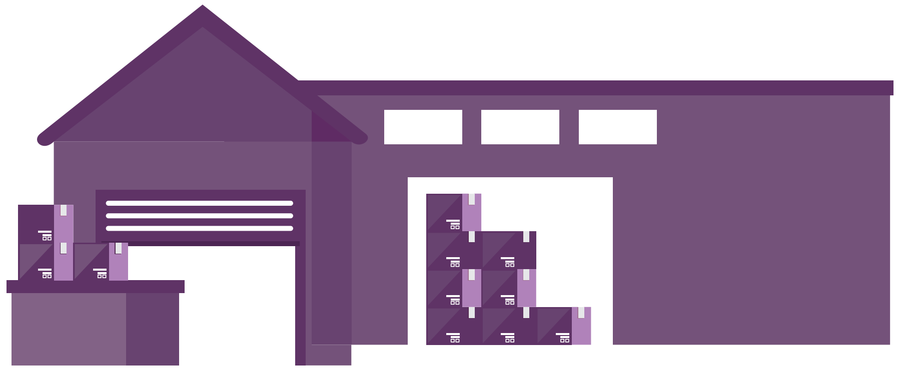
MAGNUS HASSETT
Partner and Co-Head of Industrial and Logistics

VICTORIA TOWERS
Partner and Co-Head of Industrial and Logistics

Key takeaways

This research reveals a huge range of opportunities across the UK market for those with the scale, expertise or creativity to respond effectively. The greatest opportunities will sometimes arise from solving the greatest challenges.

THE MARKET



77%

say the 'warehouse bubble' has burst

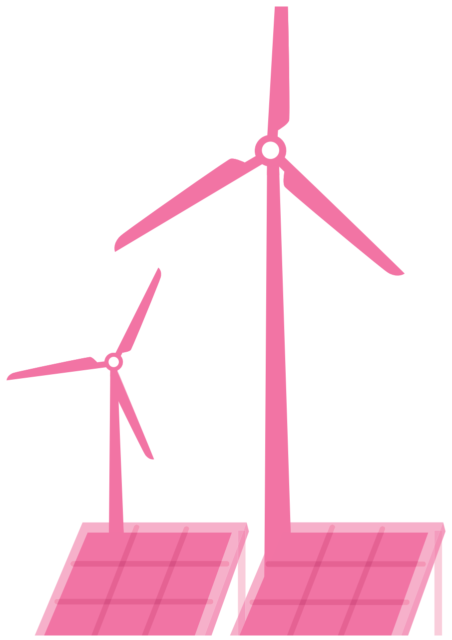
Greater London is seen as the region offering the best prospects for investment

Economic uncertainty (41%) and construction costs (39%) are currently the greatest barriers to investment

46%

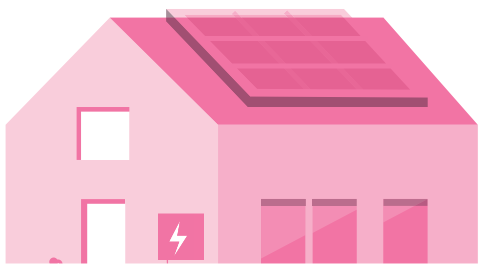
expect an increase in asset values and rental levels in 2023

TECHNOLOGY

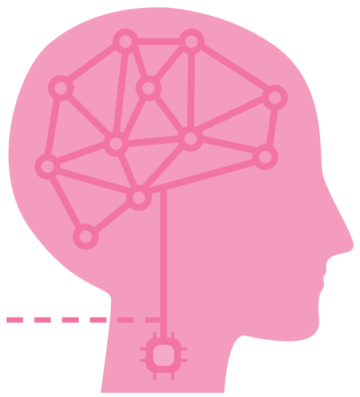


98%

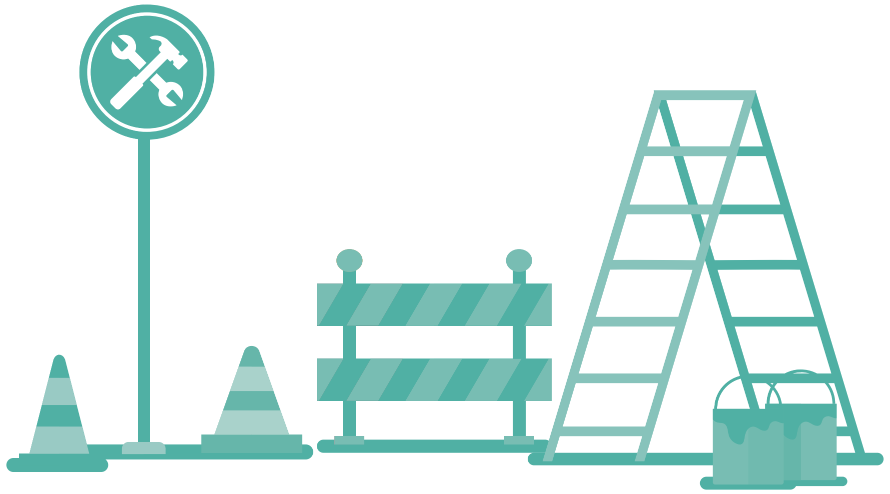
think technology can help residential and logistics co-exist in urban locations



AI polarises opinion as likely to have both the most positive and the most negative impact on the sector



SUSTAINABILITY



57%

identify cost as the greatest barrier to refurbishment of existing buildings

Respondents felt that Government incentives should focus on encouraging greater sustainability

After the bubble

As 2023 began, businesses were recovering from a turbulent political period and much uncertainty remained. Had inflation really peaked? How much would interest rates rise by? How long would any recession last?

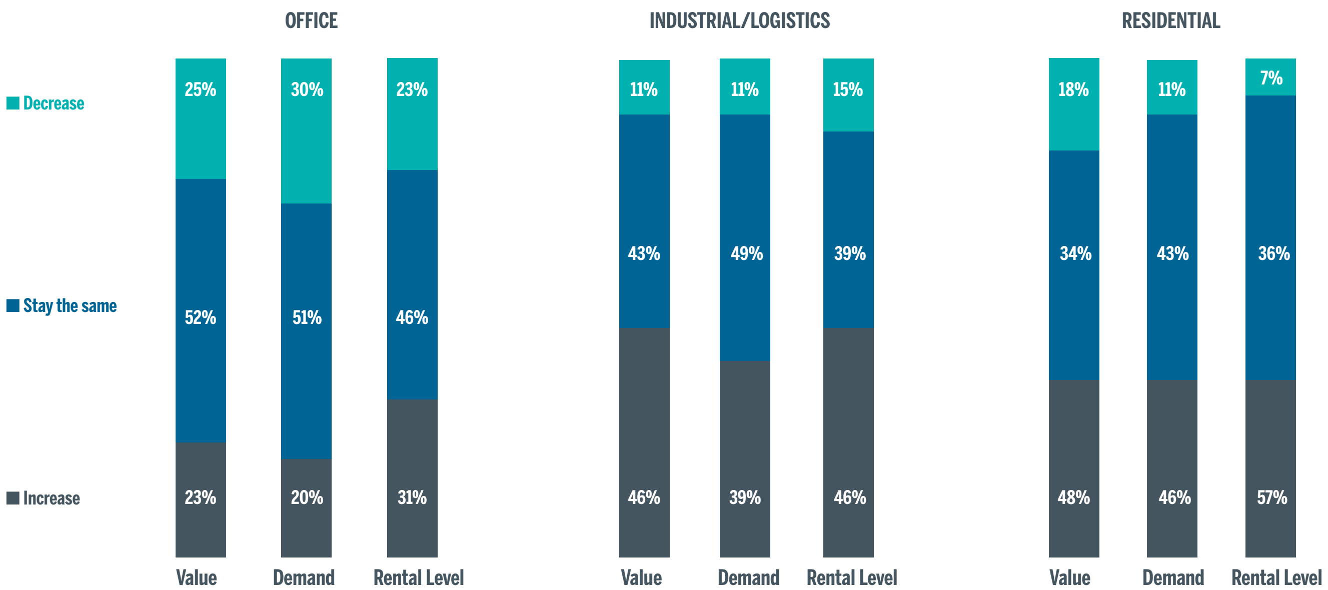
Real estate investment had fallen dramatically in Q4 of 2022 and appetite for industrial and logistics real estate had been replaced by caution. Not surprisingly our survey suggested that the 'warehouse bubble' had burst for 77% of the sector, but the jury is out as to whether industrial real estate faces a sustained downturn.

While there was a drop in tenant take up in 2022, this is only when comparing 2022 with the 'Covid amplification years' of 2020 and 2021. Research by Savills suggests that 2022 was the third highest year in history for logistics take up.

While almost half of our respondents (46%) expect an increase in asset values and rental levels in 2023, a smaller proportion (39%) believe there will be an increase in occupier demand. Overall, our survey suggests that appetite for industrial real estate is on a par with residential stock but is more upbeat than for offices.

Strong economic growth is not expected to return to the UK until Q2 2024, but a number of investors have significant levels of capital to deploy should the right opportunities arise.

Q. How do you expect the value, demand and rental level of industrial and logistics assets across the UK to change in 2023?



EXPERT INTERVIEW

Low vacancy levels drive key rental growth

DAVID TURNER

Co-Founder and Equity Partner, DTRE

"INDUSTRIAL AND LOGISTICS IS LIKELY TO BE ONE OF THE STRONGEST SECTORS WITH YIELDS STABILISING QUICKEST."

David Turner, DTRE

Occupier demand is fundamental

"Occupier demand is the grass roots of the market. That is where you should pay most attention and this market is still strong.

Last year's take up was down on the previous year, largely due to Amazon's retrenchment. That downwards trend will continue in 2023. We can see the amount taken by retailers falling away, but there's less change in demand from 3PLs and logistics providers.

Big box vacancy levels are at an historic low of 3.5%. Some grey space is coming through and we will see more as Amazon moves out of old space. Sub-10% vacancy levels bring rental growth and there's headroom.

Rental growth will continue but not at last year's 12%. Industrial and logistics is likely to be one of the strongest sectors with yields stabilising quickest. The fundamentals behind occupational demand remain strong, but could be affected by a long recession.

The development pipeline will decrease in the second half of the year as a loss of confidence from the final quarter of 2022 takes effect. In the meantime, 16 million sq ft is under construction with delivery in the first half of 2023.

£7.8 billion was traded last year, but interest rates made it harder to transact over the course of 2022. Investment might start picking up again in Q2 with a 'hockey stick' rise at the end of the year. Levels of £1.5-2 billion per quarter would be good to see and closer to the five-year average.

Drivers for location

Flexibility between B2 from B8 obscures trends in uses, but firms seem to want to do more assembly in the UK. That's creating demand for just-in-time space.

Electric vehicle take up is seeing massive growth. Their short range means facilities are still needed close to where fleets operate, driving demand in big conurbations.

Warehouses work for mid-tech and lab-enabled spaces, typically for

ancillary and back up uses, but don't badge that as life sciences. If you want to create bespoke clusters, those people won't work in a warehouse.

Some uses dictate their locations. Continued strong demand for data centres is focused on locations where the power supply is strong. Film studios have experienced a big tick up in demand, but won't ever want to be too far from the Dorchester!

London and the South East are seeing a big increase in business rates bills this year: 50% plus, we calculate. Even with Government support, rates will add to the cost base for occupiers, but there has been little real increase in costs overall and there is headroom.

New growth areas? My money's on vertical farming with hydroponics, close to markets.

Key challenges

The biggest barrier to investment is the inefficiency of the planning system. Any developer will vent against planning, but a lot of applications are from industrial. It's sheds, beds and meds that are putting pressure on the system.

The big challenge for development is cost price inflation thanks to issues with the supply chain, post Brexit import frustrations and labour – one of the biggest problems for occupiers as well as developers. The big occupiers must compete hard for people.

Technology is vital to sustainability and to tackling shortage of power. How do we charge all these electric vehicles (EVs)? We should be accelerating use of solar panels on large warehouse roofs, but installations ground to a halt when the Government cut the tariff. The real issue now is power storage.

Pressure to be fit-for-purpose

Landlords recognise the regulatory challenge coming from EPC ratings and have to factor in cap ex. It all comes off the bottom line and cash flow has to be robust. The heavy lifting is mainly on industrial estates, especially light industrial.

Whenever an older building becomes vacant you weigh up retrofit versus new build. How much value is in the building and how much in the land? Maximising rent requires a fit-for-purpose building and most buildings from the last 25 years can be brought up to standard, but older stock is under threat.

If you can do a refurbishment quickly, you'll only have a short void. It makes more sense than a timely new build.

There's still money that wants to come into logistics. We get quizzed all the time about how the occupational market is standing up to the headwinds. That's the key question: is rental growth going to continue?"

"WE SHOULD BE ACCELERATING USE OF SOLAR PANELS ON LARGE WAREHOUSE ROOFS, BUT INSTALLATIONS GROUND TO A HALT WHEN THE GOVERNMENT CUT THE TARIFF. THE REAL ISSUE NOW IS POWER STORAGE."

David Turner, DTRE

Investor and developer mismatch

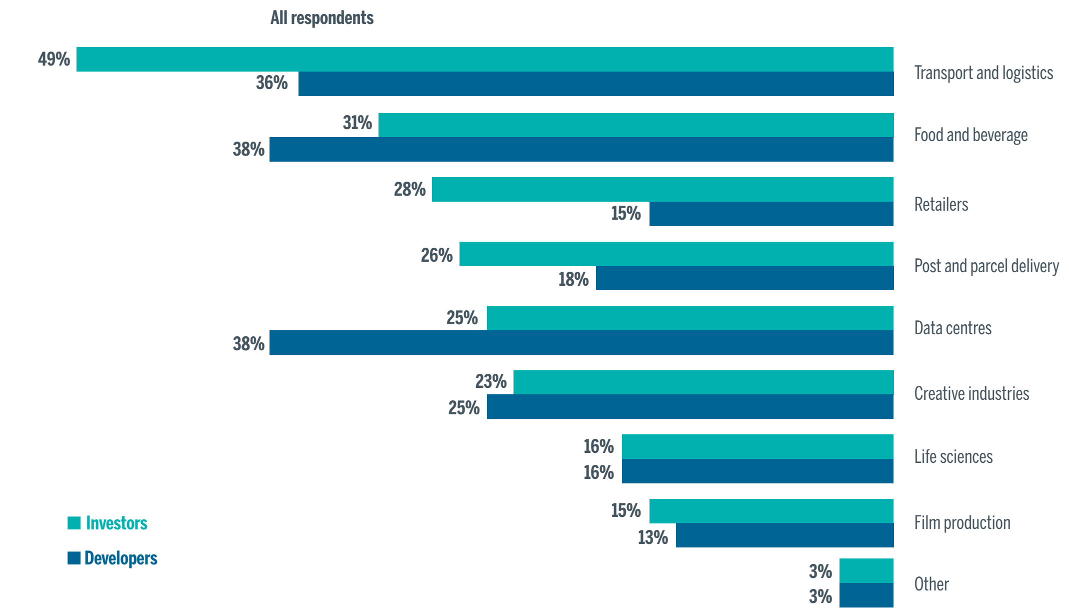
Our research suggests that there may be some differences in what investors would like to spend their money on versus what developers are looking to supply.

There is a higher demand from investors than developers in transport and logistics (13 percentage point difference), retail (13 percentage point difference) and post and parcel delivery (8 percentage point difference). A lack of supply might compound challenges already faced by many post and parcel delivery firms struggling to keep up with demand.

Where the reverse is true – i.e. there is higher demand from developers than investors – the result could be a lack of finance for speculative development. Uses most affected would appear to be data centres (13 percentage point difference) and food and beverage (7 percentage point difference).

While investors can be confident of long-term occupier demand and the relative safety of industrial compared with offices or retail, developers still need to overcome planning and construction risk. To make a scheme stack up, growth in rental income cannot fall too far behind increases in inflation and construction costs. Assuming inflation has peaked, these barriers to speculative development may ease as 2023 continues.

Q. Which uses for industrial property do you believe will experience the greatest demand from investors and developers in 2023?



The co-existence of industrial and residential

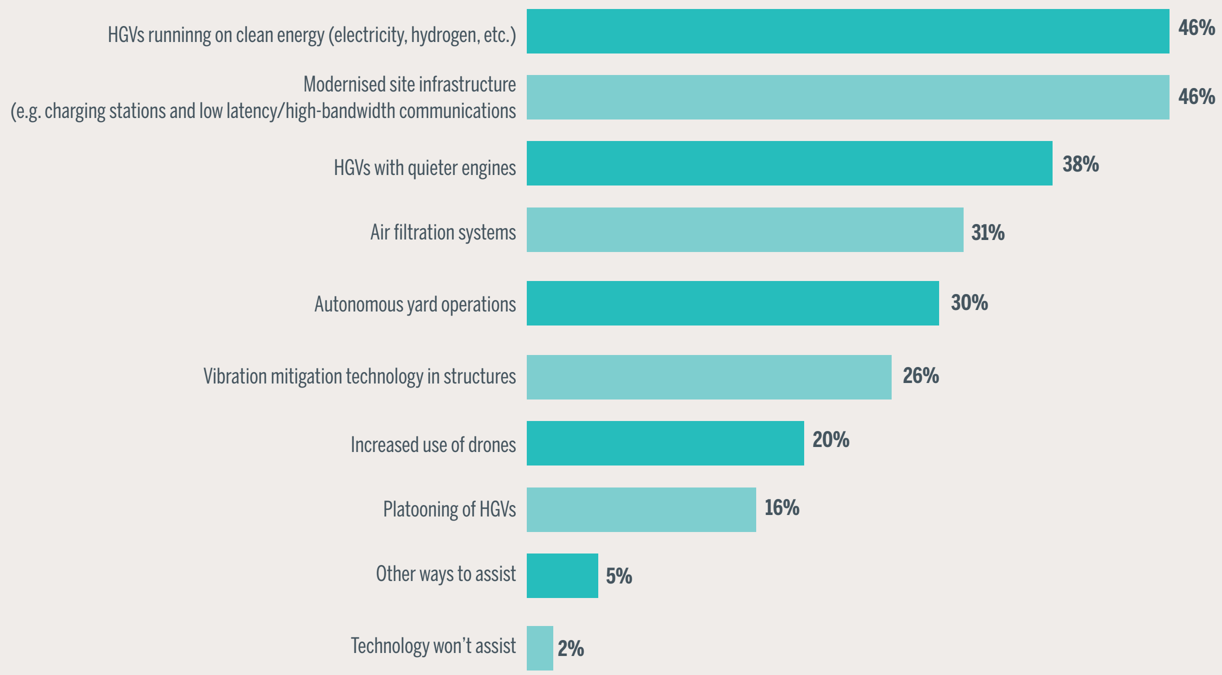
Urban logistics and last-mile real estate are expected to experience greatest demand from investors and developers in 2023, ahead of big-box and mid-box warehousing.

As last-mile delivery centres move closer to residential areas, and now exist within them, the sector acknowledges the need to be neighbourly, particularly given the drive towards sustainability.

This is one area where technology is likely to play a part in the future, according to almost all (98%) respondents. Around half say that running heavy goods vehicles (HGVs) on clean energy (46%) and creating a modernised site infrastructure (46%) will help co-location. HGVs with quieter engines (38%) and air filtration systems (31%) can also make a contribution.

The use of such technology could facilitate planning permission in residential areas, as such technology will make the scheme more attractive to local residents. Green frontages can also improve acceptability but the use of micro depots served by electric vans, perhaps in former retail premises, may be a more realistic first step to co-location in residential areas.

Q. In which of the following ways do you believe technology can assist with ensuring that logistics and residential schemes can co-exist, as last-mile logistics hubs move closer to residential areas?



The sector embraces multi-modal future...

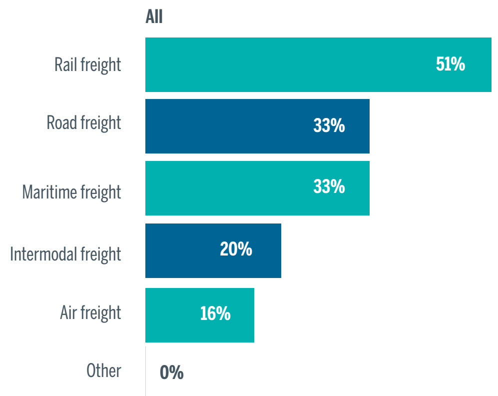
The average freight train can take 70-80 HGVs off the road, making a significant contribution to decarbonisation of freight.

Advocates of this modal shift will be heartened to see rail come top for its prospects: 51% believe rail freight will generate the greatest growth in occupier demand in 2023, compared with 33% for both road and maritime.

An increase in rail freight demand should support the creation of an efficient, multi-modal freight network across the UK, an objective of the Department for Transport's Future of Freight Plan.

Where opportunities can be found to invest in rail freight interchanges, they can be supported by growing demand. Rail is most directly relevant to large-scale industrial schemes with big-box warehousing, but low-carbon connections to urban and last-mile solutions are still needed for a truly green network.

Q. Which of the following modes of transportation do you believe will generate the greatest growth in occupier demand in 2023?



...and multi-storey future

Competition for land continues to drive interest in multi-storey industrial development although real world examples in the UK are still few and far between.

Whether that's a warehouse of two or three levels, light industrial units over half a dozen floors or the 20-storey towers seen in the largest Asian cities, the concept's value and broad applicability excites the sector: 52% have seen an increase in developer appetite in the past year and 77% believe that multi-storey sheds will play a large role in the UK logistics sector in the future.

Proof of end-user demand and the resilience of essential technology, such as goods or vehicle lifts, will allow the proliferation of a promising concept. Developers will no doubt weigh up in each case whether the inclusion of a mezzanine adequately solves the issue of local land availability.

If a multi-storey development is multi-tenanted, developers will need to assess how to keep each occupier happy. Occupiers will want certainty that they will have access to ramps between floors where required. There may also be structural concerns which result in upper floors being allocated for uses which are less intensive. Developers will, of course, need to ensure that a multi-tenanted, multi-storey scheme remains attractive to investors.

The operational nuances within multi-storey schemes will need to be reflected in a clear legal structure which sets out how the space can be used in a manner which both enhances a tenant's experience and preserves asset value for landlords.

The march of automation

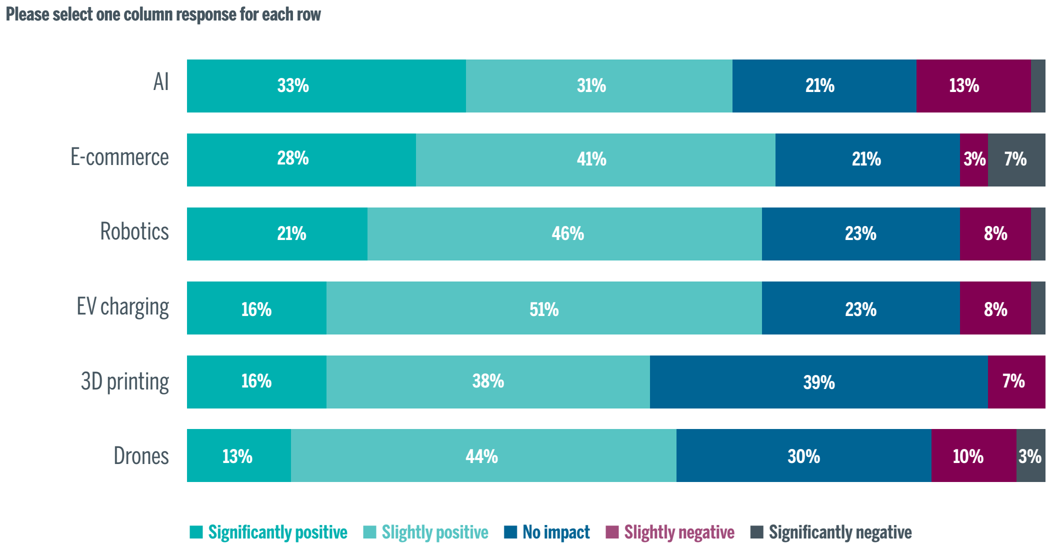
Investors and developers are positive about the impact that technology will have on the industrial and logistics sector in the next five years. There is particular optimism for the impact of e-commerce (69%), closely followed by robotics (67%) and EV charging (67%).

When it comes to technology which is likely to have a significant positive impact, respondents are most impressed by the potential of artificial intelligence (33%) which trumped e-commerce (28%). A polarising technology, perhaps due to its varied uses, AI is also seen as most likely to have a negative impact on the sector (15%).

From a legal perspective, the rise of robotics has required occupiers to place tighter controls on when landlords can enter the premises for the purposes of inspection. Occupiers who use robots to locate parcels and goods within a warehouse do not want landlords getting in the way of such operations.

Despite the excitement generated when they first came to the market, 3D printing (54%) and drones (57%) are seen as the tech least likely to have a positive impact on the industrial and logistics sector. Developers do see drone delivery as a viable aspect of a scheme, but of decreasing relevance as schemes get further away from urban areas.

Q. How much of an impact do you believe the following technologies will have on the industrial/logistics sector in the next five years?



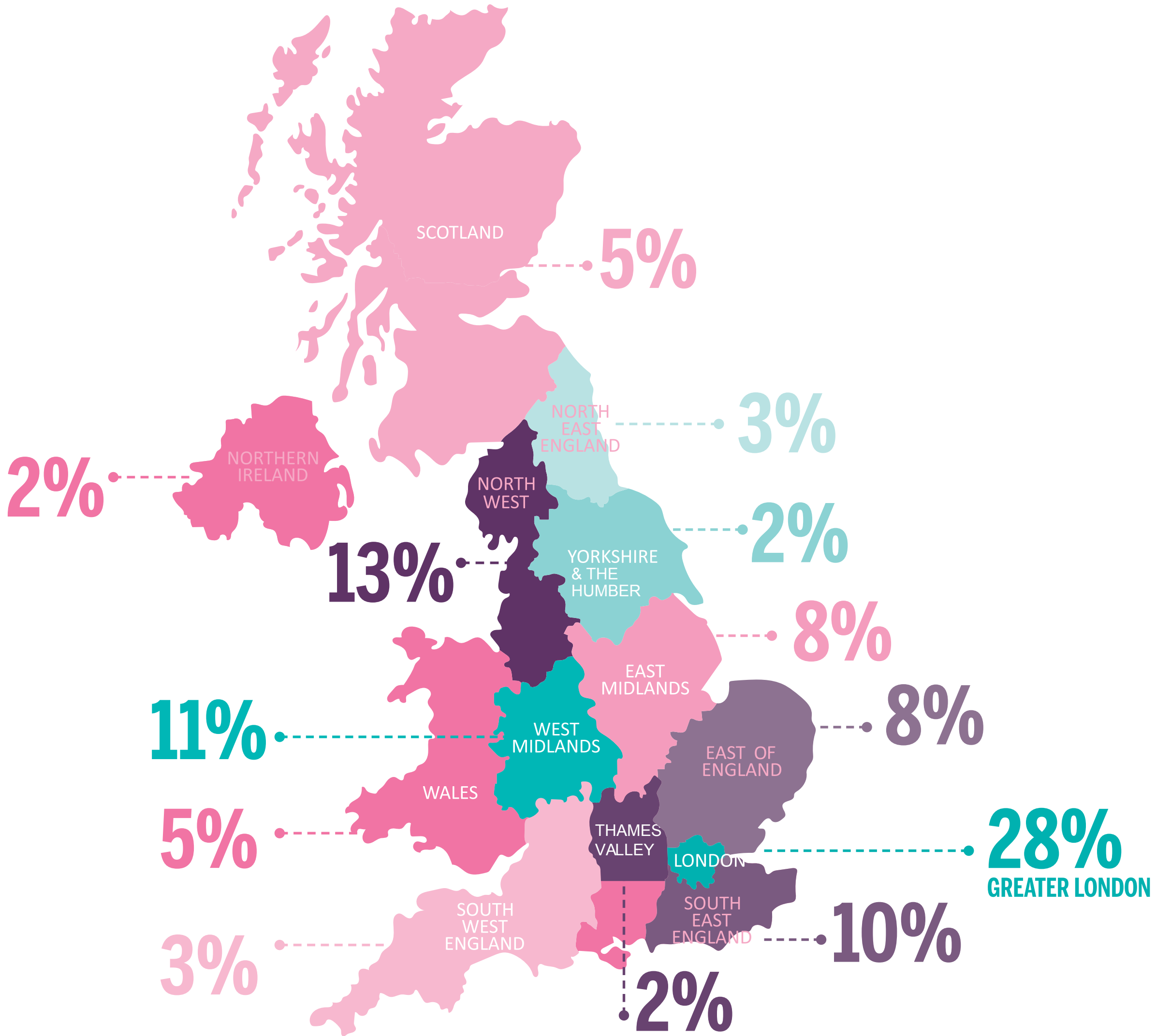
Regional prospects show national opportunity

Industrial and logistics is viewed as a nationwide opportunity by the real estate sector, and that is certainly our experience here at Forsters, but our research suggests different factors are at play in each region.

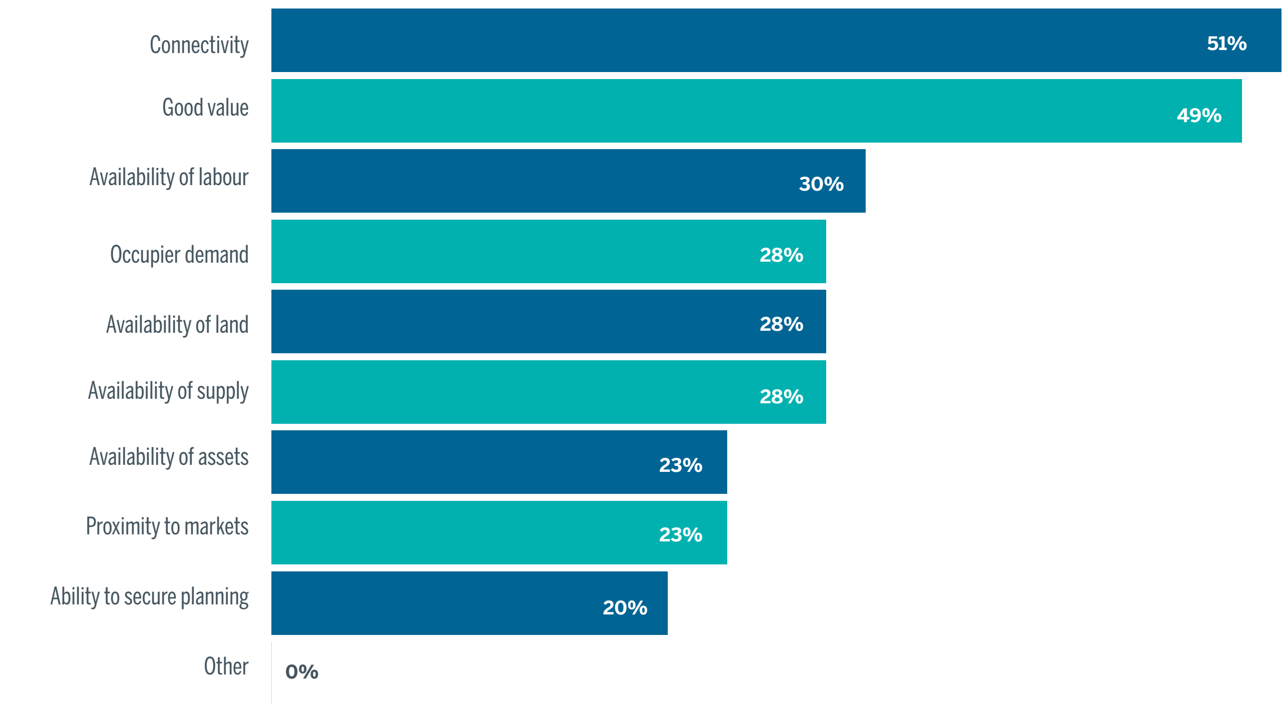
Greater London is seen as offering the best prospects for investment in 2023. However, this is lower for industrial and logistics (28%) than offices (43%) and residential (43%). Behind Greater London were the North West (13%), South East (12%) and West Midlands (11%).

Those who selected Greater London are mainly driven by its connectivity, availability of assets and availability of supply. Across all regions, the key factors for investors were connectivity (51%), closely followed by good value (49%), before a large gap to availability of labour (30%).

Q. Which location in the UK do you consider offers the best prospects for investment in industrial and logistics real estate in 2023?



Q. Why do you believe the region you selected offers the best prospects for investment in industrial and logistics real estate in 2023?



An interviewee keen to locate near "chimney pots", partly for the labour pool that comes with large population centres, speculated that increasing automation could allow warehouses to move away to more remote and cheaper land.

Tackling labour shortfall

Given the significance of a local labour pool – whether for construction or operation – a conclusion by City & Guilds that the logistics sector could be 400,000 workers short by 2026 will cause concern.

How does the industrial and logistics sector encourage more young people to enter the workforce? The most obvious way is to improve pay (51%), but careers advice was also seen as necessary: 36% advocated promoting jobs available, while 33% wanted talks in schools and the same proportion wanted the promotion of training.

At the same time as demystifying its operations, the sector should reflect on how it can make itself more attractive to a diverse talent pool. While long hours have been associated with transportation jobs, the rise in last mile logistics may support more part-time roles in daytime hours for those with family commitments.

The march of automation referred to earlier in this report may not be a threat to overall future employment opportunities within the sector. Potential employees may instead see a gradual change in the nature of the jobs required, increasing the need for engineers and technicians.

EXPERT INTERVIEW

The draw of big populations

BEN COLES

Chief Executive, Wrenbridge

Back under control

"Someone pulled the handbrake late last summer and I've not seen a correction on pricing as fast. We're pretty bullish but we couldn't fathom what people were paying for land in the first half of last year. The bubble burst over the latter part of that summer.

The fundamentals haven't changed and we could see a relatively fast bounce back. There is still a lack of stock, but occupier demand was a myth. It wasn't crazy, it was just normal. Only the investment market was crazy. People were making wild projections to get projects to stack up.

Growth opportunities...

The big growth areas for us are around London, around places like Hemel and then up the motorway corridors. Generally, there is lack of opportunity and to get pricing to work is tough. There's certainly a lack of second-hand stock: land is worth more than buildings in prime spots.

"CONSTRUCTION IS A BIGGER CHALLENGE. BUILD COST INFLATION CAN WIPE OUT A LARGE PERCENTAGE OF THE MARGIN. A CONTRACTOR GOING BUST QUADRUPLES EFFORT FOR A QUARTER OF RETURNS."

Ben Coles, Wrenbridge

End users want big populations locally and accessibility. Those who can be more transient – who need labour and the right size unit, but are relaxed about location – can go further afield.

Some of our customers are high street brands consolidating their parcel deliveries but numerous other sub-sectors, such as data centres, are still busy. Film studios are also still generating enquiries.

There is also a lack of suitable stock for more hi tech, science and hybrid users. Not just lab space, but a mix of office, light industrial, and research and development. We have a JV with a local authority and in Oxford we've gone for a higher spec building that gives the user flexibility with configuration going forward.

...and barriers to growth

A lack of opportunity is the biggest investment barrier. There is so little best-in-class product: EPC A+, BREEAM Excellent, new highly sustainable and with great tenants sitting in units in the South East of England. There have been a forward handful of investments in the last 18 months and no-one is trading if they find one.

This is why investors go up the risk curve. Planning risk is the last one they'll contemplate, behind construction risk and then letting risk.

Construction is a bigger challenge. Build cost inflation can wipe out a large percentage of the margin. A contractor going bust quadruples effort for a quarter of returns. Labour becomes an issue when development is breaking into a new area.

Development should be easier. There's been talk for years about simplifying planning. It's right to challenge developers' proposals through planning, but we get a lot of unnecessary hurdles. Biodiversity net gain of 10% is almost impossible on an urban site and fire tender access to more than 50% of the perimeter isn't much easier. Some hours-of-use restrictions can also be a bit of a nonsense.

Genuine sustainability

There's a box ticking route to sustainability or you can try to make a genuine difference. That might mean extending exercise areas/gyms, a commercial park in retained woodland and general wellbeing for staff in a nice place to work, along with on-site or local amenities. We don't do green on the roofs, where photovoltaics are a better use of space. We plan to use cladding that stores power and you have to provide for a future where 100% of lorries and vans are electric.

Wrenbridge will be net zero imminently. Many in the industry are still unclear about what this actually means as an educational process is ongoing for a lot of the industry.

We know re-using buildings can work just as well. There are different challenges, but our retrofits have all worked and been a commercial success. Sometimes we have to work harder to convince occupiers, due to a perception of re-used space.

The most useful tech at present is geared to sustainability, but there are some big changes in the pipeline. Robots, drone and driverless cars/vans are all evolving."

"THE MOST USEFUL TECH AT PRESENT IS GEARED TO SUSTAINABILITY, BUT THERE ARE SOME BIG CHANGES IN THE PIPELINE. ROBOTS, DRONE AND DRIVERLESS CARS/VANS ARE ALL EVOLVING."

Ben Coles, Wrenbridge

Persistent risks: construction and planning

When respondents were questioned on their outlook for the year ahead, they were positive on the outlook for construction across the industrial and logistics sector. 57% believe that constraints in the supply of construction materials are beginning to ease, while 67% agree that inflation in the materials market is likely to be short-term and subside in 2023.

This optimistic view may go some way to counterbalance continuing concern surrounding investors' ability to access debt to fund projects in 2023 due to market conditions. 59% say it will be slightly or significantly more difficult. However, almost eight in ten (79%) respondents state that market conditions will improve once interest rates have peaked.

If supply chain and materials challenges ease in the course of the year, projects are far more likely to prove viable.

Planning: no easy fix

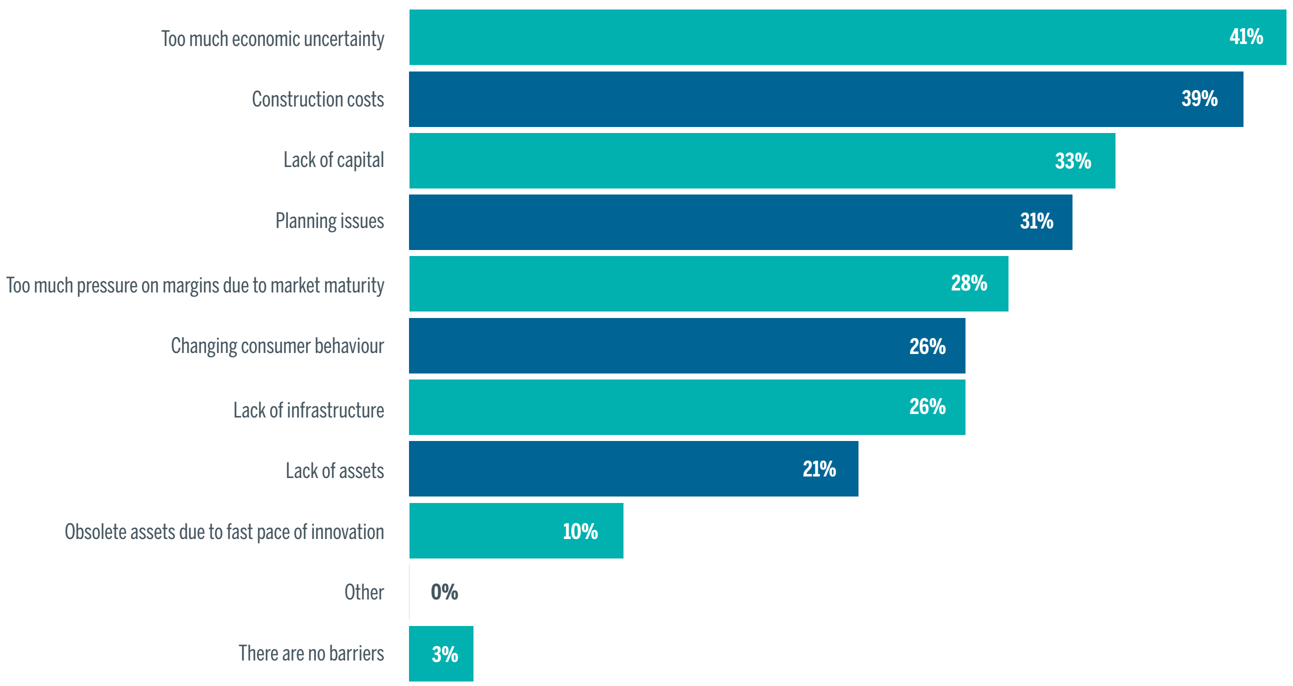
Almost all (97%) respondents identify some barriers to investing in industrial and logistics properties.

The most commonly selected barriers are economic uncertainty (41%), followed closely by construction costs (39%) and lack of capital (33%). Close to a third of respondents (31%) say planning issues are a barrier to investment.

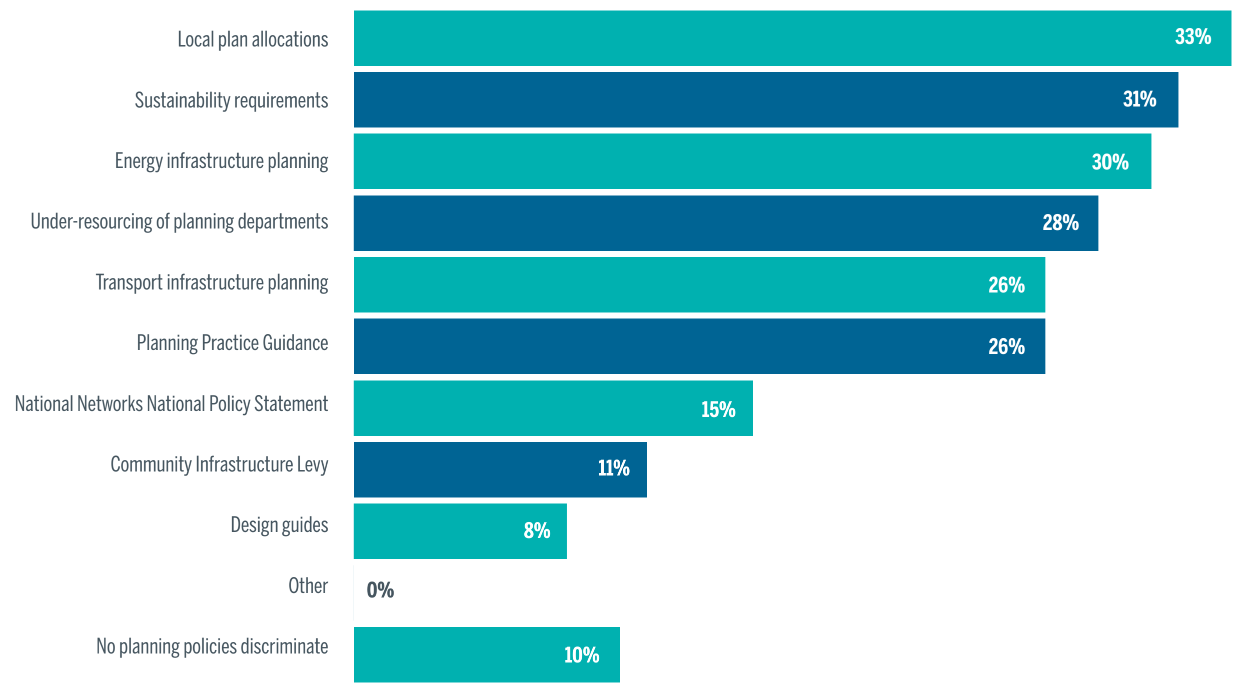
No single policy or factor stands out as discriminating against industrial development in a planning system that is generally unpopular. There is no single, easy fix that would help get projects out of the ground. A third (33%) of respondents blame local plan allocations, closely followed by sustainability requirements (31%), energy infrastructure planning (30%) and under-resourcing of planning departments (28%). While consultation is ongoing in relation to increased planning fees, staff need to be trained and retained for the planning system to have any hope of functioning adequately.

A large majority (84%) nonetheless agree that planning policy is aligned with the market in supporting the use classes and types of development most in demand.

Q. Which of the following do you believe are current barriers to investment into the industrial and logistics sector?



Q. Which of the following planning policies/factors do you believe discriminate against industrial development?



EXPERT INTERVIEW

Planning must help us build our way out of recession

VICTORIA TURNBULL

Joint Managing Director, Opus Land

"Opus Land is a multi-sector trader developer, with over 20 years' experience in the sector. We want to invest over the next 24 months, but the opportunities are currently thin on the ground.

We've reached a point in the market where vacant possession has dried up and it's difficult to make speculative development stack unless land values are materially recorrected.

What goes up...

We've seen one of the biggest hikes in construction costs over recent years – and it's one area where what goes up doesn't have to come down. Raw materials have stabilised, but the energy crisis is fuelling inflation in manufacturing as well as labour shortages and what has been high demand to sustain their operations and maximise turnover.

Rents are moving upwards and it wouldn't be a shock to see a 3% to 4% rise this year, but rent is a small part of occupier costs and therefore rental costs are low down their list of priorities.

In demand

What's most important is the right location and the right labour pool of people. They also want modern warehouses with the right eaves heights.

Demand is still there. Covid caused huge demand for logistics which will remain the dominant use. Next comes manufacturing, but we expect to see more offshoring due to the energy crisis and rising costs of manufacturing in the UK. Cold stores and dark stores could be the next growth area given how shopping habits for food have changed with other more niche requirements coming from film studios and other new entrants.

Where's the money?

Investor profile has shifted. Before the Truss premiership we saw lots of UK institutions and US private equity investors seeking

"WE NEED TO BUILD OUR WAY OUT OF THIS DOWNTURN"

Victoria Turnbull, Opus Land

safe havens for substantial sums. Conversely, lots of wise people have been sitting on cash, and they will be active in the next couple of years. In the meantime, we are dealing with much more opportunistic value-add investors looking to capitalise on current market dynamics.

Given all these contradictory factors, what has to change is land value. The values achieved last year set unrealistic expectations. Development appraisals show a loss at these historic levels, but landowners won't take 50% to 75% less unless they need to sell.

The last recession contains a few lessons. That time there was lots of stock and everything was more affordable. However, the dynamics are totally different now with supply still very low and likely to get more constrained.

Building our way out

The planning situation means more constrained stock. Policy is often ignored at committee for political gain. Housing has been politicised for years and there tends to be a knee jerk response to industrial.

We need to build our way out of this downturn, creating jobs, building new infrastructure and generating business rates to restock the Government's coffers. To do that we should be centralising policy – with a presumption in favour of development. There was nothing on commercial property in December's National Planning Policy Framework. How are large scale commercial allocations going to happen to help encourage businesses to locate or stay in the UK?

The ESG opportunity

Development is challenged by a rigid ESG agenda increasingly expecting carbon neutral construction. The bar gets higher for investors and developers every month. The industry has been slow to respond historically and many existing buildings won't have adequate EPCs in a few years. This brings further opportunity for developers and investors such as ourselves.

On those buildings not meeting the required criteria we will see a sliding scale of reducing value until then and some of these buildings could have a de minimis value in the not-too-distant future. Offices used to become obsolete very quickly and industrial is now catching up in complexity.

There's plenty we can do to work with occupiers on operational neutrality and with investors on poorly performing buildings. You can offer incentives to tenants – funding photovoltaics in return for longer leases, say – but it is still difficult for investors to fund refurbishments on secondary buildings with a lack of clarity on future value.

We have a menu of sound options for more sustainable buildings – grey water harvesting, lights with passive infra-red detection, natural ventilation, photovoltaics, smart meters, source materials locally, recycling and a greater understanding of the circular economy.

Tech's contribution

Tech provides part of the answer. On one of our buildings for Meggitt we installed six football pitches of PVs generating a good proportion of the occupier's needs and more than halving their power bill. You still contend with the UK's limited sunlight, but battery storage is getting better.

Some options are best avoided. Wind turbines don't yet offer cost value generation and are unreliable. The same goes for ground source heat pumps. Some of this tech just isn't as robust as we need but very well maybe in time.

The jury's still out on electric vehicles. Yes, we'd expect to provide 10% of parking spaces with electric charging and we'll add the ductwork for 100% of spaces, but current EV technology doesn't work for HGVs and the batteries aren't sustainable. We could still see hydrogen overtaking EVs in logistics.

All these things will find their own level. The major concern is over vote winning policies dictating planning and scuppering development, even on allocated sites. We should be building ourselves out of recession, but not if local politics gets in the way."

"WIND TURBINES DON'T YET OFFER COST VALUE GENERATION AND ARE UNRELIABLE. THE SAME GOES FOR GROUND SOURCE HEAT PUMPS. SOME OF THIS TECH JUST ISN'T AS ROBUST AS WE NEED BUT VERY WELL MAYBE IN TIME."

Victoria Turnbull, Opus Land

Incentives needed for investment

With 92% of respondents identifying tax incentives that could result in more investment, the survey finds that the Government could do more to encourage or steer growth.

Most popular are measures aimed at encouraging the use of green technology and the lowering of carbon emissions (44%). This is followed by Research and Development Expenditure Credit (31%) and Structures and Buildings Allowances (30%).

Interviewees saw the business rates revaluation in April 2023 as likely to have a negligible impact on occupier decisions, but rates remain an unpopular tax: 39% think rates should continue to be calculated by space occupied, while 52% would make a fundamental change to the current system and tax occupiers on profit realised from that space.

A Budget for investment?

The industrial and logistics sector will be encouraged by the announcement in the Spring Budget of "full-expensing" for capital expenditure to 31 March 2026. Companies will be able to deduct 100% of their qualifying expenditure on main rate pool plant and machinery and 50% for special rate pool assets (i.e. long life assets).

Expenditure on investment is finally being given the tax focus and priority needed to help maintain and grow the industrial and logistics sector. There is some risk that the temporary nature of full expensing could mean that rather than encourage new investment it only brings forward future investment. The sector will want the Chancellor to fulfil his promise to make this change permanent.

The new investment zones, like freeports, will benefit from reliefs from Stamp Duty Land Tax, business rates, employer National Insurance contributions and enhanced Capital Allowances and Structures and Buildings Allowances. They will also have access to flexible grant structures worth over £80 million for the five years of each zone, which should further encourage investment and should help drive business to target areas.

Sustainability: sticks and carrots

The industry is increasingly committed to meeting the Government's target to reach net zero carbon by 2050, but respondents highlight the need for assistance to get there.

Pressure to create more sustainable real estate is coming from all sides – from the Government, funders and occupiers – although our survey found that industrial tenants are no more demanding than office tenants.

Costs block refurbishments

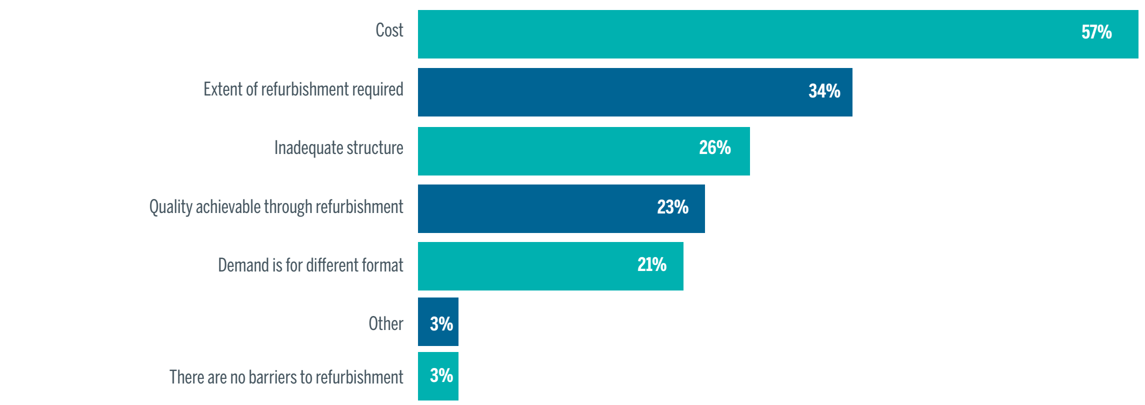
The deadline by which existing leased properties must carry improved energy performance certificates is upon us. Current projections from the Government suggest that by 2027, newly leased non-domestic properties will have to have an EPC rating of at least C, rising to B by 2030.

However, almost all (97%) respondents identify barriers to refurbishment: 57% say that cost is an issue, while 34% highlight the extent of refurbishment required and around one quarter blame inadequate structures (26%) or the quality achievable through refurbishment (23%).

Respondents predict almost no change in the composition of their portfolios. Approximately 57% of portfolios comprise retrofitted property, a proportion that respondents expect to slightly reduce to 54% by 2030.

Currently, the use of renewables and a drive to gather operational emissions data is front and centre of environmental sustainability for developers and investors, respectively. While this is commendable, the focus will turn to the long-term need to reduce embodied carbon emissions. For the industrial and logistics sector to continue in its drive to achieve net carbon zero, there needs to be a definitive move towards rewarding developers for retrofitting existing buildings and investors need to lead the charge.

Q. Which of the following do you believe are current barriers to refurbishment?



FORSTERS

EXPERT INTERVIEW

Stranding risk becomes a real concern

PHIL IRONS

Managing Director of Transactions for the UK and Ireland, Patrizia

"It's been extreme to see deals moving 150 basis points, but the market has come back. There's definite liquidity at prices the market is happy with and the consensus is that sustained rental growth will drive values going forward.

Demand for the right product

Demand from investors has bounced back, so long as it's the right product. That's largely well-located, urban, multi-let industrial. Occupational demand is driving the popularity of quasi last-mile, multi-let estates – and the occupier base on those sites is increasingly diverse. Gym operators are replacing the metal bashers.

Good locations are close to significant population centres and that's more about the delivery market than the workforce. The major challenge for these sites is that we're losing so much land to residential. How would we level the playing field? Increasing the affordable required on residential would help us to compete, but I'm careful what I wish for.

Another challenge is in managing multi-let industrial: it's a time-consuming job and one that's best outsourced. Agglomerating these sites brings a lot of value and liquidity, but you can end up with a large number of tenants paying relatively small amounts of rent.

Sustainability in practice

We place huge weight on sustainability right now. It's not just about the end user and operational efficiency anymore, but there's a lot to be gained by engaging with tenants and getting a green lease in place for access to power usage data.

Sustainability is a real, practical concern. Underwrite purchase of older stock and the key issues are the stranding risk and the cost of rectifying it. It's difficult to calculate accurately, but I'm pretty sure the costs are higher than most in the industry estimate.

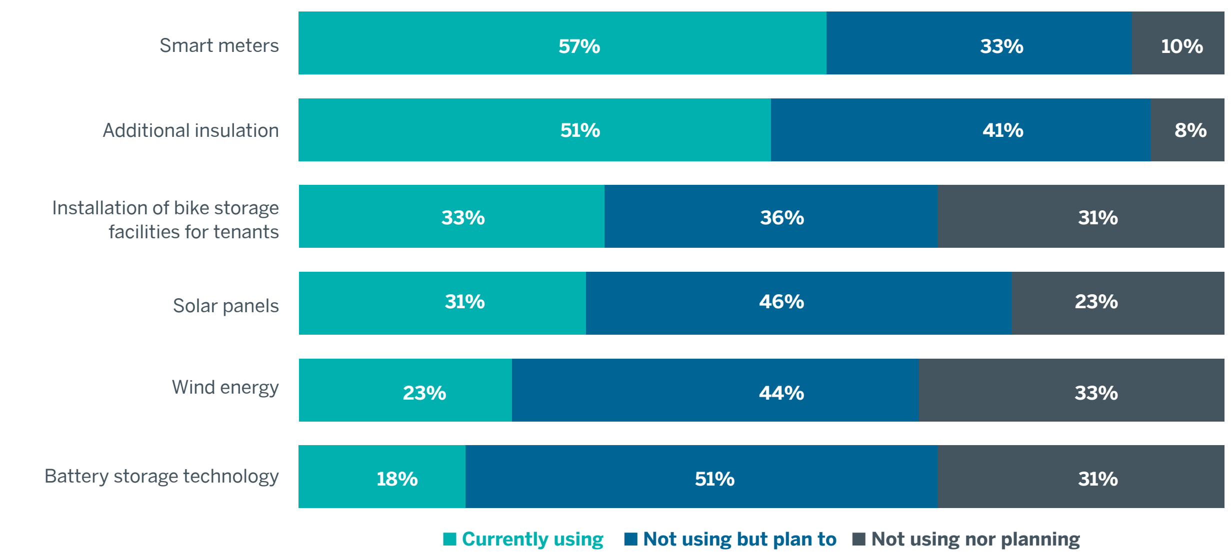
That's the big barrier to retrofit: the rents don't justify the costs. It's not that rents are lower for retrofitted buildings – simply that construction costs have become the biggest challenge in development and the costs have gone up far more than the rents. It's a challenge, but it's not going to stop investment in retrofit becoming increasingly mainstream."

Landlord/tenant collaboration on operational efficiency

The pressure on landlords and tenants across all sectors to reduce energy use has been compounded by steeply rising prices since Q1 2022.

Respondents believe that the most effective way that tenant behaviour can change to improve the environmental performance of an asset is a reduction in electricity usage (44%). Collaboration between all stakeholders is key.

Q. Which of the following are you presently or intending to use for improving the sustainability of your existing developments/portfolios?



Smart meters (57%) are most popular as a means of improving the sustainability of existing developments, followed by additional insulation (51%). Only 10% and 8% respectively are not planning to implement these measures in the future.

Making provisions for solar panels is now widespread across new build industrial and logistics properties, so it is unsurprising that 77% of respondents currently use solar panels or plan to. Although only 18% currently use battery storage technology, a huge 51% are planning on using it, more than any other implementation suggested.

The measure least likely to be introduced is wind energy (33%), consistent with interviewee concerns about the reliability of wind turbines.

The role of the green lease

Parts of the industry are moving up a gear in terms of recognising how integral green lease provisions are becoming, in a world where assets will need to be environmentally efficient to avoid being "stranded" due to statutory requirements and advances in technology.

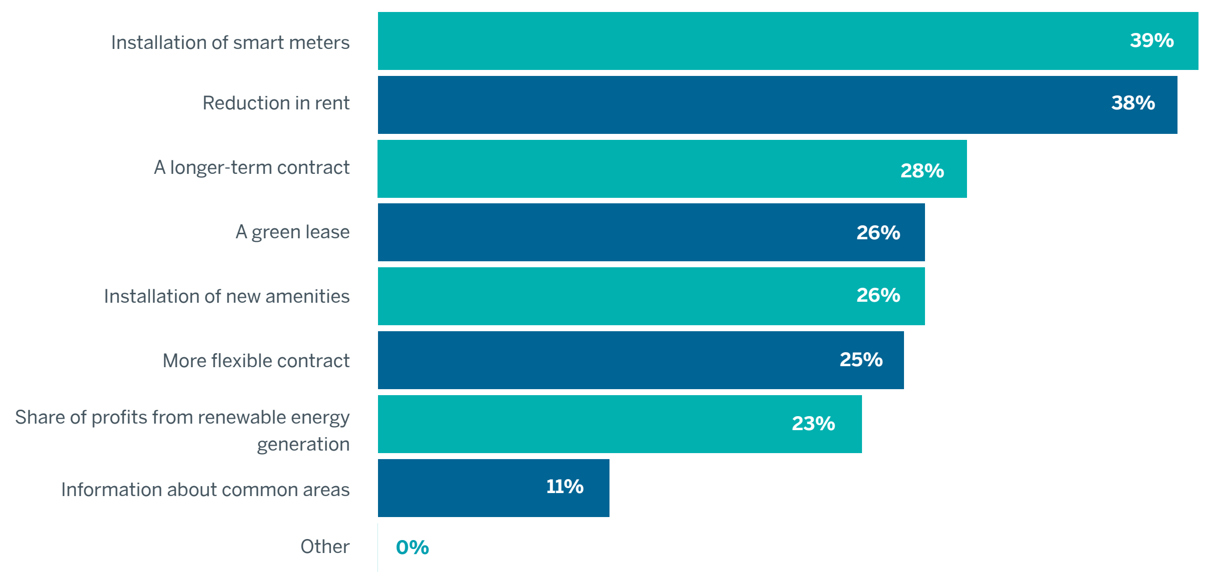
Green lease provisions are fundamental to setting the framework for a collaborative relationship between landlords and tenants in which both parties work together to achieve environmental objectives, such as the sharing of data and reductions in waste and water consumption.

This is likely to develop not only in the context of environmental sustainability but also in relation to the growing focus on social sustainability. The move to

create better workplaces and managing business impact for the good of employees, those in the supply chains, customers and local communities will no doubt gather momentum in the coming months and years. Legal documentation, along with development and investment drivers, will adapt and enhance accordingly.

Q. Which of the following do you believe would be effective if offered to tenants by landlords as part of a reciprocal agreement to reduce carbon emissions?

When it comes to incentivising tenants to reduce energy consumption, 39% advocate the use of smart meters as part of a reciprocal agreement. Only 26% of respondents see green lease provisions as the most effective incentive to offer a tenant.



Drivers for decarbonisation

While there is a general understanding of the need to improve environmental performance, knowledge of how to do so, and how to measure those improvements, is still lacking.

The strongest motivation for decarbonisation in the sector, according to respondents, will come from Government incentives (49%), ahead of investment returns (38%). The sector also seeks support to be more sustainable in the form of Government subsidies for renewable energy (54%), assistance with measuring progress (34%) and expert guidance (26%).

Manifesto for growth

Overall, respondents' clear understanding of the need to improve sustainability is aligned to their belief that the industrial and logistics sector is set for a positive 2023. Barriers remain, and more Government support is required for growth to be maximised, but as economic headwinds recede, both investors and developers appear to be well placed to push forward.

Despite the sector's role as the backbone of the country's transport network, it cannot afford to be complacent. To thrive, the sector needs to adapt to changing circumstances. Priorities must be to:

- lobby for significant investment in infrastructure, such as rail freight terminals;
- take advantage of the nationwide investment opportunity and the distinct features of each of the regions within the UK;
- capitalise on the expected easing of both inflation and supply constraints in the construction materials market;
- lobby for additional support for the planning system;
- explore the tax incentives which were announced in the March 2023 Budget;
- embrace the use of automation, but also be mindful of the challenges; and
- embrace the opportunities presented by greater sustainability or risk being left behind.

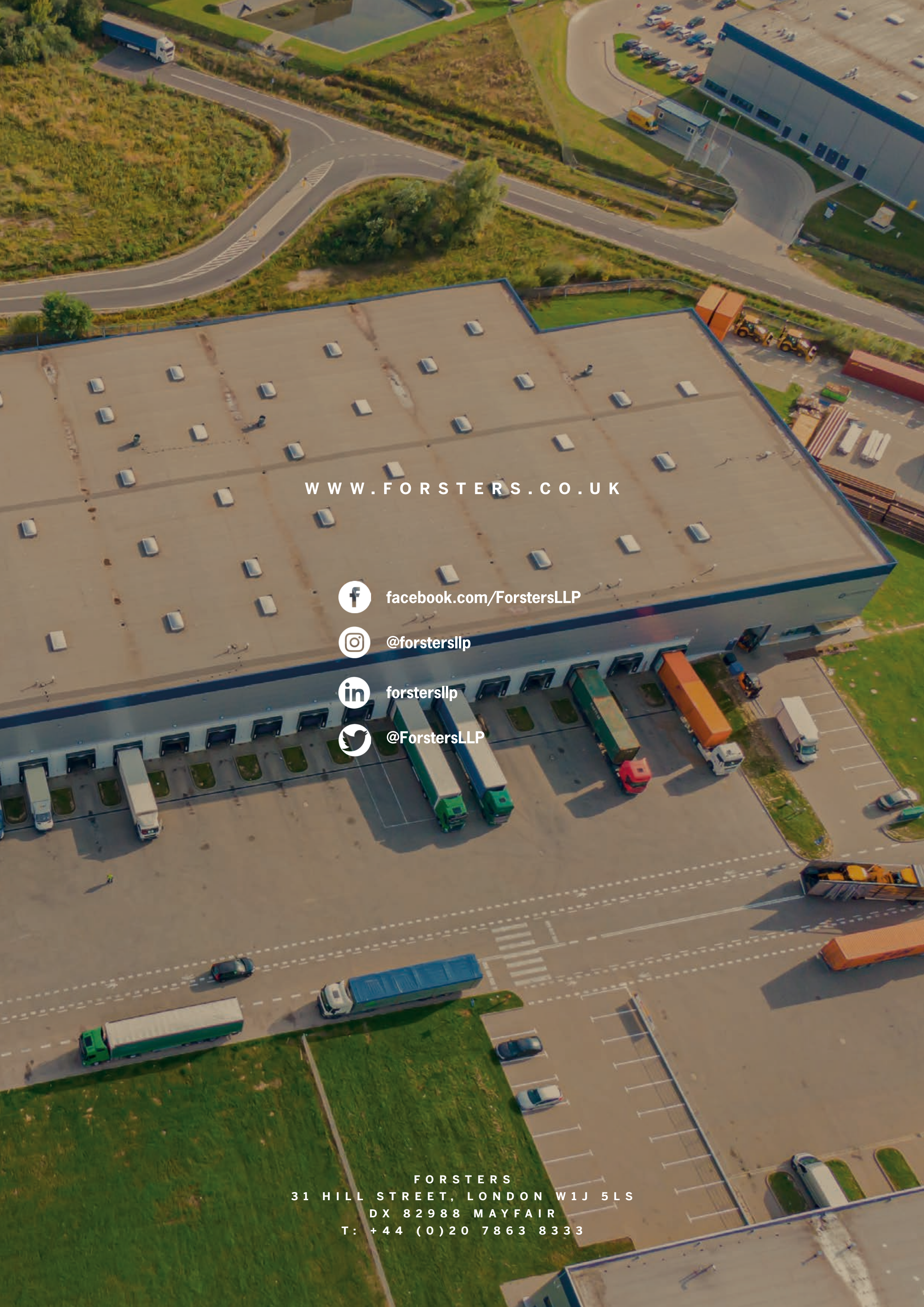
About Forsters

At Forsters, we thrive on helping our clients make the most of opportunities. We have the experience and expertise to advise them through challenging times, ensuring that assets are future proofed to remain attractive to investors and occupiers in a sustainable world.

Forsters has one of the largest legal real estate teams in London, with a practice comprising over 100 lawyers. Our Industrial and Logistics sector group is made up of leading specialists from across the practice, encompassing planning, finance, corporate, employment, tax and property litigation teams. This mix makes for a strong, talented group of lawyers who are able to draw on their experience and sector knowledge to deliver innovative, commercial solutions.

For more insights and details of our recent experience visit forsters.co.uk

Methodology
This research was conducted online by FTI Consulting, a global business advisory and research firm. The study ran from 9th to 17th January 2023 (inclusive) and involved the opinions of n=61 UK-based professional investors and developers in UK real estate assets with managerial roles. For more information about the methodology: stratcommresearchemea@fticonsulting.com



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