Bull and Bear

Industrial

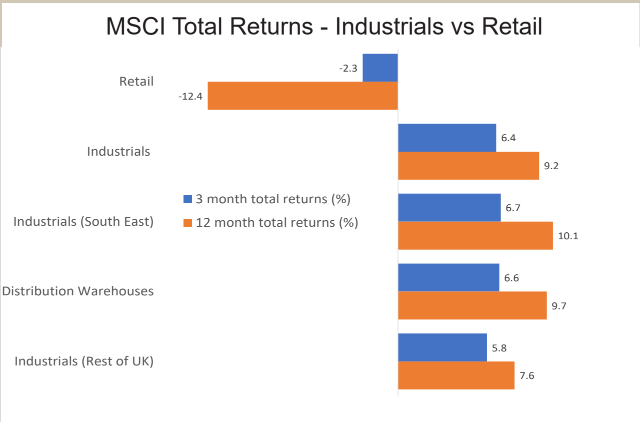
This week, Bull and Bear discuss the current darling of UK Real Estate, the industrial sector.

Bear: You seem to be in a jovial mood today.

Bull: I am. Spring is in the air and after all the doom and gloom of retail last week, it's time for a proper pick-me-up. Let's focus on the industrial sector where it has been all go, go, go! After all, industrials delivered an impressive total return of 6.4% over the last three months of 2020 alone and a whopping 9.2% over 12 months.

Bear: Wow! That's impressive.

2020 saw the largest sector divergence in IPD/ MSCI history



Source: MSCI

Bull: Yes, and apparently someone said that the spread of performance between industrial (best) and retail (worst) was the largest in the history of IPD/MSCI. You know what – there is a real smell of bitcoin around the industrial sector at the minute. Everyone wants a piece. And I love it.

Bear: But industrials are so incredibly expensive to buy just now. Yields for last-mile investments in London are close to 3%. That's more akin to landmark West End office yields.

Bull: Maybe, but industrial rental growth is going to be great. Remember, it was only a few years ago that landowners were flogging their sites for residential development when industrial occupier demand was on its knees. As a result, there is a real shortage of industrial development land now. And the current demand from consumers for e-commerce is going to push up demand even more. Some of my best buddies in the industrial agency world are suggesting 7% to 10% rental growth per annum.

Bear: For heaven's sake. Don't believe everything you hear. This current boom is bound to end sooner or later. And if developers aren't careful, they will simply push rents above occupiers' affordability – just like they did in the retail sector. Look what happened there!

Bull: Maybe. However, even you would have to agree that industrials seem to be a decent bandwagon to be on for the next year or so.

Bear: I accept that - which is why I have been investing in SEGRO and L&G's IPIF fund. They are easy to get in and easy to get out of. And they delivered me 14.6% and 11% total returns respectively in 2020.

Bull: Good one, Bear. So, do I take it that you are still a buyer?

Bear: No, but nor am I a seller. View me as a holder. I like the current dynamics, but I am concerned that there is a lot of hot air out there and some of the steam is bound to be taken out of the sector when this COVID-thing blows over.

Bull: I don't think you need be too concerned. From what I heard at St Bride's Managers' recent Navigators' meeting, they are still cautiously optimistic about the sector. And their view was reinforced by those nice people at Kimmre who gave a very interesting market presentation.

Bear: We will see. Anyway, I thought I would treat you to three facts that you may not know about the UK industrial market:

1. Three of the world's top ten largest industrial units (by sq. ft.) are in the UK – Morrison's Distribution Centre in Sittingbourne (919,433 sq. ft.), Shaw National Distribution Centre in Lancashire (1m sq. ft.) and the Amazon Fulfilment Centre in Dunfermline (1m sq. ft.). Worldwide, the largest, by a measure, is Boeing's Everett Factory in Washington, US (4.3m sq. ft.).
2. 2020 saw a record take-up (48.5m sq. ft.) for large distribution warehouses (over 100,000 sq. ft.) in the UK. It will be interesting to see whether this continues in 2021.
3. Some UK regions have less than one year's worth of supply and vacancy rates are at historic lows.

Bull: Okay. I have a couple facts for you in return:

1. There is an estimated 69 sq. ft. of warehouse floorspace per home in England. Applying the same ratio, and to match the Government's target of 300,000 new homes a year, would suggest that another 20.6 million sq. ft. of additional warehouse floorspace is required annually.
2. Amazon alone were responsible for 25% of the UK's industrial take-up in 2020 and 40% of all space taken-up in London and the South East.

Bear: I am not surprised by that last one. It doesn't take a genius to work out that Amazon are expanding at a ruinous rate.

Bull: Ruinous?

Bear: Apart from 'stealing' business from the High Street, Third-Party Logistics operators are going to struggle big-time too.

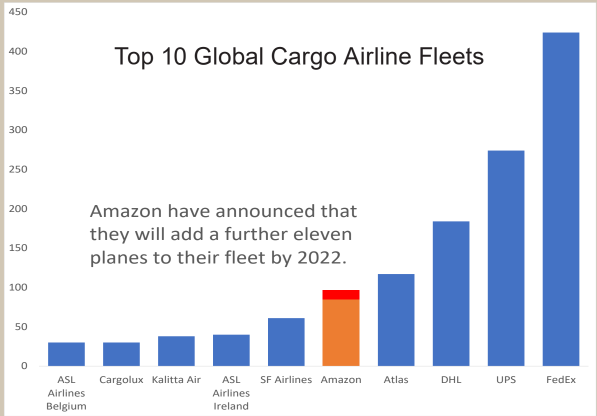
Bull: Are you joking? I know my local DPD and Hermes delivery drivers on a first name basis now. These companies have never been busier.

Bear: Exactly, but they are looking the wrong way when it comes to Amazon's expansion. I expect that you have noticed more Amazon vans on the roads recently. They are taking a lot of their services in-house. Mark my words, it will not be long before the DPDs of this world will have to look elsewhere for business.

Bull: Really?

Bear: Yes. In the US, Amazon already deliver an estimated two thirds of their parcels themselves. And, we know that the UK is quick to follow America's lead. Amazon have also just announced that they will be adding another eleven planes to their global airline fleet and they are slowly catching up with the big freight hauliers. If I was a Third-Party Logistics company in the UK, I'd certainly be keeping my eyes on my rear-view mirror.

Amazon have quietly made their way into the top 5 largest cargo airline fleets, with 85 planes



Source: Plane Spotters

Bull: Hmmm I see your point. Whilst we are on the issue of freight, what do you think about these eight new English freeports (with others to follow in Wales, Scotland and Northern Ireland)? They are going to be another great addition to our logistics network, aren't they?

Bear: Why do you say that?

Bull: They will allow raw goods to enter the UK from abroad, be processed and then exported without being subject to tariffs. And businesses located within the freeports will benefit from tax breaks such as no stamp duty, full rebates for construction and machinery investment, five years of zero business rates and the prospect of not paying employee's national insurance contributions for new jobs until 2031.

Proposed English Freeports	
Freeport	Projected Job Creation (No.)
East Midlands Airport	60,000
Solent	25,000
Thames	25,000
Teesside	18,000
Liverpool City Region	14,000
Felixstowe and Harwich	13,500
Plymouth	9,000
Humber Region	7,000

Bear: They sound a bit like the old enterprise zones if you ask me. Even so, let's hope that they have a positive impact on local economies, infrastructure and jobs. We could do with a bit of a shot in the arm.

Bull: I am sure they will. Which reminds me. Have you had your jab yet? I had mine last week. I never felt a thing and I've had no ill-effects at all.

Bear: Without wanting to put a downer on things, have you seen the price of steel recently? If I was a contractor I would be mighty concerned.

Bull: Trust you to find one of the few negatives in the industrial market at present!

Bear: Sorry Bull, but structural steel prices went up by £50 per tonne in January alone and have increased from £500 a tonne last summer to more than £700 a tonne now.

Bull: Wow! Why?

Bear: China produces more than half of the world's steel and is typically the largest exporter. However midway through 2020, China began importing at their highest levels since 2009 to meet their own domestic demand. As a result, there is now every chance that there will be more price increases this year and that is not good for construction costs.

Bull: Okay Bear. I think we have time for one more topic each and I know that you wanted to touch on ESG matters.

Bear: Yes. ESG is moving rapidly up the agendas for investors, occupiers and developers alike and whilst new sparkling industrial units may meet the required standards, upgrading the nation's secondary stock is going to be a real challenge. Moreover, simply switching out of older buildings to newer ones is not the answer as you are merely transferring the responsibility to someone else.

Bull: That's a fair point, but at least industrial environmental performance is arguably the easiest of the three principal sectors to fix. Besides E is only one third of ESG. The social dimension of industrial must have a say too, not least in terms of local employment.

Bear: I understand that but there is so much more to be done in this field and I fear the sector is being left behind, certainly when compared to offices which seems to be making reasonable strides forward.

Bull: Point taken. Whilst we are on the subject of distribution, did you know that Netflix are making their way into the industrial sector? Apparently, there was a massive surge of media and film take-up in 2020 and a little birdie told me that Netflix are currently in talks to take the whole of SEGRO's Enfield Park (200,000 sq. ft.) as a serviced film studio. On top of this, Sky are building new film and TV studios in Hertfordshire. And, US firm, Blackhall Studios, are constructing a new £150m studio in the Thames Valley.

Bear: Could it be that it might be an opportunity to take our series to the big screen?

Bull: Hmm. I wouldn't hold your breath. You've got a face better suited for radio!