



MONTAGU EVANS TALKS...

SCOTTISH INDUSTRIALS – A STRUCTURAL YIELD SHIFT

BY ROSS BURNETT AND STEVEN MCDONALD

With the continued growth of online retail and greater reliance on regional accessibility and last mile delivery, could this now manifest itself in a structural regional yield shift with Scottish yields having the potential to compress and narrow the gap between north and south?

With record yields being achieved in the UK industrial sector we consider Scottish industrial yields against this backdrop.

The industrial and logistics investment market continues to be underpinned by the strong performance of the occupational market. This has been driven by the ever-expanding supply versus demand imbalance and the continued growth of online retail and home delivery.

Industrial and logistics is the sector of choice for many investors, particularly UK Funds and REITS but the buyer pool has deepened as private equity and overseas capital has become increasingly active in the sector. The first half of 2020 saw UK investment volumes totalling £2.1 billion, with UK Funds and REITS making up almost 75% of the transactions.

The sector was the first to be released from the restrictions of the post lockdown valuation Material Uncertainty Clause, reflecting the continued flow of transactions, depth of buyer pool and pricing confidence. Pricing has remained robust and in certain prime areas has sharpened during 2020.

Industrial investment yields are trading at record levels across the UK. Recent headline deals in London such as Electra, Canning Town; New England Industrial Estate, Barking and a single let unit at Park Royal are a selection of deals that have transacted at yields of sub-3%. These demonstrate a continuing trend of yield compression as investors seek to increase their exposure to this sector.

Moving northwards out with London and the South East into the Midlands and the North West, the theme

of record yields being achieved continues. For example the sale of the Sainsbury's Distribution Centre at Hams Hall Birmingham and the sale of Hermes, Omega North, Warrington are both reportedly under offer at yields of sub-4%.

Prime industrial yields in Scotland are between 4.75%-5.0% which have been achieved in recent multi- and single-let transactions such as Ribston's acquisition of Prestonfield Park Industrial Estate, Edinburgh; Knight Frank Investment Management's acquisition of Amazon, Dunfermline and Blackbrook's purchase of Sainsbury's Regional Distribution Centre in East Kilbride. Whilst these yields paid are themselves at record levels for the Scottish market, they are still at a discount of circa 150-200 bps when compared to headline deals in London and the South East, and circa 100 bps on transactions in the Midlands and North West.

There are of course a variety of considerations to partly explain this yield differential, including wider political, economic and demographic factors, as well as land availability, supply/demand balance and rental growth expectations which are greater for London and the South East, the Midlands and the North West.

The structural change in the industrial market driven by the growth of online retail and parcel delivery is of course well documented. However the growth of online retail and parcel delivery does not differentiate between Scotland and England, rather it thrives on large population clusters, and approximately 70% of the Scottish population reside in the Central Belt with Glasgow, the third largest city in the UK and Scotland's dominant industrial market, having a catchment population itself of 2.3m people.

The Central Belt has an excellent transport network providing high connectivity by road, rail, air and sea. The transport network provides suppliers with immediate accessibility to customers making up a high proportion of Scotland's population. Scotland's prime distribution corridor is the M8 between Glasgow in the West and Edinburgh in the East. Glasgow has the added benefit of immediate connectivity with the M74 which is the



national motorway link between Scotland and England.

The prime logistics market centres on Cambuslang and Eurocentral to the east of Glasgow with Eurocentral having the further benefit of a major rail freight hub and terminal which provides direct access to Europe via the Eurotunnel.

Pre-letting through design and build remains the dominant form of take-up and this trend is expected to continue. The May 2020 pre-letting of 145,000 sq ft to Amazon at Glasgow Business Park and the September 2019 pre-letting of 50,000 sq ft to DHL at Clyde Gateway East being two high profile examples in the Scottish market. With no new speculative developments completed since the global financial recession, the availability of new or modern stock has all but evaporated. There is nothing being built speculatively in the Central Belt. The second-hand market has also seen strong occupational activity with availability under pressure and widely regarded to be at its lowest levels in five years. Notable lettings in the second-hand market included the NHS taking 122,000 sq ft at Titan, Eurocentral at £6.25 per sq ft and Hermes Parcelnet taking 94,000 sq ft at Colossus 2, Eurocentral at £5.75 per sq ft.

With yields at record levels and under further pressure, income performance will be the key for many investors over the short to medium term. With a backdrop of strong demand and chronic under-supply, conditions are present in the market to unlock significant rental growth on rent reviews over existing stock. This underlying trend and lack of supply will fuel rental increases, break options not being exercised, and lease extensions will prevail within the market. Almost all industrial and logistics rent reviews are reversionary in the Scottish market particularly in the Central Belt at prime areas such as Cambuslang and Eurocentral. Lease expiries also present the opportunity for significant rental growth for landlords and potential difficulties for tenants due to the absence of security of tenure from the Scottish leasing system.

As investment capital aggressively seeks industrial assets, Scotland offers opportunities for exposure to the sector at yield levels discounted against many areas of

the UK, but with strong underlying fundamentals. During 2020 YTD, Scottish industrials have attracted around £180m of investment, which represents just under 20% of all Scottish commercial property investment this year. Furthermore, Scottish industrial investment during Q3 2020 was greater than Q1 and Q2 combined. Institutions, specialist property companies and overseas capital have all been active.

Investor appetite for the industrial sector shows no signs of softening. The keenest yields are centred around London and the South East, followed by the Midlands and North West. However Scottish industrial yield levels do currently offer investors exposure to the sector in a mature, established market at enhanced income returns, with good levels of rental growth predicted underlined by a demand /supply imbalance and the prospect of further yield compression if this geographical yield differential erodes.

SUBSCRIBE
TO READ
MORE

TALK TO ONE OF THE TEAM



ROSS BURNETT
IS A PARTNER SPECIALISING IN INVESTMENT

T 0131 221 2483
E ross.burnett@montagu-evans.co.uk



STEVEN MCDONALD
IS A PARTNER SPECIALISING IN INDUSTRIAL
AND TRADE LEASE ADVISORY

T 0141 227 4699
E steven.mcdonald@montagu-evans.co.uk