FIERA REAL ESTATE

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Bridging the Logistics Gap:

The Case for Ground-Up Development in Small-to-Mid-Box Logistics

Over the past eighteen months, geopolitical volatility has had a significant (if not understated) influence on where investors are parking their money.

Some impacts of rising instability, from a renewed focus on national security to an increase in defence spending, have already materialised. Others have taken more time to unfold, including the dual forces of deglobalisation and supply chain disruption. For the logistics sector, which will undeniably be predisposed to these shifts, its role in underpinning the modern economy has never been more obvious. From comprehensive capital expenditure programmes focused on delivering much-needed infrastructure to resolving dependencies in international trade, domestic provision of logistics facilities will service every aspect of supply-led reform.

The impact of the e-commerce boom on the rapid growth in demand for logistics space is well-documented. But renewed interest in ground-up development is now supported by widening occupational demand as firms nearshore their supply chains closer to end markets and hedge against geopolitical uncertainties.

Media and industry discussions often focus on the big box segment of the logistics market. But at over 95 percent of all stock, it is the small-to-mid-size category that is the backbone of the UK's e-commerce network. These are the schemes under 250,000 sq ft that act as the 'spoke' to the big box's 'hub', traditionally as the last mile for delivery firms and online and omni-channel retailers.

This is a marketing communication.

Yet with renewed interest comes different expectations of what this stock should look like. Occupiers and investors alike have become increasingly discerning, demanding newer, greener stock as they seek to decarbonise their portfolios and meet stringent ESG targets. Newer facilities are also higher in volume, with greater yard space that can accommodate modern vehicle requirements, improving efficiencies for occupiers.

Though take-up of Grade C space sits at nearly all-time lows, ageing facilities continue to make up the vast majority of available stock. According to Knight Frank research from 2023, around 62% of all logistics space will fall short of an EPC B rating by the end of the decade.

Delivery of newer facilities is suppressed by supply-side constraints including suitable land in reach of both households and wider distribution networks, as well as the challenges of aggregating portfolios at scale. A supply-demand imbalance means that institutional-grade space carries a significant green premium, commanding higher rents that – in many cases – remain modest compared to overall occupier expenditure.

While there will naturally remain some demand for older stock, the ability to build in flexibility to newer facilities also increases their appeal. The small-to-mid-box category is one of the most flexible of all commercial asset classes, providing for a more diverse tenant pool than that of big box units, which are limited primarily to the largest distributors.

Those facilities that have been designed to prioritise flexibility can accommodate not only last-mile logistics firms, but storage space, manufacturing, traders and showrooms, to give some examples.

We therefore believe that the greatest opportunity in the logistics market lies in bridging the gap for ground-up development strategies for Grade A small-to-mid-box space.

As the interest rate environment improves, this sub-sector is also likely to benefit from a subsequent growth in transactional activity. Those managers with granular site-sourcing capabilities in undersupplied locations and a track record for successful planning and delivery are poised to reap the greatest rewards.

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