SPECIAL REPORT

War and inflation challenge development, but fundamentals remain strong

Rising construction costs and materials shortages are hampering developer activity, but the long-term outlook for logistics real estate remains rock-solid

BY **MARIANNE KORTEWEG**

Logistics developers are not easily fazed by a crisis.

As our annual survey of the leading pan-European players reveals, they have forged ahead with development activity, built pipelines and expanded into new markets despite the constraints of a two-year health pandemic. Over the past three years, they have delivered a total of more than 22 million m² of industrial and logistics space, up 21% on levels recorded for 2018-2020.

Of course, market conditions have helped: lack of supply and intense occupier and investor demand for warehouse and logistics facilities – fuelled primarily by the ongoing surge in e-commerce – have made anything they built a red-hot commodity. Stiff competition for scarce assets has driven prices through the roof for those seeking to buy, while limited supply has put upward pressure on rents for new developments.

Yet meeting that demand despite adversity – in the form of disrupted supply chains, travel restrictions and labour issues – testifies to the grit and adaptability that have always characterised this hardy real estate group.

Now, it is getting to grips with a new crisis: the war in Ukraine and its ramifications for the sector.

Robert Dobrzycki, CEO and co-owner Europe of leading industrial group Panattoni which has traditionally had a strong presence in Central and Eastern Europe, but no exposure to Ukraine or Russia, says the development business is 'clearly' being affected by the conflict. As with any crisis, the biggest initial impact is the 'huge uncertainty' it creates, which 'freezes a lot of processes and in most cases is temporary and short-term', he says.

Dobrzycki cites disruption to supplies of building materials, disruption to construction, and a spike in inflation – leading to higher construction costs – as the most immediate pain points.

'Before, a substantial amount of steel and concrete used to come from either Russia or Ukraine, as well as coal which was used to produce steel in Europe,' he says. 'Due to the war, these supplies have been substantially disrupted and because of that, contractors have started to freeze quotes to watch which way the market is going.'

This, he says, has led to sharp increases in the prices of building materials. 'We've been seeing cost inflation for a while, but since Russia's invasion of Ukraine it has spiked. I'm convinced this spike is a short to mid-term phenomenon but it looks like inflation, which was there anyway, will go on for a while.'

LONGER DELIVERY TIMES

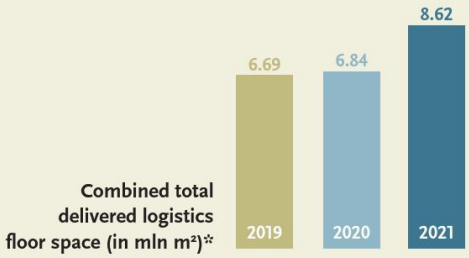
Adds Dobrzycki: 'I'm receiving calls which I never received in the last two years, from contractors worried about pricing or timing of delivery of a project.'

The Panattoni boss says warehouse development is clearly slowing down because of the crisis, which will have a knock-on effect on supply of product. The company currently has 4.73 million m² of projects under construction across Europe.

Top Logistics Developers

BASED ON COMPLETIONS 2019-2021

Panattoni tops our ranking for the sixth year in a row with close to 7 million m² of completed warehouse space over the last three years. UK REIT Segro, which ranked third in 2021, climbs to second spot this year, trading places with Prologis which slips to third position. Combined, the 16 companies featured in this year's ranking delivered 22.1 million m² of industrial and logistics space across more than 580 projects.



	Number of projects	Urban logistics 2019-2021 m²	Completed floor space 2019-2021 m²
1 Panattoni	133	1,317,585	6,979,307
2 Segro		412,621	2,546,896
3 Prologis	99		2,408,909
4 CTP	120	1,632,000	1,781,000
5 GLP Europe	55		1,482,415
6 VGP	72		1,470,000
7 WDP			1,260,210
8 P3 Logistic Parks	40		1,125,000
9 7R		95,000	868,000
10 Garbe Industrial Real Estate	27	41,159	699,358
11 Logistics Capital Partners (LCP)	8	49,085	463,366
12 AXA IM Alts			316,048
13 Verdion	9	119,752	234,961
14 Delin Property	10		202,000
15 ECE Work & Live	5	11,500	169,000
16 Sirin Development	6	135,600	135,600

* DELIVERED PROJECTS INCLUDE NEW SCHEMES, EXTENSIONS AND/OR REDEVELOPMENTS COMPLETED IN 2019-2021. THE MINIMUM TOTAL GLA FOR PROJECTS IS 5,000 M².

SOURCE: PROPERTYEU RESEARCH

Land availability is still tight

Scarcity of land is still one of the main factors hindering the supply response to the extraordinary demand for logistics property across Europe.

Without exception, the developers PropertyEU spoke with cite tight land conditions – due in large part to strict zoning and environmental procedures – as a perennial problem and one of the main constraints to expansion in many countries.

'In Germany, 40 hectares of land are given out for development every day. It is getting really difficult to find space,' says Jan Philipp Daun, managing director and CIO of Hamburg-based Garbe Industrial Real Estate. Only in the UK is the situation even worse, he remarks.

Says Jonathan Compton, senior director of logistics strategy at CBRE: 'Industrial land prices in the UK are increasing to levels and at rates never seen before. Record occupational demand is creating an acute shortage of supply. Developers are looking to build more but obtaining planning consent for warehousing is challenging which is adding fuel to the fire.'

Limited land availability, along with considerable upward pressure on values, rising construction costs and a challenging planning process, has caused developers to change their construction strategies and move up the risk curve, according to CBRE.

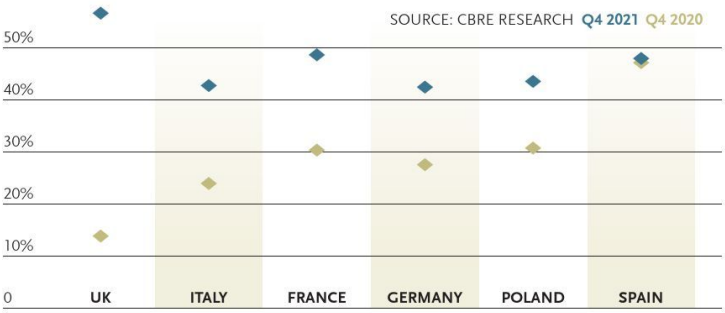
The firm's latest logistics research reveals that both the size and type of stock coming to the market have shifted to smaller and more speculative developments. In Q4 2021, speculative development accounted for 57% of space under construction in the UK, compared to just 14% in Q4 2020.

The picture is similar in other European countries (see chart). In France, spec developments accounted for 48.7% of total space under construction at end 2021, against 30.4% a year earlier, while in Germany the spec percentage was 42.5% versus 27.6% 12 months previously.

Joerg Kreindl, head of Industrial & Logistics Occupier EMEA at CBRE, says: 'Developers have adapted their construction strategies to respond to the continued growth of occupational demand, but our view is that this renewed speculative activity will not be enough as to move the vacancy rates up significantly. Built-to-suit schemes historically subdue rental growth, so this speculative wave is also partly responsible for the jump in prime rents.'

Development is increasingly speculative

SPECULATIVE PERCENTAGE OVER TOTAL LOGISTICS SPACE UNDER CONSTRUCTION



'This crisis is most certainly exacerbating the inflationary pressures being felt within the construction industry following the pandemic'

REMON VOS, CEO CTP

'On average I think you would have to add two to three months to the development process right now. But it's hard to predict with what is going on. We would be pricing and estimating time on a case-by-case basis. In terms of contractor prices, you don't want to keep a quote in the air for more than a week or two because the situation is changing so fast. That's the reality.'

MANAGING EXPECTATIONS

At Germany-based Garbe Industrial Real Estate, which is active on the development side in 10 European countries including Poland, the Czech Republic and Slovakia, the Ukraine crisis is not yet slowing down activity in term of square metres, according to managing director Jan Dietrich Hempel.

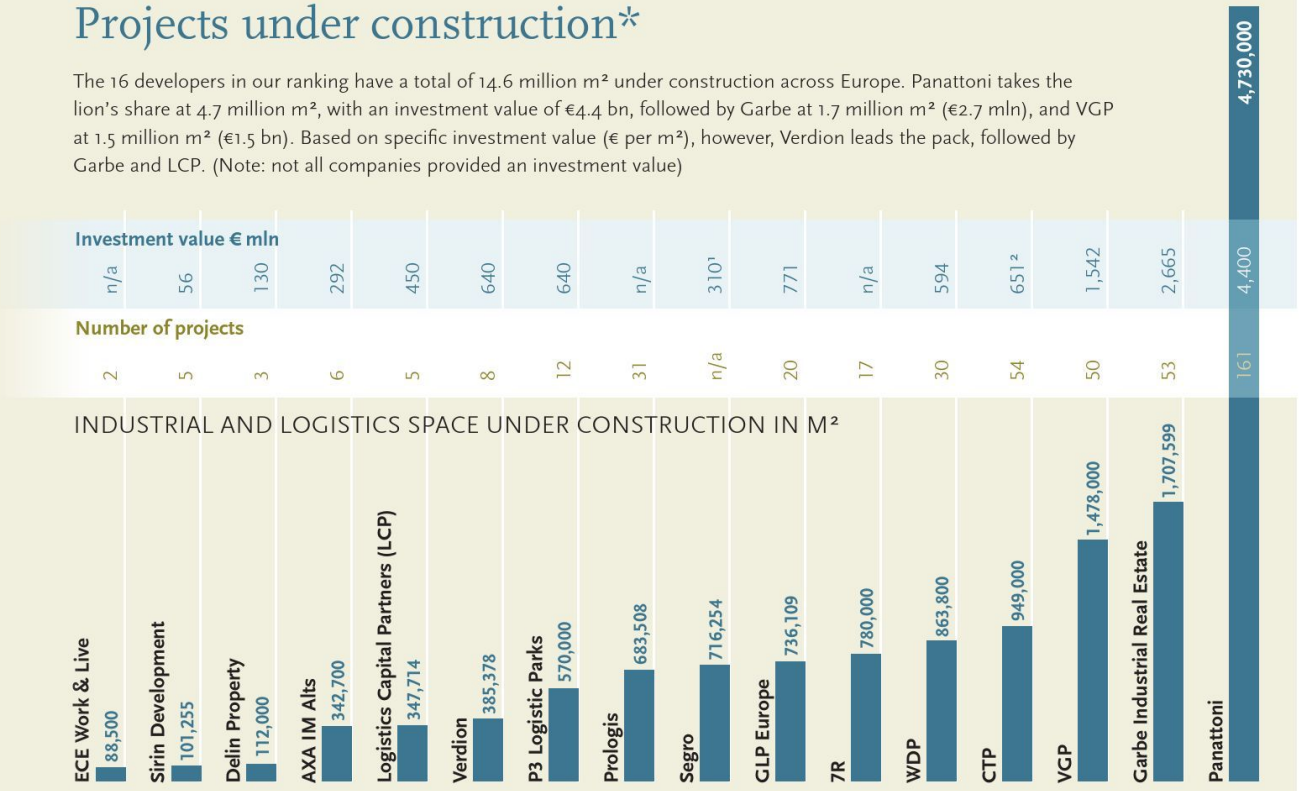
In the current volatile environment, the company is primarily concerned with concluding agreements with sub-contractors and managing tenants' expectations, he says.

'Most sub-contractors are now asking for more flexible pricing, and what also makes things tricky for our tenants is completion dates – these are getting potentially slightly delayed.'

He explains: 'In the current situation, with sub-contractors not being quite so sure

Projects under construction*

The 16 developers in our ranking have a total of 14.6 million m² under construction across Europe. Panattoni takes the lion's share at 4.7 million m², with an investment value of €4.4 bn, followed by Garbe at 1.7 million m² (€2.7 mln), and VGP at 1.5 million m² (€1.5 bn). Based on specific investment value (€ per m²), however, Verdion leads the pack, followed by Garbe and LCP. (Note: not all companies provided an investment value)



*PROJECTS UNDER CONSTRUCTION ARE THOSE FOR WHICH ALL REQUISITE PERMITS HAVE BEEN OBTAINED AND ON WHICH CONSTRUCTION ACTIVITY HAS STARTED. INCLUDES GREENFIELD AND BROWNFIELD DEVELOPMENTS. THE MINIMUM TOTAL GLA FOR PROJECTS UNDER CONSTRUCTION IS 5,000 M².
¹ ESTIMATED COSTS TO COMPLETION
² THE MARKET VALUE OF IPUD AS OF YE2021

about getting certain building materials like insulation components, steel products or other materials on time – even if they have signed a contract – delays might develop.'

Hempel notes that 'while everyone understands the situation, it may get challenging to align interests with your sub-contractors and tenants'.

Warehouse tenants – and Garbe has around 400 of them in various sectors – are being affected by the war in Ukraine and its side effects in different ways, says Hempel. Some are requiring additional temporary space, for example to park half finished products while waiting for components whose supply has been disrupted to come in.

Others have seen operations hampered or even grind to a complete halt. Car manufacturer BMW, for example, was forced to idle a production plant in Bavaria because it could no longer get wire harnesses, a crucial component, from its supplier in Ukraine.

Inflation is also a worry. 'For the time being, the rise in prices of construction materials will only get worse,' predicts Hempel. 'Longer transportation times for raw materials like steel which would normally come from Russia and associated countries but which don't anymore are also driving prices up. Steel and timber, which comes from places in Siberia and elsewhere in Russia, are the main materials being hit.'

Listed Czech-based group CTP, which is active in four markets bordering Ukraine – Poland, Slovakia, Hungary and Romania – but does not have any assets or development sites in the country itself or Russia, says its development business is experiencing 'only very limited and temporary disruption to labour availability and raw material supplies'.

'So far, where there have been supply-side disturbances, our in-house construction and procurement teams have successfully sourced stock from alternative markets,' says company founder and CEO Remon Vos. 'We continue to closely monitor the situation, and assuming that the war does not extend beyond Ukraine's borders, we remain confident our development pipeline will remain on schedule and that we will be able to meet the occupational requirements of our clients.'

Vos attests the crisis is 'most certainly exacerbating the inflationary pressures being felt within the construction industry following the pandemic'. To date, he says, the group has been able to minimise the impact on its development activities through its in-house construction and procurement capabilities, as well as its long-standing supplier relationships. CTP currently has 54 projects totalling around 950,000 m² under construction across Europe.

More broadly within the industrial and logistics sector, Vos notes that much of the inflationary pressure has been compensated by rising rental levels on new developments. 'As with the pandemic, we are seeing tenant demand further strengthen in the region as global occupiers move operations west out of Ukraine, as well as continue to build inventory levels to prevent further supply-side shocks.'

NEARSHORING AND RESHORING

Paradoxical though it may seem when set against the devastating human consequences of the war, this impetus to nearshoring and reshoring of operations is seen by most developers as potentially positive for their business. First triggered by the outbreak of the coronavirus pandemic two years ago, which caused massive disruption to global supply chains and upheaval in container shipping, the trend is expected to accelerate due to the crisis in Ukraine. Indeed, many experts see the military conflict as dealing another major blow to over-globalised and interdependent supply chains, at a time when they were still recovering from the chaos caused by Covid.

'The trend we saw of reshoring and nearshoring production during the pandemic will speed up due to this war and its consequences,' says Hempel. 'For Central European logistics real estate at least, this is an accelerator.' Ultimately, he believes, Europe as a whole will witness a trend of businesses shifting production and inventories closer to home, whether that be Germany, the Benelux or certain regions in France or northern Italy.

Panattoni's Dobrzycki similarly believes that supply chains will continue to shorten as turbulence in global shipping and port congestion continue, prompting companies to search for alternatives.

'There will be more warehousing demand on the Continent for storage purposes and manufacturing capacities,' he says. 'So, on the one hand it will be more expensive to build because of inflation, but on the other hand there will be more tenant demand.' Like Hempel, he believes Central Europe will be in a prime position to benefit. 'There'll be more demand there, which we will try to serve but it will be quite challenging because of all the issues.'

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JAN DIETRICH HEMPEL, MANAGING DIRECTOR GARBE INDUSTRIAL REAL ESTATE

LABOUR ISSUES

A rather more tragic side-effect of the Ukraine war which some developers say they are experiencing is a human resources one – the impact on labour. Dobrzycki, for one, says he has had to deal with a labour crunch at its operations in Central Europe as a result of the war. 'We had a lot of people working in our warehouses and on our construction sites who were from Ukraine. And a lot of those went back to fight the war – I wouldn't say it was 50% of the workforce, but it still made a noticeable impact, so that's another factor which is slowing down construction and ultimately disrupting operations.'

At the same time, he anticipates an increase in the potential labour pool if the war drags on and some Ukrainians who have fled their country decide to stay longer in countries like Poland, Slovakia and Hungary. 'It's difficult to say that the war is creating something positive, but fundamentally for the business it would be positive.'

Garbe's Hempel says much of the skilled labour his company uses for building warehouses comes from Poland or Southeastern Europe – from countries like Romania and the Balkans. 'The shipping industry, including logistics freighters, is being hit far harder by Ukrainians who want to go home and fight than the warehouse construction business.' He points out that labour issues were far more acute during the pandemic, when migrant workers could not travel due to Covid restrictions. 'It's different with this crisis,' he says.

RENTAL GROWTH REMEDY

Many developers are also looking to rental growth as a panacea for the high inflation. 'I think there is room for substantial rental growth,' says Dobrzycki. 'The current spurt in prices might be hard to recover through rents, but after things stabilise there will still be inflation and those higher costs need to be passed on to the customer via higher rents.' He adds: 'In many cases in Europe, rents are still quite low in my opinion, if you look at things from a demand point of view.'

In the UK, too, the demand-supply imbalance on the back of surging e-commerce activity has accelerated rental growth across all regions, particularly through 2021. CBRE says double-digit year-on-year growth was booked in most regions in 2021, with prime rents for UK big box logistics space reaching £20 per ft² by the end of the year.

For the moment, at least, the industry consensus is that the ongoing massive demand for warehousing will offset the short-term headwinds facing it. 'It's clearly not business as usual, but it's business under slightly more difficult conditions,' says Hempel. 'I would tend to be moderately optimistic, because at the same time as there is this negative impact from the Ukraine crisis, we also have some relief from the Covid crisis. I think this is often forgotten in all the discussions about the war and its consequences.'

One factor that could affect Garbe's development business, he says, is if certain materials prove to be in such critical short supply in the next few months that the construction side simply grinds to a halt. 'That would be if the materials you need, regardless of price, are simply not available. Whether this is a scenario that has to be reckoned with I'm not quite sure – I think the likelihood is not

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ROBERT DOBRZYCKI, CEO PANATTONI EUROPE

too big.'

Moreover, he says, Garbe's business model is such that it does not depend on constant development. 'We can develop, and we do, if we have the opportunity, but the bulk of our business is assets under management. In proportion to our existing logistics real estate, new developments are such a small fraction. So if development slows down, it's a pity, but it doesn't put us in dire straits.' As of mid-January this year, Garbe had €9.5 bn of logistics assets under management. Panattoni's Dobrzycki is similarly optimistic about the long-term outlook: 'As with any crisis, the market will stabilise over time. The next few months will be still nervous, but slowly that should ebb away.'

'It's interesting because whenever a crisis starts, people are afraid of demand collapsing – that there's going to be a recession etc. But we are seeing more demand, and even if there is a temporary nervousness on the investors' side and on the funding side, it's going to go away because the fundamentals in terms of real estate investment and development are extremely strong. What we are facing is a short-term shock, and that is what we are managing right now. But demand in our sector is stronger than ever and will continue to stay strong.' ■

Supporting the Ukraine relief effort

Logistics developers were among the first in the real estate industry to support the humanitarian relief effort following Russia's invasion of Ukraine, offering both financial help and assistance in kind.

CTP has committed €10 mln to UN refugee agency UNHCR as well as offering financial support and vacant warehouse space to local relief agencies for emergency supplies at its parks in Hungary, Romania, Slovakia and the Czech Republic. The company has also made accommodation available at its Domeq residential project in the Czech city of Brno and within the Marriott Courtyard hotels in Pilsen, Prague and Brno.

CTP's CEO Remon Vos said the company's 'widespread network of logistics and industrial parks in the countries neighbouring Ukraine mean we have the physical and financial resources on the ground to immediately step up and deliver support at scale to where it is urgently needed'. He added that CTP 'will do more as the situation develops'.

Belgium-headquartered VGP said it had made a charitable contribution of €3 mln to support refugees from Ukraine in Slovakia, Hungary and Romania. The donation is being split equally between the three countries, all of which border Ukraine and where VGP has a long-standing presence. The firm said it 'deplores the violation of international law and the aggression of the Russian regime against Ukraine', adding: 'We stand with the Ukrainian people of whom many are working on our construction sites and have their families and houses shelled.'

'Given how rapidly events are unfolding on the ground, our group will deploy the resources locally, in close cooperation with respective VGP country management, to select humanitarian relief organisations as recognised by UNHCR.

More than five million Ukrainians had fled the war by mid-April, according to figures from UNHCR, with women and children accounting for more than 90% of refugees.

In Poland, Panattoni is part of a group of real estate companies that have banded together to help alleviate the situation for Ukrainian refugees crossing the border. By mid-March, 12 entities were involved in the initiative: besides Panattoni, they include AFI Europe, Atenor, Cornerstone Investment Management, Echo Investment, EPP, Globalworth, Griffin Capital Partners, GTC, HB Reavis Poland, Immofinanz, and Skanska. The companies are converting mostly office space into temporary accommodation in Warsaw. 'The real estate industry is uniting to provide shelter for refugees from Ukraine, which has been attacked by Russia,' the group said in a statement.