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BY MARTEN & CO

PROFESSIONAL

Urban Logistics REIT

REITs | Update | 22 December 2021

In the sweet spot

It has been a whirlwind few months for Urban Logistics REIT (SHED) as it continues to grow rapidly in one of the best-performing real estate sectors in the UK. The group deployed the proceeds of a July capital raise in short order and earlier this month raised a further £250m to plough into a NAV accretive pipeline. The logistics sector is currently in the sweet spot, with high demand for space and a chronic lack of supply resulting in strong and sustained rental growth.

Not resting on its laurels, SHED has an active asset management approach to its portfolio, whereby it has been driving valuations up through lettings, refurbishments and development. Testament to this, the group posted a portfolio valuation uplift of 11.3% on a like-for-like basis in the six months to September 2021 – 71% of which was due to asset management initiatives.

Earlier this month SHED moved its listing from the AIM market to the premium segment of the main market of the London Stock Exchange, which should improve liquidity in its shares.

‘Last mile’ logistics

SHED invests in a diverse portfolio of single-let, urban logistics properties located in the UK with the aim of providing its shareholders with a 10% to 15% total return per annum.

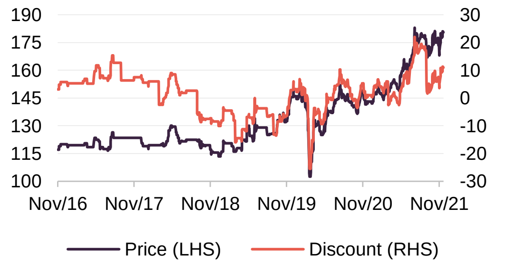
Year ended	Share price total return (%)	NAV total return (%)	Morning-star UK REIT total return (%)	Peer group share price TR (%)	Peer group NAV total return (%)
30/11/2017	9.2	5.1	11.8	11.4	6.2
30/11/2018	1.5	17.6	(2.8)	0.2	15.7
30/11/2019	20.2	18.5	23.3	17.9	10.5
30/11/2020	17.8	5.2	(16.5)	19.2	10.4
30/11/2021	18.4	20.3	29.9	37.0	29.4

Source: Morningstar, Marten & Co

Sector	Property – UK Logistics
Ticker	SHED LN
Base currency	GBP
Price	180.5p
NAV	162.6p
Premium/(discount)	11.0%
Yield	4.2%

Share price and discount

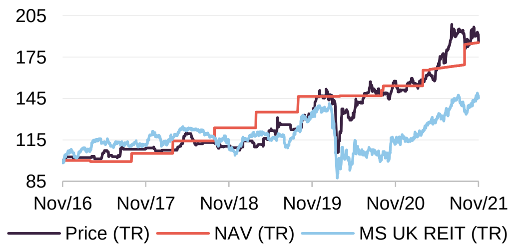
Time period 30/11/2016 to 20/12/2021



Source: Morningstar, Marten & Co

Performance over five years

Time period 30/11/2016 to 30/11/2021



Source: Morningstar, Marten & Co

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Contents

Domicile	England and Wales
Inception date	13 April 2016
Manager	PCP2 Limited
Market cap	£851.9m
Shares outstanding (exc. Treasury shares)	472.0m
Daily vol. (1-yr. avg.)	829.9k shares
Loan to value	16.9%

Click here for our initiation note

Click here for an updated SHED factsheet

Click here for SHED's peer group analysis

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Click here to provide feedback to the company

Click if you are interested in meeting SHED's managers

Click here for links to trading platforms

Market outlook

In our initiation note on SHED, which was published in August this year and can be read by clicking here, we highlighted the steep growth trajectory that the company was on, having just raised £108.3m (its third successful capital raise during the pandemic totalling £336.7m). After deploying all of those proceeds in short order (its portfolio is now worth £660.5m – up 30% in six months to 30 September 2021), the group recently raised a further £250m in a substantially oversubscribed issue. Earlier this month, it also moved its listing to the premium segment of the main market of the London Stock Exchange from the AIM market. This should further increase liquidity in its shares.

The company is in the sweet spot when it comes to property investment. The logistics sector, in which it invests, has favourable demand and supply characteristics that have resulted in heightened and sustained rental and capital value growth (more details follow). This has been intensified during the COVID-19 pandemic, where lockdowns and restrictions have forced the already-growing online retail sector into overdrive.

Urban logistics properties are typically smaller in size and enable the last mile distribution of products to homes or businesses

SHED is the only listed property company that is 100% focused on the 'last mile', or 'last touch' as the manager likes to call it, part of the wider logistics market. It is the part of the market that the manager says is the most supply-constrained, and has also witnessed strong demand growth over the last five years as the prevalence of e-commerce has increased in the UK. The COVID-19 pandemic has only exacerbated this demand growth, particularly from online retailers. This supply-demand imbalance has led to rental growth across the sector.

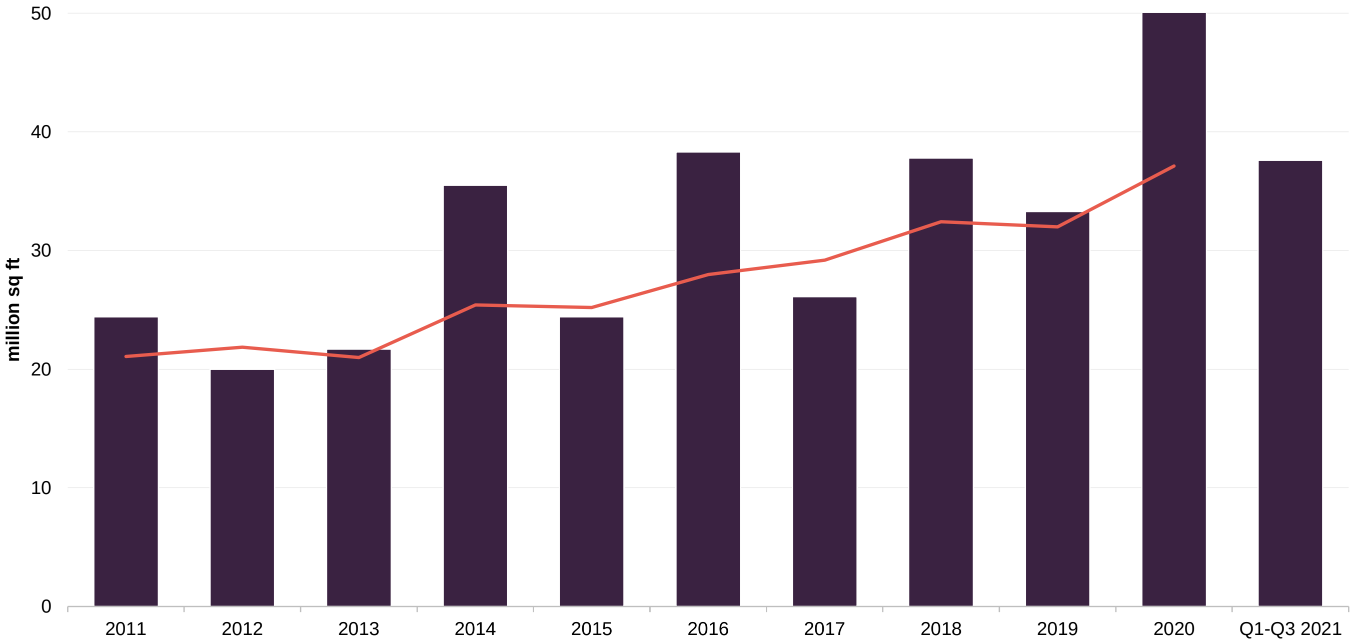
The 'last mile' sub-sector enables the last part of a product's journey in the supply chain to homes or businesses. Tenants in this part of the sector are focused on the distribution of domestic UK products, such as food and pharmaceuticals. SHED's tenants are typically third-party logistics companies and UK businesses that deliver staple domestic products to homes and businesses and require last mile or e-fulfilment services. Facilities are typically 20,000 sq ft to 200,000 sq ft in size and are located close to towns and cities, and on arterial roads.

Demand and supply imbalance leading to rental growth

Take-up of logistics space in 2021 set to break all-time record set in 2020

Demand for logistics space had been growing for a number of years, as shown in Figure 1, but the pandemic has resulted in a surge in these numbers. In the first nine months of 2021, 37.6m sq ft of warehouse space (in units above 100,000 sq ft) has been leased, according to Savills. This not only beats take-up figures for seven of the last 10 whole years, but eclipses the five-year average and puts 2021 on track to be a record-breaking year.

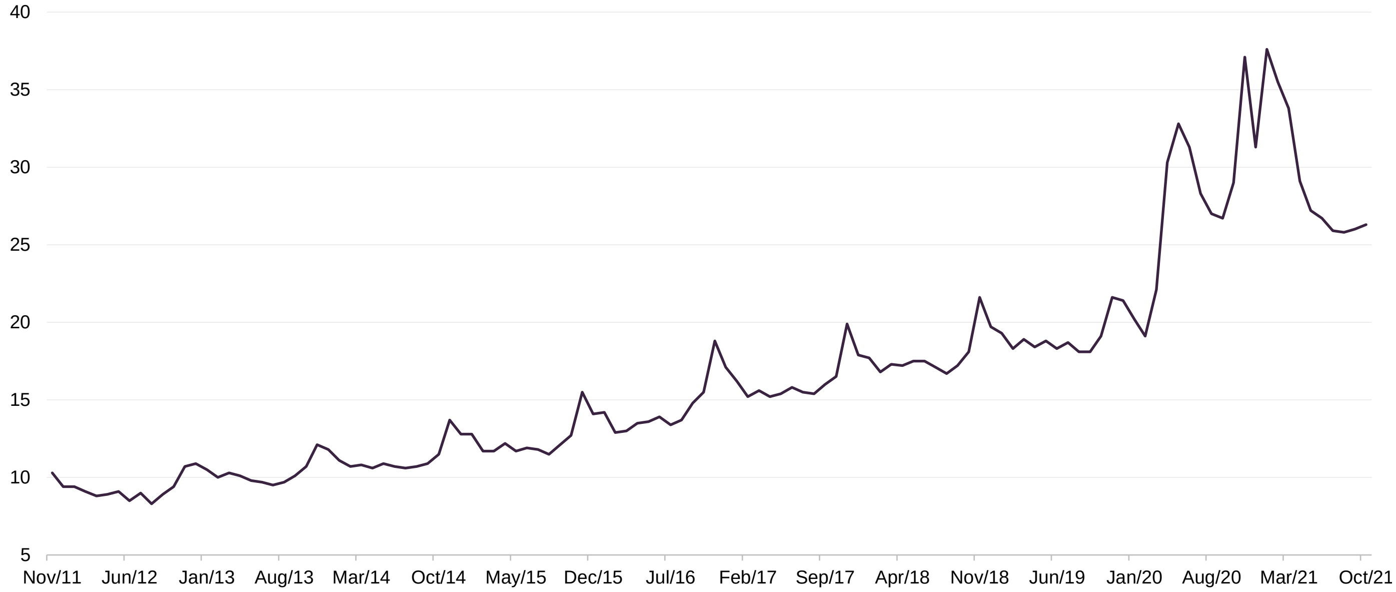
Figure 1: Logistics take-up



Source: Savills Research, Marten & Co

Reasons behind the rise in demand are twofold. Firstly, online retailing – a trend that has accelerated since the pandemic was declared in early 2020. Figure 2 shows the increase of online retail sales as a proportion of all retail sales in the UK. In February 2020, e-commerce accounted for 19.1% of all retail sales in the UK; by October 2021 this had reached 26.3%, having been as high as 37.6% in January 2021 (previous Office for National Statistics estimates suggested the UK would reach 25% by the end of 2022). Whilst COVID-19 has certainly accelerated the trend to e-commerce, Figure 2 shows that this had been building over many years. It is expected that consumer behavioural patterns developed during the pandemic will prevail post-pandemic, and a majority of the new e-commerce demand will stick.

Figure 2: Online retail sales as a percentage of total retail sales in the UK



Source: Office for National Statistics, Marten & Co

Secondly, supply chain resilience. Businesses are looking to strengthen their supply chains, with shorter, more dependable supply chains and greater stock capacity. The dependence on Far East Asia was exposed at the start of the pandemic and events such as the Suez Canal incident in March 2021 further enhanced the argument for a shorter supply chain, resulting in a re-shoring or near-shoring of manufacturing facilities closer to the end consumer. A 'just-in-time' supply chain model had been deemed to be the most cost-efficient by industries, but since the pandemic shut off supply chains from Asia inventory levels have increased to stave off any further supply chain shocks. Brexit and the recent lorry driver shortage have also compounded the issue, giving freight operators a renewed focus on resilience.

> Logistics vacancy rates at all-time lows of 3.62%

On the supply side, the logistics market in the UK continues to be acutely constrained by available space. The vacancy rate is at just 3.62%, according to Savills. SHED's manager believes that the 'last mile' urban logistics sub-sector is the most constrained part of the wider logistics market due to several factors. There is estimated to be 16.67m sq ft of speculative logistics developments underway in the UK, according to Savills, but mainly in the 'big box' sub-sector (units above 300,000 sq ft) where economies of scale can be achieved. There are also long lead times on planning in many areas and a global shortage of labour and materials.

Given these market dynamics, sustained rental growth should follow. Generally, rental growth is seen at a vacancy rate in any market of less than 12%, according to Savills. With a critical lack of supply, with vacancy rates at sub-4% and construction of new-build stock unlikely to see vacancy rates increase, Savills says that it has observed quoting rents grow by as much as 20% in key locations in the UK this year.

Buoyant investment market

£10.8bn has been invested in the UK logistics market in the first nine months of 2021

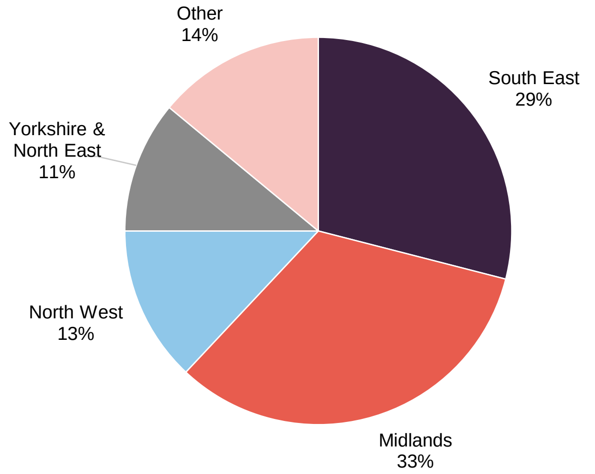
Given the supply-demand characteristics and rental growth forecasts, investors continue to clamber for logistics assets. Investment volumes for the first nine months of 2021 total £10.8bn, according to Savills, surpassing the £10.2bn recorded for the whole of 2020. Driven largely by private equity backers, Savills notes that overseas investors remain the most active, accounting for 52% of all transactions. Investor appetite for the sector has meant values have continued to rise with Savills stating that prime yields have contracted to 3.25%.

Against this backdrop of low yields, SHED's manager believes that the 'last mile' urban logistics assets, which are typically smaller lots sizes of between £5m and £15m, require greater sector knowledge and intensive asset management to extract value. In the six months to 30 September 2021, SHED says that 71% of the 11.3% like-for-like capital uplift in its portfolio valuation was attributed to asset management initiatives rather than market movement, which is quite some going, given the yield compression mentioned earlier (more details on the asset management initiatives that has driven valuation growth is on page 8).

Asset allocation

SHED has a portfolio of 91 assets worth £660.5m (at 30 September 2021) located across the UK, with a focus on the South East and the Midlands. The portfolio has a WAULT of 7.9 years, with a spread of short- and long-term leases.

Figure 3: Portfolio by location



Source: Urban Logistics REIT, Marten & Co

Since the £108.3m equity raise in July 2021, SHED has deployed or committed £134m of capital on new acquisitions. These include a mix of income-producing assets and forward funding development commitments. Income-producing assets include:

- two units in one transaction – a 128,460 sq ft property in Rugby and a 124,134 sq ft property in Huntingdon – for £27.6m at a net initial yield (NIY) of 4.5%;

- a 239,867 sq ft warehouse at Spennymoor, near Durham, let to Stanley Black & Decker, for £8.65m at a NIY of 8.2%; and
- three units in Farnham, totalling 43,958 sq ft for £8.5m and a NIY of 4.5%.

Forward funding commitments financed through the equity raise in July include:

- four units totalling 118,540 sq ft on a business park near Rochdale, as well as a single unit of 44,608 sq ft in Castle Donnington, just off the M1 motorway south of Nottingham, for a combined price of £17.4m and a NIY of 6.2%;
- the redevelopment of a site in Golborne, near Manchester, resulting in a new building of 120,750 sq ft for £13.3m, with an expected NIY on cost of 6.2%; and
- the redevelopment of a 121,078 sq ft vacant warehouse unit on the Walworth Industrial Estate near Andover for a total cost of £11.95m and an expected NIY of 5.8%.

Tenants

Figure 4: Top 10 tenants

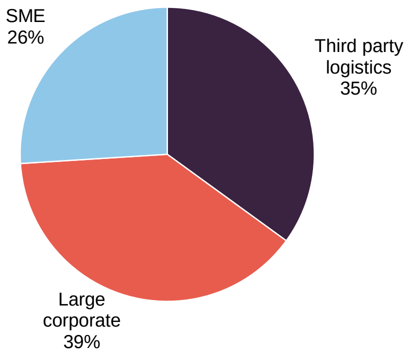
Company	Sector	% of rent
Culina Group	Third party logistics	8.1
XPO	Third party logistics	6.0
Unipart Group	Third party logistics	5.3
Fidens Studios	TV and film location agent	4.8
Giant Booker	Food wholesale	4.1
Kinaxia Group	Third party logistics	4.1
Amazon	Online retail	3.4
CDS Superstores (The Range)	Home retailer	3.3
Pegler Yorkshire Group	Manufacturer	3.3
Central Pharma	Pharmaceutical supply change management	2.9
Total		**45.3**

Source: Urban Logistics REIT, Marten & Co

SHED's top 10 tenants account for 45.3% of its contracted rent and are made up of largely global third-party logistics operators, as shown in Figure 4. The manager states that a large proportion of the SME category (26% of portfolio – as shown in Figure 5) is also made up of smaller third-party logistics companies. 'Third-party logistics' refers to the outsourcing of e-commerce logistics processes and includes inventory management, warehousing, and fulfilment. They typically run contracts for e-commerce companies from their sites. SHED's largest tenant, Culina Group, is the logistics arm of the Müller Group – the multinational dairy giant. The Unipart Group is running a contract on behalf of the NHS. Other top 10 tenants that may not be household names include Fidens Studios, which provides space for Netflix filming productions, and Pegler Yorkshire, which is part of the €5.7bn market cap

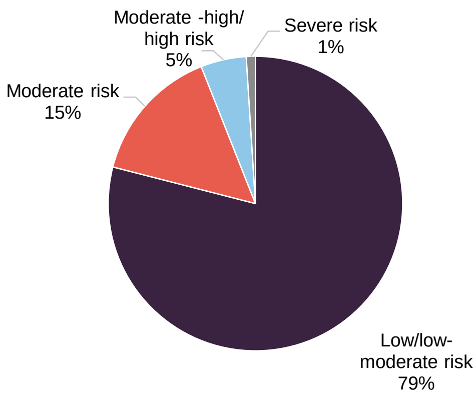
Dutch manufacturing conglomerate Aalberts, which is listed on Euronext Amsterdam.

Figure 5: Tenant diversity



Source: Urban Logistics REIT, Marten & Co

Figure 6: Tenant credit rating



Source: Urban Logistics REIT, Dun & Bradstreet, Marten & Co

Figure 6 shows that 79% of tenants across SHED's portfolio have been rated low/low-moderate risk (as a percentage of contracted rental income) by Dun and Bradstreet, which is reflected in rent collection figures during the pandemic. The company has received near-100% of rent due since March 2020.

Asset management initiatives

SHED likes to buy assets that have asset management potential so that it can drive up capital values. This is mainly achieved through lease events, such as expiries or rent reviews, and also includes refurbishments. During the six months to 30 September 2021, SHED completed 15 lettings or rent reviews, achieving like-for-like rental growth of 29.8% overall and generating an additional £1.6m of annual rent.

Being able to grow the valuation of its portfolio through asset management (74% of portfolio valuation uplift since inception has been due to asset management initiatives) allows SHED to control its LTV. The value of the portfolio is less reliant on the wider market, meaning that it is somewhat shielded from a turn in market conditions and valuation falls.

SHED can also drive value through developments (no more than 10% of gross asset value is permitted to be deployed on developments at any one time). Since IPO, SHED has completed £56.7m of forward funding developments and major refurbishments at a 6.2% yield on cost. The projects have been valued (at 30 September 2021) at a 29.9% uplift on cost. Lettings have been achieved on 87% of the space, 100% including rent guarantees. The group has a further committed development pipeline with a gross development value (GDV) of £71.6m, which is expected to generate £4.5m in annual rent and provide a 6.0% yield on cost.

SHED states that risks associated with inflation rises in construction is met by its developer partners, with fixed-price forward funding costs set at the outset. SHED bears the letting risk.

Equity raise and pipeline

On 2 December, SHED raised £250m through an oversubscribed placing of shares at 170p per share (a 4.9% premium to adjusted EPRA net tangible assets (NTA) – a new reporting measure replacing EPRA NAV for property companies) and will now look to deploy those proceeds on its acquisition pipeline. The pipeline is worth in excess of £400m, has a net initial yield of 5.4% and has a South East and Midlands focus. It has a WAULT of 8.4 years (to expiry – 7.8 years to first break) and an average rent of £6.02 per sq ft. The manager says that it expects the proceeds to be deployed within three to six months.

On 20 December, the group announced the first acquisitions following the equity raise, buying four assets for £28.6m, reflecting an average NIY of 5.82%. The assets, three of which are income producing and the fourth a forward funding development project, comprise:

- Elland Road, Leicester - A distribution depot off the M1 motorway totalling 27,115 sq ft, the site is a parcel delivery hub let to the Royal Mail Group. The purchase price paid was £3.18m at a NIY of 5.0%;
- Caswell Road, Northampton - a 22,783 sq ft warehouse let to Tuffnells Parcel Express until 2031. The purchase price paid was £5.6m at a NIY of 5.7%;
- Riverside Park, Dundee - a warehouse facility of 117,031 sq ft near the airport, in Dundee. The purchase price was £6m at a NIY of 6.0%. The site is occupied by Hermes Parcelnet and presents asset management opportunities to achieve a strong reversionary yield; and
- Newhall Road, Sheffield - the company has entered into an agreement to forward fund the development of a new logistics unit in Sheffield. The agreement is subject to planning, and the development is expected to complete in November 2022, and will comprise a warehouse of 131,500 sq ft. The project is targeting a 6.0% NIY on cost.

Figure 7: SHED's acquisition pipeline

Location	Price (£m)	NIY (%)	Annual rent	Rent per sq ft	WAULT (years)
South East	103.4	5.2	£2.1m	£8.09	5.6
Midlands	180.5	5.4	£10.0m	£5.84	7.9
North West	38.0	5.1	£2.0m	£5.91	11.2
Yorkshire & North East	90.2	5.5	£5.5m	£5.82	9.2
Total/Average	**412.1**	**5.4**	**£19.6m**	**£6.02**	**8.4**

Source: Urban Logistics REIT, Marten & Co

Performance

Figure 8: SHED performance over five years

Source: Morningstar, Marten & Co

SHED's NAV has made strong progress since its inception, as the portfolio has expanded and valuations increased through a combination of asset management initiatives and market movement. At its last valuation report, at 30 September 2021, the group's EPRA NTA rose 7.3% in the six months.

Peer group comparison

Figure 9: Peer group analysis

	Market cap (£m)	Premium/ (discount) (%)	Yield (%)
Urban Logistics REIT	852	11.0	4.2
Warehouse REIT	718	12.1	3.7
Tritax Big Box REIT	4,453	28.5	2.7
SEGRO	16,702	56.1	1.6
LondonMetric Property	2,691	28.4	3.2

Source: Morningstar, Marten & Co

Figure 10: Peer group analysis – performance over one-, three- and five-years*

	1-year NAV TR (%)	3-year NAV TR (%)	5-year NAV TR (%)	1 year price TR (%)	3-year price TR (%)	5-year price TR (%)
Urban Logistics REIT	22.3	49.0	79.2	18.4	67.7	85.9
Warehouse REIT	35.7	68.2	-	42.5	93.5	-
Tritax Big Box REIT	29.3	51.8	94.8	48.6	98.8	123.5
SEGRO	28.9	64.0	127.3	57.5	152.1	304.6
LondonMetric Property	27.6	43.8	100.1	28.2	73.7	135.0

Source: Morningstar, Marten & Co. Note*: performance calculated to 30 November 2021

Click here for an up-to-date comparison of SHED and its Property – UK Logistics peer group

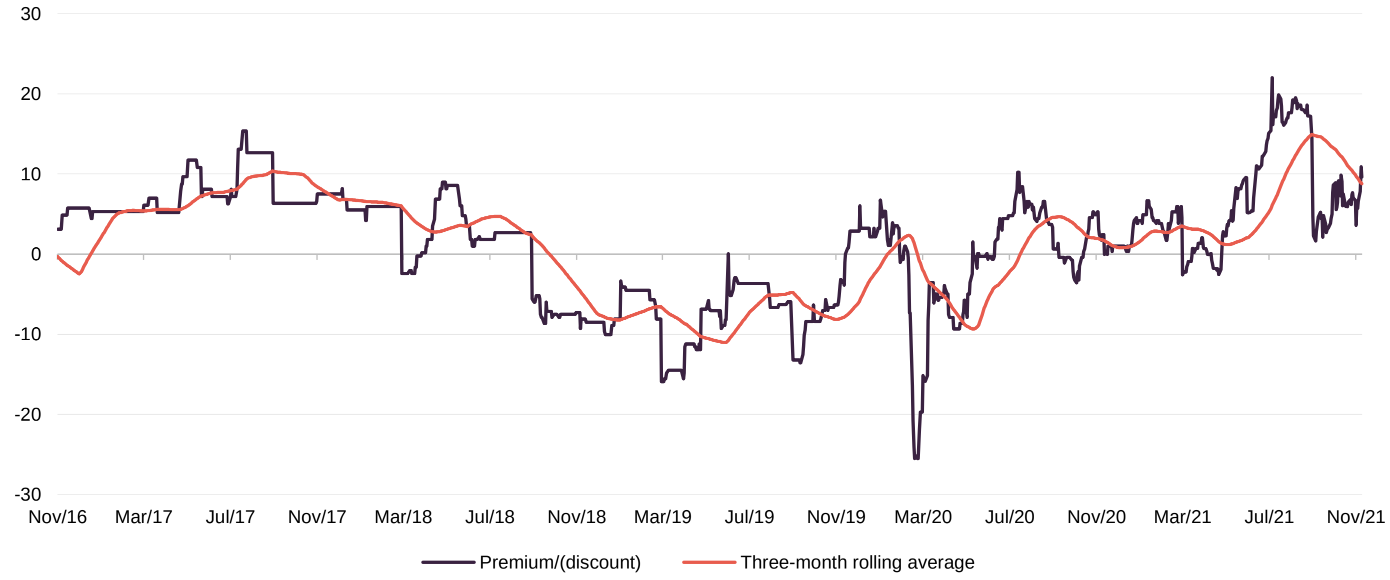
SHED is listed in the Property – UK Logistics sector by the AIC, which also comprises Warehouse REIT and Tritax Big Box REIT. As previously mentioned, there is no other listed company that is exclusively focused on the urban logistics sub-sector and therefore it is difficult to make a like-for-like comparison. Warehouse REIT's portfolio is more focused on multi-let industrial assets (which have a completely different tenant base type), while Tritax Big Box REIT is focused on the larger end of the logistics market (warehouses in the 500,000 sq ft plus size range), which perform a different role in the supply chain to urban logistics. We have included other listed property companies focused on the industrial and logistics sector for further comparison. SEGRO is by far the largest and has a mixed portfolio of big box assets, urban logistics and developments. LondonMetric has a big weighting to urban logistics assets, but also owns big box and a separate long-income portfolio.

SHED is on the smaller end of the peer group, for now, but has a comparable NAV total return performance and a superior dividend yield. Its share price total return performance has lagged its peers, however.

Premium/(discount)

SHED has fluctuated between trading at a discount to NAV and a premium for much of its existence (the early days were skewed by a lack of liquidity in its shares). Its share price slumped in March 2020 as part of a wider market sell-off as the COVID-19 pandemic hit, with its discount widening to around 25%. It quickly regained its losses and as the market recognised the strength of its portfolio and the logistics market, its rating moved to a premium. On 20 December 2021 it was trading at an 11.0% premium.

Figure 11: Premium/(discount) over five years



Source: Morningstar, Marten & Co

Fund profile

> The fund's website is urbanlogisticsreit.com

SHED invests in and manages a portfolio of urban logistics assets – defined as smaller single-let warehouses (in the 20,000 sq ft to 200,000 sq ft size range) located close to major conurbations across the UK – which is diversified by tenant. SHED is the only real estate investment trust (REIT) wholly focused on these assets. The strategy aims to capture rental value growth through active asset management initiatives and upward momentum in rents and capital value.

SHED was initially listed on the AIM market of the London Stock Exchange on 13 April 2016 as Pacific Industrial & Logistics REIT. The group deployed the capital (and debt) from its IPO into a portfolio of 11 urban logistics property assets across the UK and has since made several successful placings to grow its portfolio. It now has a portfolio of 91 assets, worth £660.5m at 30 September 2021.

Moved to a premium listing on the London Stock Exchange

As mentioned earlier, SHED's share capital was admitted to the main market of the London Stock Exchange on 7 December 2021, having traded on AIM since inception. The move should increase liquidity in its shares. SHED has a conservative capital structure and a measured approach to the use of debt, with a target loan to portfolio value (LTV) of 30% to 40%. At 30 September 2021, the group's LTV was 16.9%.

The manager – PCP2 Limited

The company's manager is PCP2 Limited – part of the Pacific Investments Group, which was founded by Sir John Beckwith and has an extensive track record in real estate, having developed more than 65m sq ft of real estate assets globally. SHED's manager is led by Richard Moffitt and Christopher Turner. Richard is chief executive and looks after investment management, while Christopher looks after the asset management. They are backed up by the financial team, led by Stuart Roberts.

Both Richard and Christopher have considerable sector knowledge and have a long track record of success in logistics and real estate, built up over more than 25 years. The manager identifies and acquires assets (the majority of which have been off-market, utilising its contacts and reputation in the sector) and implements its asset management strategy to create value for shareholders.

Previous publications

QuotedData has published one previous note on SHED – *Shed load of growth to come*. You can read it by clicking the link.

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