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Tritax big box bonanza

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With the establishment of a new REIT, Tritax is heading all guns blazing into what it believes to be the growing market of megasheds. Property Week talks investment and strategy goals with Colin Godfrey.

Tritax partner Colin Godfrey could certainly be described as bullish about the future of newly formed Tritax Big Box REIT, which has the satisfying ticker BBOX: "We want to be a market leader that redefines REITs in the UK."

This is an institution that has set its sights on not only conquering the sheds market in the UK, but setting new benchmarks for REITs. Outlining an ambitious acquisition plan, along with intentions for a further fundraising later this year, Godfrey is clearly passionate about its ambitions for "the most exciting time of my career".

Tritax's REIT was established in November 2013, and by December had raised £200m to invest in its specific target market: sheds and warehouses sized from 500,000 sq ft up to 1m sq ft. BBOX's first purchase was of Marks & Spencer's environmentally excellent 900,000 sq ft megashed in Castle Donington for £82.6m, representing a yield of 5.2%, closely followed by the acquisition of a 585,000 sq ft shed for £48.75m, let to Sainsbury's with an unexpired lease term of at least 13 years, representing a yield of 6.65%. Godfrey says that another offer is currently in the pipeline, with the aim for up to five more to complete in the next four months.

Setting up the REIT was a logical step for Tritax, explains Godfrey. Since being established in 1996, the company has acquired and developed more than £2.1bn of property assets , and its current portfolio has an acquisition value of around £1.2bn. Over the years Tritax has moved towards larger assets.

“It was a natural evolution for Tritax to move into the institutional marketplace, and the REIT was a natural solution to that,” says Godfrey. “We started the process about two years ago, and we’ve been peddling the bike since then. We’ve been fortunate in the timing of bringing our offer to market, as the city has been a lot more buoyant.

“In some ways the market wasn’t ready to listen when we launched, however, but we knew the timing was right for us. We felt that the market for big-box distribution was mispriced and saw an opportunity to springboard from our expertise in the sector and take advantage of the seismic
change going on in the UK economy and in the way we shop.”

This seismic change, as Godfrey describes it, is the bedrock of the REIT’s philosophy. The focus on sheds alone stems from a belief that distribution networks are fundamentally changing as e-tail continues to grow, and that yields as they stand today do not reflect the big opportunity megasheds present. And Godfrey has a convincing argument for the growth of this segment.

“Retail is morphing through the back door into megasheds,” he observes. “They’re the quasi shops of the future, of today. Everything stems
from megasheds.”

Statistics surrounding the growth of e-commerce and “click and collect” back up Godfrey’s belief that the amount of stock passing through warehouses towards smaller distribution hubs is only heading one way. Online sales now account for 10%-13% of total retail sales in the UK and are set to increase to 20%-25% by 2020. As a result, sheds are growing in size as retailers and distributors need more eave height to house the technology required for sorting and picking stock, as well as to cope with stock moving in and out ever faster as next-day and even same-day delivery become the norm.

Godfrey also argues that the UK is the perfect country to cope with these changes in logistics. Unlike in Europe, where distances between locations are often much greater leading to high fuel and staff costs, the UK has a mature infrastructure. “To some degree, same-day delivery is only deliverable because of the peculiarity of the UK and the density of the framework,” he says.

Equally convincing is Godfrey’s argument for why rent and yields can only improve for the sector. “The traditional understanding for the relationship between the main property sectors and yields is based on a preconceived understanding of the drivers that affect them.”

Godfrey compares yields in different sectors; for high street retail, the value of a shop is vested in its exclusive position, which drives rental growth year on year and is why retail yields are 4%. Retail shops have little obsolescence, and do not degrade over time. Offices, on the other hand, have a high level of obsolescence in their fabric, so yields are higher and rental growth is not so high. Industrial yields have been high because there has so far been a plentiful supply of land and few planning constraints. As businesses have outgrown space and do not want an older building, they have paid for a building nearby to be developed. This has held back rental growth, which is reflected in the yield.

“We believe this has been turned on its head,” says Godfrey. “The obsolescence factor for megasheds is now much less, because they are harder to come by. The supply and demand factor will keep up demand, so we see strong prospects for rental growth moving forward. Our belief is that the industrial megabox has and will continue to see yield compression. This is not a short-term seismic shift, but a long term structural change in the economy. This is a change for years to come.”

Plan of attack

“Our aim is to have six or seven assets using the £250m of equity, £160m of debt that we have initially,” explains Godfrey. “So far we’ve spent £130m, which will be £175m if our current purchase completes.

“We have a target of being fully invested in six months and I believe we’re ahead of the curve. We’re pleased with our assets so far although yields have definitely tightened in the market. The last deal was, in my view, the best asset in the market bar none. It has the eaves height, right size and location and 23 years’ unexpired to Marks & Spencer with a fixed increase review pattern.

“Subject to properties being available, we hope to come back in the autumn or winter to further fundraise for another sum, a little larger than the initial raise. Our ambition is to increase the REIT to a net asset value of £1bn, and I believe this is eminently achievable.“

Overall, the REIT is aiming to achieve a blend of secure long-term income streams with more opportunistic assets, such as the acquisition of the Sainsbury’s shed which offers opportunities to work with the tenant. Godfrey adds that working with tenants in terms of their changing needs, and even business development overall, is further part of the company’s philosophy.

“Our belief is that historically the relationship between landlord and tenant has been at arm’s length,” he argues. “The landlord collects the rent and has words at rent review. We’re looking to build relationships with tenants, to understand their business and what makes them tick and how we can help them to expand. This means being flexible and building a multi-tenant mix across the UK.”

Again, the argument behind this approach appears logical. Occupiers are increasingly investing in high-tech picking technology, which is very often bespoke and can cost up to three times the value of the shed itself. If an occupier is willing to make such an investment, chances are it will stay put and become a long-term tenant. The longer the lease, the higher quality the tenant.

Tritax Big Box REIT does not restrict its current asset search to any one area, although location is the main consideration, says Godfrey. The north-west, M1 corridor, the Midlands, the M25 belt and the south-west are all options, and the asset list currently being considered comprises about 25 properties.

The search is limited to existing buildings and prelet, forward-funded sites rather than speculative development. For the 50 acres needed to build a megashed, along with modern requirements such as enough power, a developer needs to have a tenant to justify the investment of such a large amount of money. The eave height needed to house modern technology can cost twice as much as a shed of a more modest, traditional height, and planning permission can be tricky, because planning authorities need to be assured that traffic flows would remain steady on nearby motorways.

Marks&Spencer's shed in Castle Donington received a BREEAM excellent rating and is carbon neutral

Instead, developers will identify land, put in the infrastructure and market the oven-ready site to potential occupiers. And the occupiers will come, believes Godfrey, who highlights Marks & Spencer as an example of a retailer that currently has a requirement for four more sheds of 900,000 sq ft with multiple mezzanines. As more outgrow their current homes and develop their omni-channel strategies, the race will be on to find space.

Though the aim is to spend a lot of money in the next six months, it is not about speed, emphasises Godfrey, it is about the right product. The majority of assets are off market, and have been sourced using Tritax's deep contact book and relationships within the investor agent community.
"We've been very active to approach owners," he reveals. "We have our fingers very much on the market pulse; you have to. Now we've launched BBOX, a lot of people have come to us directly and recognise that we're focusing purely on a subsector."

This very specific focus is how Tritax is aiming to shake up the UK REITs market. "When you look at the spectrum of REITs, it's a real mixed bag underpinned by traditional property companies with a cross section of expertise," he explains. "In the US, the REIT market is very much like a supermarket shelf, where you have the ability to buy shares in a subsector. The UK needs these subsectors to give investors the chance for stock selection."

Though this approach could be described as putting all Tritax's eggs in one basket, Godfrey does argue compellingly for why this is a good idea. There are other prospective competitors in the megashed space undoubtedly, such as the mainstream institutions and, with yields compressing, others may crowd into this market. But the REIT does seem somewhat ahead of the game.

“I would argue that a business could either cover the whole market, which brings danger of not doing anything well, or make sure that it is the best advised and has the best understanding of the area. I believe that key to delivering value to the investor is in allowing people to understand the subsector and putting all our energy into it.”

Energy is not something Godfrey is short of, and the path for spending the first round of funding seems to be reasonably clear. When it comes to further fundraising, the REIT is confident of increased interest.

Godfrey argues that the main reason that Tritax Big Box REIT has attracted such interest is because this e-tail phenomenon is visible to all: “You can touch and feel this; you can see the message of what’s happening to retail day to day in the press and how we’re shopping. Everyone gets this message from all walks of life. That’s why we’ve caught the imagination of the market and have a deep pool of investors right across the spectrum. Megasheds are the nucleus of e-tail.”

The newly formed reit has bought the Leicestershire shed from Aprirose Real Estate Investment, which forward funded the development by First Industrial and Clowes Developments for £73m in 2011.

It is let to Marks & Spencer for the next 23 years and the purchase price of £82.6m reflects a net initial yield of 5.2%. Completion of the deal is expected on Tuesday. The purchase will initially be funded out of equity proceeds, with senior debt finance expected to be introduced in the near term. It is located adjacent to a rail freight terminal.

Colin Godfrey, partner at Tritax, said:

“This is one of the tallest and most efficient distribution units in the UK. It was purpose-built for Marks & Spencer to meet the needs of their online and national store distribution requirements. It provides only the second facility of its kind for Marks & Spencer and Tritax Big Box Reit is delighted to become their new landlord.”