RESEARCH

LOGISTICS & INDUSTRIAL

OCCUPIER & INVESTMENT MARKET COMMENTARY **H2 2014**

Economic overview

The UK economy continues to strengthen, supported by the sharp fall in oil prices. Growth of 0.5% was recorded in Q4, according to official data. This brings annual growth for 2014 to 2.6%, up from 1.7% in 2013, and the economy's best performance since 2007. The Bank of England is forecasting 2.9% GDP growth in 2015.

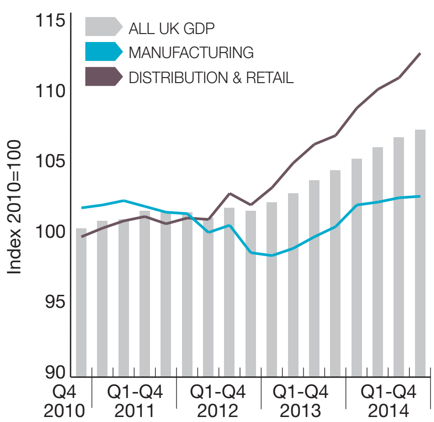
Of more direct relevance to logistics, UK Distribution and Retail remains one of the strongest performing economic sub-sectors, recording annual growth of 5.3% in Q4 2014. However, UK manufacturing output is flat with below average annual growth of 2.1% in Q4 2014 (Figure 1).

Occupier market

In line with improving economic growth, occupier demand is strengthening. A total of 23 million sq ft of units above 50,000 sq ft was acquired for occupation in H2 2014. This is 3.5% higher than H1 2014 and 19% above the five-year bi-annual average. It also brings the total for 2014 up to 45 million sq ft (Figure 2).

FIGURE 1

UK Economic output indices



Source: ONS

Market activity in the second half of the year was mostly concentrated in the Midlands, which saw 11.5 million sq ft of take-up, accounting for half of UK logistics take-up in 2014.

Not surprisingly given the acute shortage of existing supply, 'built-to-suit' deals amounted to 7.3 million sq ft in H2, the highest level seen since before the downturn. The Midlands also dominated pre-commitment activity in H2, with 5.0 million sq ft, which accounted for 68% of the total.

While there remains a shortage of good quality standing stock across the UK, the situation is most acute in the wider South East and Midlands regions, the latter of which has only six months' worth of supply now available following the exceptionally high level of take-up of 11.5 million sq ft in H2.

The diminishing supply of new and good quality distribution space across all size categories is leaving occupiers with a lack of choice. The restricted choice of accommodation in the market has in effect given landlords the advantage to reduce incentive packages across all regions, this has subsequently been followed by a lengthening of lease terms, effectively narrowing the level of flexibility standing stock typically offers compared with design and build solutions.

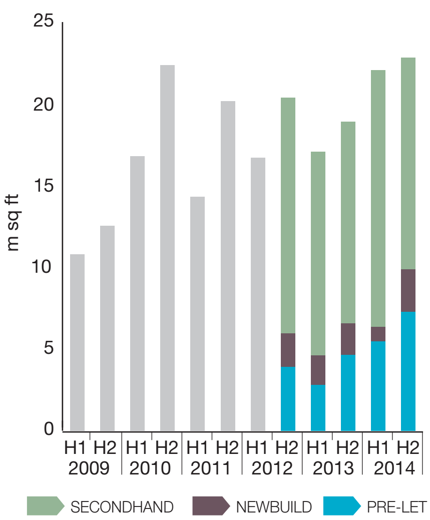
In the big-shed market, supply of units above 100,000 sq ft now stands at just 6.4 million sq ft, down 78% from its peak in Q1 2008 (Figure 3). While speculative development of units in excess of 50,000 sq ft increased by 80% during the period to stand at 2.5 million sq ft across 13 schemes.

With occupier demand strengthening, supported by economic growth and the benefits of lower fuel prices, and availability trending down, we expect to see more speculative development and further increases in prime headline rents in 2015, particularly across the South East and Midlands markets, where take-up is concentrated and where the imbalance is most acute.

Please refer to our regional LOGIC reports for more detailed commentary.

FIGURE 2

UK Logistics take-up (50,000 sq ft plus)

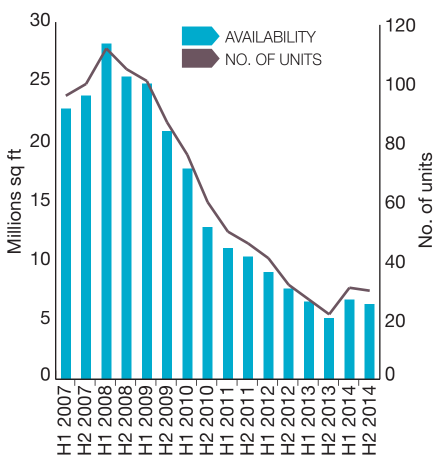


Source: Knight Frank Research

FIGURE 3

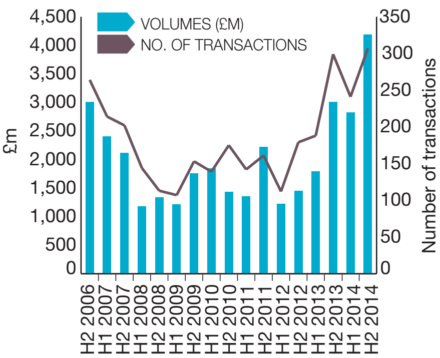
New sheds available (100,000 sq ft+)

Includes speculative development



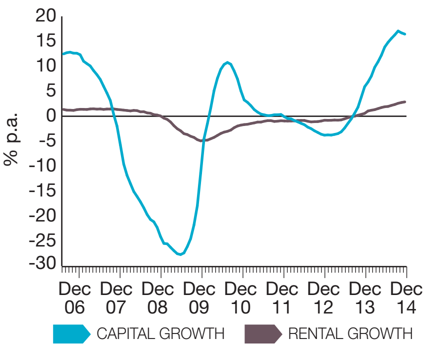
Source: Knight Frank Research

FIGURE 4
Industrial investment transactions



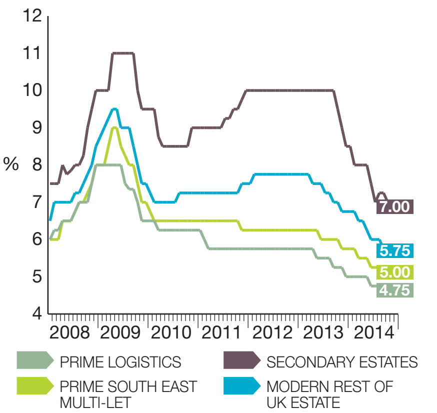
Source: Property Data / Knight Frank Research

FIGURE 5
Industrial sector performance



Source: IPD

FIGURE 6
Single-let and multi-let warehouse yields



Source: Knight Frank Research

Investment market

The latest figures from Property Data show the strength of investor appetite for UK industrial stock. Total investment in this sector during the second half of 2014 rose to £4.2bn. This is 39% above the same period last year, bringing the total for the whole of 2014 up to a new record high of £7bn (Figure 4).

UK institutions and quoted property companies were the most active investors during 2014, while overseas investors continued to capitalise on an improving market by realising their profit.

The positive fundamentals of supply shortages and strong occupier demand are reflected in recent industrial performance. The IPD Monthly Index shows that this sector achieved a 21-year high total return of 24.4% over the 12 months to December 2014. Industrial performance in 2014 was underpinned by strong capital growth and the long awaited return of positive rental growth (Figure 5).

The sheer weight of money targeting this sector has helped push prices up. Over the past 12 to 18 months we have seen significant yield compression resulting from the strong levels of investor demand for prime product. Yields for prime multi-let and secondary estates hardened further during H2, moving in by 25 bps in the six months to December. Yields for single-let distribution however remained broadly unchanged at 4.75% (Figure 6).

Moving forward, the outlook for the Industrial sector in 2015 is positive, driven by a strong occupational market and continuing investor demand. The latest IPF consensus forecast shows that this sector is expected to outperform the All Property average in 2015, achieving an average total return of 13%, compared with a UK-wide industrial average of 12.4%. Longer term industrials are forecast to be the lead performing UK sector providing average annual returns of 7.9%, between 2015-19, compared with an All Property average of 7.2%.

Selected warehouse / logistics transactions in H2 2014

Property	Vendor/Purchaser	Price	NIY	Date
Fairfield Trade Park, Villiers Street, Kingston	Aberdeen Asset Management/DTZ IM	£12.22m	5.15%	Sep-14
Toyota, Magna Park, Lutterworth	Chubb Pension Fund/Aviva Investors	£17.45m	5.39%	Nov-14
Bunzl & DAU Draexlmaier, Birch Coppice, Tamworth	IM Properties/Aberdeen Asset Management	£33.73m	5.06%	Nov-14
West Ham Industrial Estate, Basingstoke	La Salle IM/CBRE Global Investors	£39.96m	6.31%	Nov-14
Next Distribution Unit, West Moor Park, Doncaster	Next Plc/Legal & General	£66.70m	4.40%	Dec-14
Endeavour Park, Southampton	Canmoor & Harbert/Aviva Investors	£37.50m	5.15%	Dec-14

Source: Knight Frank Research

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