

H1 2013 LOGISTICS & INDUSTRIAL

Occupier & investment market commentary

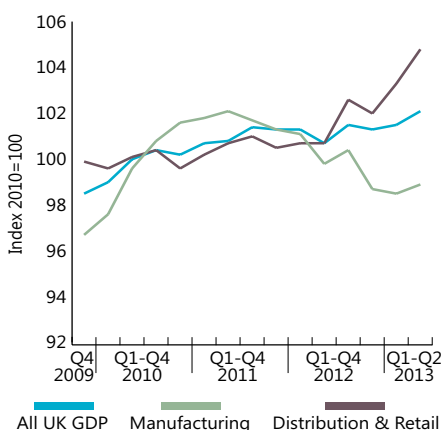
Economic overview

Official data for the UK economy indicates that growth is not only returning to trend but is also broad-based. Preliminary figures from the ONS reveal that UK GDP expanded by 0.6% in Q2 2013, rising from 0.3% in Q1 (Figure 1). The outlook is also improving. The National Institute of Economic and Social Research predict UK GDP growth of 1.2% in 2013, double the Government's official estimate of 0.6%, published in March.

With particular relevance to logistics, Distribution & Retail is one of the UK economy's lead-performing sectors, recording growth of 1.5% in Q2. The structural shift towards e-commerce is also stimulating market activity. Online purchasing is making up an ever-expanding share of UK retail sales, with, for example, John Lewis reporting a 17.2% growth in online sales over the first half of its financial year.

While the performance of UK manufacturing has been less sanguine, the sector recorded growth of 0.4% in Q2 following two successive quarters of contraction. Moreover, recent evidence points to stronger growth in the second half of 2013, with Markit's Purchasing Managers Index (PMI) for manufacturing hitting its highest level in two years during July.

Figure 1
UK economic output



Source: ONS

Occupier market

For units above 50,000 sq ft, total UK-wide take-up was a robust 18.1m sq ft in H1 2013, down 12% on H2 2012's strong total, but 8% above H1 2012. New-build space accounted for 10% of H1 take-up, while pre-let design and builds accounted for 20% of take-up with major deals seen in London & the South East, Midlands and North West (Figure 2).

H1's largest pre-let saw Marks & Spencer agree to build a 900,000 sq ft distribution hub at DP World's London Gateway Logistics Park, Essex. The deal marks the first commitment at what is set to be Europe's largest logistics park, at 9.25m sq ft when fully built-out. Other significant pre-lets in H1 included John Lewis at Magna Park, Milton Keynes (625,000 sq ft) and Asda at Omega South, Warrington (600,000 sq ft).

UK retailers continue to drive demand in the shed market, including the supermarkets, discount retailers and those seeking to enhance their multi-channel offering, such as fashion retailers. Following on from H2 2012, H1 also saw continued activity among parcel carriers, as they seek to capitalise on the burgeoning growth in online orders.

Across all size formats, the UK's supply of new and good quality industrial stock is becoming increasingly scarce. For example, in the big-shed market (100,000 sq ft+), new build supply stands at an eight year low of 6.6m sq ft and is down 77% from its peak in Q1 2008 (Figure 3).

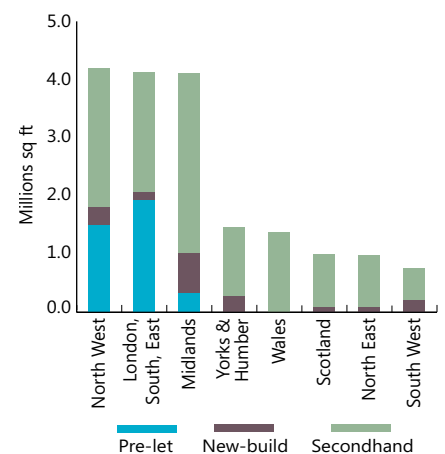
While the supply situation has long provided a strong case for speculative development, viability concerns over achievable rental levels and lease terms have been a barrier to new construction. However, incentive packages have reduced sharply across many key markets and, with the funds under increasing pressure to spend, we expect speculative development to spread to other regions beyond Greater London over the next 12 months.

A number of developers have been actively readying their sites in preparation for new development over the past six months. While

isolated cases of spec-build are expected in the big shed market, the majority of larger requirements will continue to be satisfied through the traditional design and build route. Instead, speculative activity will focus on smaller schemes, where landlords can be more confident of securing tenants on longer, less contract-driven, leases.

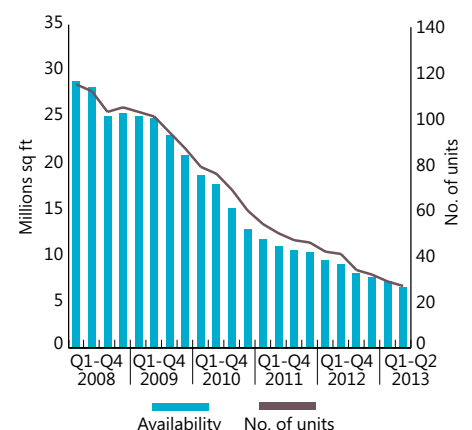
For more detailed commentary on the occupier markets, please refer to our regional LOGIC reports.

Figure 2
H1 2013 take-up (50,000 sq ft+)



Source: Knight Frank

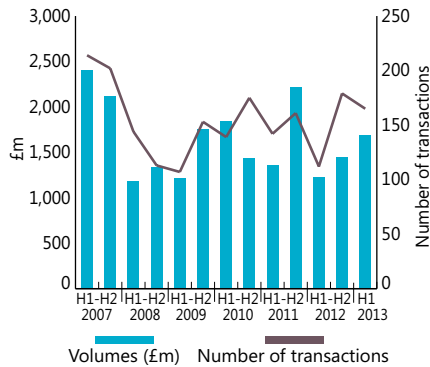
Figure 3
New sheds available (100,000 sq ft+)



Source: Knight Frank

Figure 4

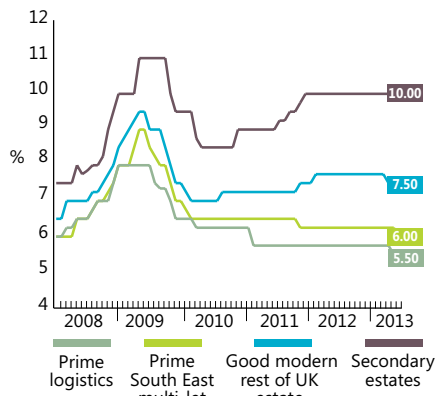
Industrial investment transactions



Source: Propertydata.com

Figure 5

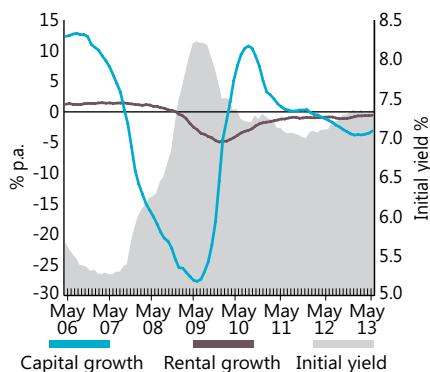
Warehouse and industrial yields



Source: Knight Frank

Figure 6

Industrial sector performance



Source: IPD

Investment market

Spring brought a marked improvement in investment demand, with activity driven by renewed pressure to spend among the UK Funds. Transaction volumes reached a robust £1.69bn in H1 2013, 17% above the total for H2 2012 and 37% above the H1 2012 total. Moreover, underlining the improving depth of demand, H1 comprised 165 deals, up 47% on the same period last year (Figure 4).

Portfolios and large-lot sizes continue to attract healthy interest from both domestic and overseas investors in search of long income streams. H1's headline deal saw ProLogis and Norges Bank IM purchase the LondonMetric portfolio in a joint venture for £248m, reflecting a 6.25% NIY and a price significantly above book value. H1's largest deal for a single estate was Henderson's £74m purchase of RD Park, Hoddesdon, reflecting a 6.55% NIY.

The clearest improvement in sentiment during H1 related to single-let assets further up the risk curve, particularly those offering mid-term income, (i.e. 5 to 10 years) in tightly supplied markets. One such deal in July comprised LondonMetric's £51.4m purchase of Marsh Leys, Bedford, which is occupied by Argos with 9.5 years remaining on the lease (Table 1).

Investors' heightened appetite for risk is also reflected in a number of short-income deals (i.e. 5 years) for prime quality distribution in H1. This is particularly significant for the market, as third party logistics operators typically take on shorter, contract driven leases, and make up a key element of occupier demand. A notable example in H1 was Henderson Global Investors' purchase of 310 Trafford Park, reflecting an approximate 7.00% NIY.

While increased interest in shorter income is partly true of other sectors, it has arguably been most pronounced for logistics, where investors are being increasingly drawn to both the structural rise in occupier demand (related to the expansion of e-commerce) and the scarcity of good quality supply which has come to characterise the sector.

The increased weight of money in the market has driven up values, with deals taking place towards the end of H1 at prices that were unthinkable earlier in the year. Unsurprisingly, yields hardened across the industrial and logistics sector in H1 (Figure 5). Prime yields for single-let 20-year income with fixed RPI uplifts moved in by 25 bps to 5.50%, while 15-year income hardened to 6.00%. Demand for multi-let remains concentrated in the wider South East region, with prime yields hardening from 6.25% to 6.00% during H1.

Table 1

Selected warehouse / logistics transactions in 2013 to date

Property	Vendor/Purchaser	Price	NIY	Date
LondonMetric Portfolio (11 distribution assets)	LondonMetric Property / Prologis, Norges Bank	£247.56m	6.25%	Jun-13
RD Park, Hoddesdon, Hertfordshire	Goodman, SWIP / Henderson Global Investors	£74.00m	6.55%	May-13
Argos, Marsh Leys, Bedford	Private / LondonMetric	£51.42m	7.00%	Jul-13
Unit 1200 & 1300, Magna Park, Lutterworth	Nissan / M&G Investments	£27.00m	8.48%	Jun-13
Merlin 310, Trafford Park, Manchester	Aviva / Confidential	£19.80m	7.06%	Jun-13
Newton's Court, Dartford (multi-let)	Hermes / Ignis Asset Management	£18.00m	6.42%	Jun-13

Source: Knight Frank

Commercial Research

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