RESEARCH

Knight Frank

LOGISTICS & INDUSTRIAL

OCCUPIER & INVESTMENT MARKET COMMENTARY **H1 2016**

Economic overview

UK economic growth accelerated to 0.6% in Q2 2016, up from 0.4% in the previous quarter, according to the latest official preliminary estimate. Given that this period encompassed great uncertainty in relation to the EU referendum, such economic performance exceeded expectations. The pick-up in economic activity was boosted by production output; with manufacturing output up by 1.8%. There was also strong growth across the distribution and retail sub-sector (Figure 1).

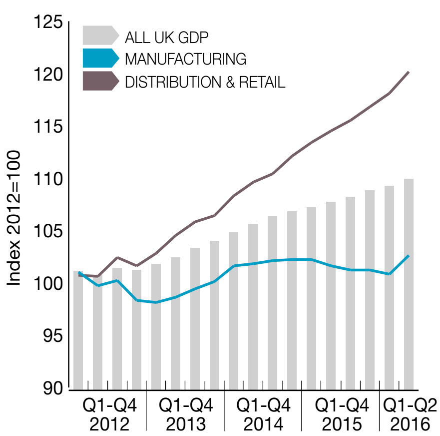
Whilst it is too early to say how the economy is responding to the referendum result, there are positives for the logistics and industrial property sector, which is the least exposed sector and stands to gain from a weaker exchange rate.

Occupier market

The uncertainty surrounding Brexit is reflected in occupier take-up figures for the first half of the year. A total of 16.2m sq ft of units above 50,000 sq ft was acquired for occupation in H1 2016. This is 14% below the level of take-up in the H2 2015 period and 4% below the level of take-up in the same period a year ago (Figure 2).

FIGURE 1

UK Economic output indices



Source: ONS

The picture is mixed at regional level however. The South West region in particular has seen an unprecedented level of take-up of 2.4m sq ft – taking its share of the UK market up to 15%. This is more than four times the level of take-up in H2 2015 and almost double the level of take-up over the same period in the previous year.

In the Midlands, which is historically the dominant UK region accounting for 38% of national take-up, demand is relatively strong with c.6m sq ft of industrial occupier space taken in H1 2016; down 20% on H2 2015 but up 33% on the same period last year.

The picture in London and the South East is very different. Take-up of 2.5m sq ft in H1 2016 was 30% down on the half year prior and has also seen an absence of large pre-lets which had supported the take up figures for some time. In the North East enquiry levels dropped significantly in the second quarter of the year, although this region has been adversely affected by the sharp fall in oil prices.

Amazon remains one of the largest retailers in the regional markets, accounting for a significant proportion of demand for both second-hand and new space. Amazon's lettings in the first half of 2016 include – Cherry Blossom Way Washington (100,282 sq ft), two speculatively built warehouses at Airport City Manchester (271,350 sq ft) and Trafford Park Union Square (176,080 sq ft). Amazon has also recently announced its intention to take 2.2m sq ft at a forward funded development on Roxhill and Port of Tilbury's 70 acre London Distribution Park in Essex.

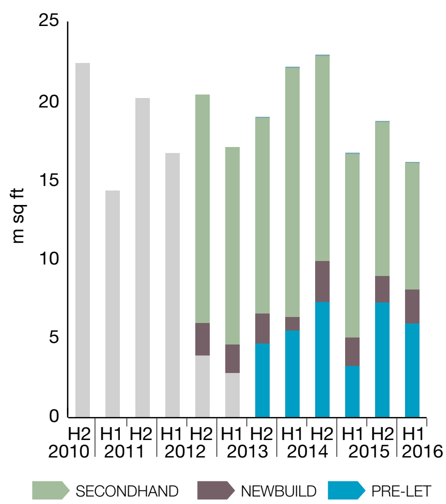
In the big-shed market, newbuild supply of units above 100,000 sq ft currently stands at c.11m sq ft, compared with a peak of 27m sq ft in 2008 (Figure 3).

Whilst developers are cautious in the wake of Brexit, the outlook for the logistics and industrial sector is relatively positive given the broad tenant base, continued growth of online retail sales and general shortage of good quality building.

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

FIGURE 2

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

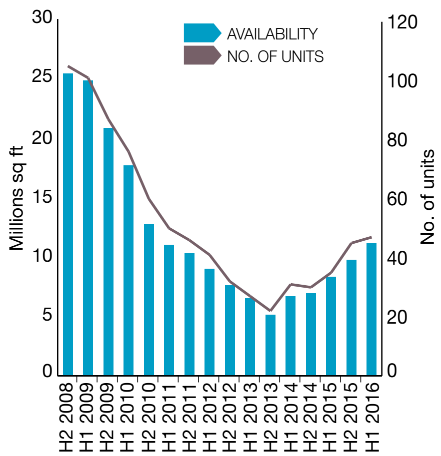


Source: Knight Frank Research

FIGURE 3

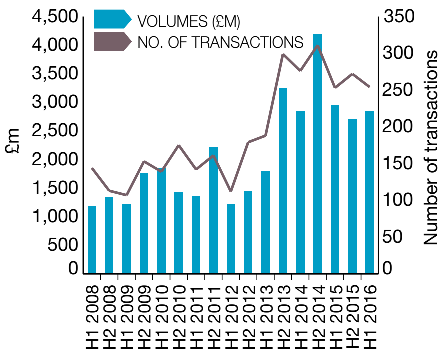
New sheds available (100,000 sq ft+)

Includes speculative development



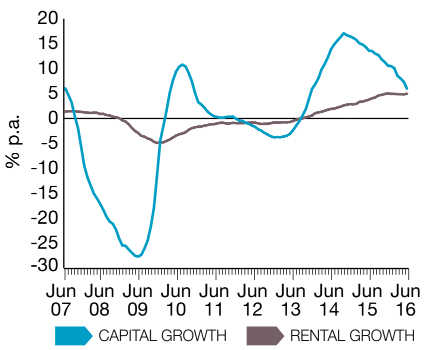
Source: Knight Frank Research

FIGURE 4
Industrial investment transactions



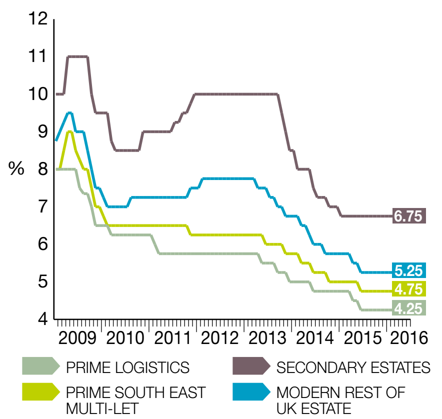
Source: Property Data / Knight Frank Research

FIGURE 5
Industrial sector performance



Source: IPD

FIGURE 6
Single-let and multi-let warehouse yields



Source: Knight Frank Research

Investment market

The Brexit effect has clearly impacted on the investment market, which along with other sectors of the commercial property market has cooled somewhat in recent months.
The latest figures from Property Data show that following a strong start to the year the volume of industrial investment transactions slowed to £1.1bn in Q2 2016, down from £1.8bn in the first quarter of the year and £1.7bn over the same period last year. This brings the total for H1 2016 to £2.9bn (Figure 4).

UK institutions and property companies have been the most active players so far this year accounting for 35% and 29%, respectively, of total investment activity over this period. Overseas investors accounted for a further 21%.

Looking more closely at the investment market, whilst there is continued investor appetite for industrial stock, there are fewer competitors in the investment arena and demand is more risk averse. Prior to Brexit there had been strong demand for multi lets at the primer end of the market; post Brexit the demand for multi lets has dropped off but there is now greater demand for assets with long leases to strong retail covenants.

In line with the general cyclical slowdown that is evident across all sectors of the commercial property market, the IPD Monthly Index shows that both industrial rental and capital value growth has been significantly weaker. In the twelve months to June 2016, industrials achieved an annual capital growth rate of 6.0% and rental value growth rate of 4.9% (Figure 5). However, industrials are now clearly ahead of the other two main sectors and the consensus is for industrials to remain the lead performing sector over the next three to five years.

Industrial yields have stabilized over the past six months, with single-let distribution yields at 4.25% and yields for mult-let and secondary estates at 4.75 and 6.75%, respectively (Figure 6).

Selected warehouse / logistics transactions in H1 2016

Property	Vendor/Purchaser	Price	NIY	Date
Apex Park, Daventry	Prologis UK Ltd/KF IM	£36.6m	5.65%	Jun-16
Newlink Business Park	Indian Investor/Tritax Big Box REIT Plc	£77.3m	5.86%	May-16
Astmoor Industrial Estate	Columbia Threadneedle/ Oxenwood Real Estate	£17.8m	7.90%	Apr-16
Imperial Park, Coventry	Rigby Group Evander Properties/M&G Real Estate	£50.5m	6.00%	Mar-16
Portbury Way, Bristol	Asda Plc/Tritax Bigbox REIT Plc	£25.2m	5.18%	Mar-16
The Vault, Liverpool	Deutsche Asset Wealth/ Hasalnvest	£48.1m	5.27%	Feb-16

Source: Knight Frank Research

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