H2 2012
LOGISTICS & INDUSTRIAL

Occupier & investment market commentary

Knight Frank

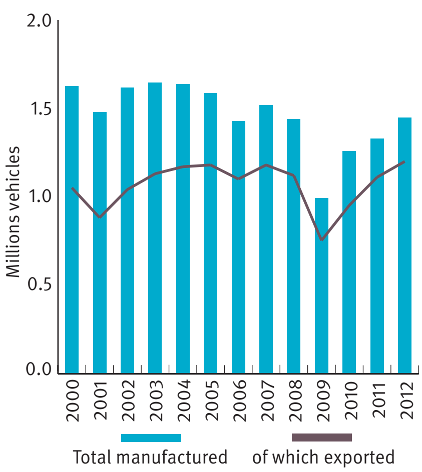
Economic overview

Preliminary estimates from the ONS reveal that UK GDP contracted by 0.3% in Q4 2012, fuelling fresh concerns that the UK could re-enter recession. However, much of the fall has been blamed on the temporary disruption to operations at one of the North Sea's largest oil fields.

Hopes that Sterling's devaluation would provide a fillip to UK manufacturing apparently remain unfounded in the recent figures, with manufacturing output declining by -1.5% in Q4. However, this is at odds with the positive news from the UK automotive industry, with UK car exports reaching a record of 1.2m vehicles 2012 on the back of increased demand in the Far East (Figure 1).

Of particular relevance to the logistics sector, however, Transport and Communications saw relatively resilient growth of 0.5% in Q4 2012. The structural shift to internet consumption continues to stimulate demand for logistics space, with 15.5% growth in internet sales recorded over the year to December 2012, compared with overall growth in retail sales of just 0.3%.

Figure 1
UK car production



Source: SMMT

Occupier market

Take-up recovered strongly in H2 2012, following subdued activity for many UK regions last summer. Take-up for units over 50,000 sq ft was 20.5m sq ft in H2 2012, 22% above H1 2012 and the highest since H2 2010. Most regions saw stronger take-up in H2 compared with H1, with the three exceptions being the greater South East area, the North East and Scotland.

Approximately 20% of H2 take-up involved pre-let agreements, with Sainsbury's 1m sq ft pre-let of DIRFT II, Daventry from ProLogis the largest by a clear margin. Other notable pre-lets included Asda's commitment to 700,000 sq ft at Avonmouth and Brake-Brothers' agreement to design and build 200,000 sq ft at Omega, Warrington.

The well-documented success of car manufacturers JLR and Nissan has been an important driver of demand in the Midlands and the North East respectively. However, UK retailers remain the predominant source of shed demand, particularly those looking to enhance their multi-channel offer. Increased interest has also been seen among parcel carriers, as they adjust their networks to accommodate the rapid expansion in e-commerce sales.

In the UK's big-shed market, 7.7m sq ft of new-build supply was available at the end of 2012, down 73% from its peak in Q1 2008 (Figure 3). Given what remains is largely concentrated in South Yorkshire and the North Midlands, occupiers will have to increasingly turn to design and build arrangements.

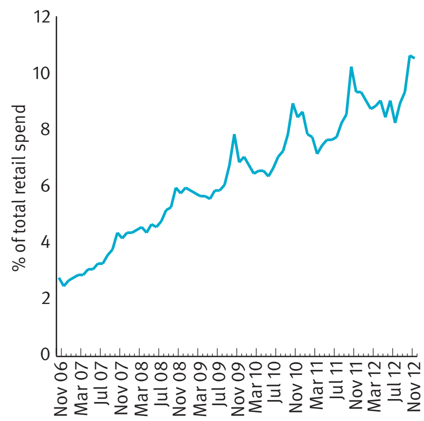
However, many occupiers such as third party logistics operators remain averse to the long leases associated with such agreements. Consequently, there is an increasingly compelling case for landlords to refurbish 'tired' but well-located distribution units to a standard which will appeal to those occupiers seeking more flexible solutions.

The financial climate continues to hinder speculative development, with current activity largely confined to several mid-size unit schemes in outer London. However, with good quality supply of 20,000 sq ft to 70,000 sq ft units critically low across the UK generally, several schemes are expected to come forward in other regions in 2013.

The steady erosion of supply is yet to translate into prime headline rental growth. However, incentive packages on good quality existing stock have hardened in many of the UK's key markets over the last 12 months, and this trend is expected to continue in 2013.

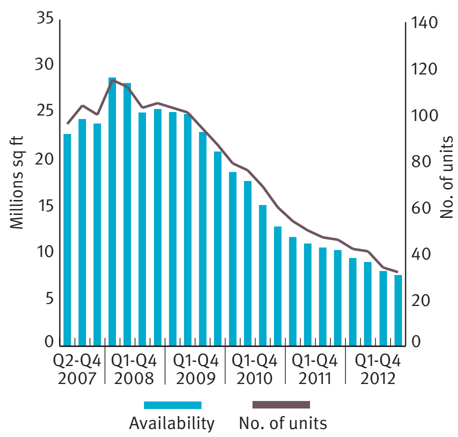
For more detailed commentary on the occupier markets, please refer to our regional LOGIC reports.

Figure 2
Internet sales



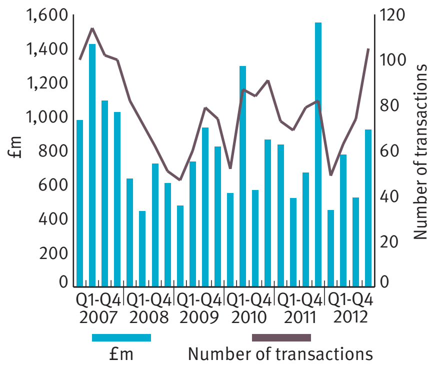
Source: ONS

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



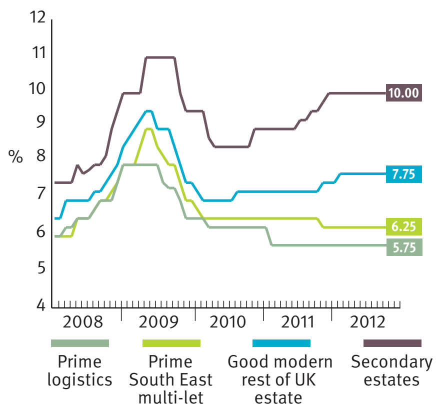
Source: Knight Frank

Figure 4
Industrial investment transactions



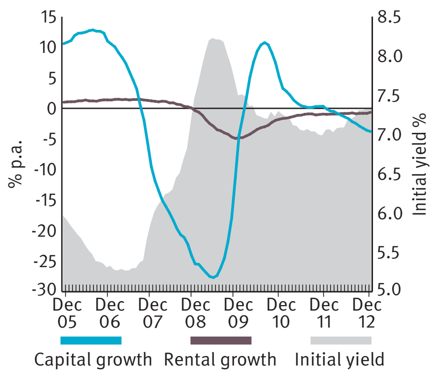
Source: Propertydata.com

Figure 5
Warehouse and industrial yields



Source: Knight Frank

Figure 6
Industrial sector performance



Source: IPD

Investment market

UK industrial investment volumes reached £1.45bn in H2 2012, 18% above H1 2012. Moreover, the number of transactions increased markedly at the end of 2012 with 105 deals seen in Q4, the highest quarterly total since Q2 2007 (Figure 4). Overseas investors have also emerged as key players in this sector, accounting for 26% of 2012 turnover, compared with a long-run annual average of 12%.

The largest transaction in H2 comprising solely industrial property was Threadneedle's acquisition of 'Project Galahad' (a portfolio of ten secondary multi-let estates) from SEGRO for £111m, reflecting a net initial yield of 8.4%. Meanwhile, H2's largest deal for a single asset took place in London, where Standard Life purchased Staples Corner Business Park from Orchard IM for £43.98m, reflecting a net initial yield of 6.23%.

Prime single-let distribution remains highly sought after by both overseas investors and UK Funds. Prime distribution yields were broadly unchanged throughout 2012, at 5.50% to 5.75% for 20-year income with fixed RPI uplifts, discounted to c.6.00% to 6.75% for 15-year income. However, with little pressure to sell, such opportunities are likely to remain in short supply, a factor which should preserve pricing at its current level in 2013.

Encouraged by evidence of tightening supply in the key distribution markets, investors are increasingly seeking higher yielding 'near prime' product. Typically, this comprises modern, well-located assets which may be slightly compromised, perhaps offering shorter income (i.e. less than 10 years) or an element of covenant risk, with M&G's £22.1m purchase of Heritage House being one such example (Table 1).

Interest in prime multi-let industrial remains the preserve of the UK funds, with evidence that demand is broadening beyond London and the South East. The recent sales of Solar Park and Monkspath Industrial Estate, Solihull and the Fern Portfolio demonstrate the geographical spread of demand, albeit focused on the very highest quality product. Yields for prime multi-let estates have been stable at c.6.00% to 6.25% in the South East, and in the UK regions, yields for good quality multi-let estates range from 7.50% to 7.75%.

While the majority of investors continue to remain averse to poorer quality secondary and tertiary product, H2 saw of a degree of opportunity-driven activity in the multi-let sector. A number of property investors have exploited distressed positions, buying opportunistically off high yields with a view to repositioning the asset through active management.

Table 1
Selected warehouse / logistics transactions in H2 2012

Property	Vendor/Purchaser	Price	NIY	Date
CrossDox, Erith	Bericote Properties / Aberdeen AM	£15.00m	5.70%	Sep-12
Staples Corner Business Park, London	Orchard Street IM / Standard Life	£43.98m	6.23%	Oct-12
Lymedale Business Park, Newcastle-under-Lyme	RREEF / Blackstone	£22.86m	8.29%	Nov-12
Solar Park, Solihull	AXA / Ignis Property Fund	£22.70m	7.59%	Nov-12
Heritage House, Enfield	Standard Life / M&G Property	£22.10m	6.95%	Dec-12
Fern Portfolio (Wimbledon, Swindon, Kidlington)	Crown Estate / Knight Frank Investors	£32.26m	7.42%	Dec-12

Source: Knight Frank

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